



## Called to Account – Measuring, Reporting and Acting on Sustainability

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Adair Turner, the chair of the UK's Financial Services Authority, memorably expressed the belief that “market economies will not of themselves combine [enterprise] with environmental sustainability or with a reasonably just and good society.” Dramatically he declared that “capitalism needs to be saved from itself.”

Today, in the UK and elsewhere, there is an intense interest in whether and how businesses and governments are deploying capital in a sustainable, just and good way.

The UK government's £37bn bailout of RBS and Lloyds had, by last July, effectively provided every household in the UK with a £3000 investment in bank shares. The terms of the bailout requires the government's UK Financial Investments (UKFI) body, which holds these assets, to engage with the investee companies, following the best practice of institutional shareholders. Improved financing of SMEs – a mechanism to support employment in the domestic economy - has been a condition of the government's support for the banks. Now, civil society groups are also pushing UKFI to demand high standards of disclosure on, for example, the risks of investing in carbon-intensive oil production from oil sands.

The footage of banking leaders being compelled to account for their role in the global financial crisis by the Treasury Select Committee and Congress-appointed FCIC may have provided some moments of *schadenfreude*. But leaders outside banking and across the business world, have been shocked by how quickly governments, civil society and shareholders can turn on individual companies and, indeed, whole sectors who were just doing “the business of business”.

At the same time, politicians are accused of failing to allocate resources in a joined up way across the economy. The current *bête noire* of green businesses in the US and UK are government commitments to absolute national carbon emission reductions as part of the Copenhagen Accord, while subsidising the legacy industries responsible for the emissions. This causes more frustration when it's perceived that the government support for the activities and technologies to meet those targets is less generous than the emerging economies - and China in particular.

Behind all of these challenges lies the question of how to account for risks and opportunities beyond the obvious and immediately accessible financial metrics. It has led management accountants to begin asking themselves “what will it cost us to meet society's demands for sustainability and responsibility”? At the same time, sustainability professionals are thinking about Turner's more fundamental challenge, “how can we save capitalism from itself”?

Trucost and Net Impact are working in different ways to help financial managers to counterbalance the economic focus on esoteric mechanisms such as Special Purpose Vehicles and Collateralised Debt Obligations as a source of short-term profit or risk mitigation. We believe accounting for the long term sources of value and systemic risk, as recognised by sustainability professionals, is equally, systemically important.

Trucost is a for-profit consultancy, based in the UK. Trucost's environmental scorecard is used by investors, businesses and public sector organisations to account for the full environmental impact of their supply chains, investee companies and operations.

Net Impact is a global nonprofit membership network, with 15,000 members, which helps connect thought leaders and practitioners who are committed to using the power of business to deliver a net positive environmental, social and economic impact. Net Impact offers individual members and partner organisations opportunities to access focus groups and collaborative fora for discussing and resolving the difficult issues in sustainable business.

We seek to equip, educate and inspire politicians, investment professionals and other business people to better engage with the long term interests of a wider stakeholder base which includes investors, consumers, employees and taxpayers. We recognise that those interests are potentially limitless – we don't claim to help organisations do what Goldman Sachs boss Lloyd Blankfein described as "God's work" - but we believe that most of them are aligned on the desirability of a stable environment and sustainable growth.

In the first of two articles, we're going to focus mostly on environmental sustainability.

## **Why we think Accounting and Sustainability disciplines need each other**

The Peak Oil Taskforce – led by Solarcentury’s Jeremy Leggett, Virgin’s Richard Branson and other business leaders - has issued a report which assesses these sorts of risks in relation to crude oil, on which many of the fundamental building blocks of industrial capitalism are based. In the UK this is described as an “oil crunch”, which could match the credit crunch in severity of impact, as imminently as 2015.

Reading this report, a professional involved in agriculture, transport, logistics, retail – in fact most sectors of the economy - trying to work out the “cost of being sustainable” might be having a sinking feeling. It’s a tough call to price a long term deal for a hydrocarbon-based polymer product, or supplies of goods with a large petroleum-transport footprint, or fertilizer-reliant “soft commodities”, when oil prices can fluctuate from \$30/barrel to \$140 in the space of 6 months. Yet if a professional needs to hedge their risks, they need to work out the amount of hydrocarbon-related exposure in their building portfolio, highway logistic network, shipping route. From that stable base, they’re in a much better position to take bets on new processes, materials, facilities and logistics.

Fossil fuels and carbon emissions are accessible examples of sustainability risks. But there are many others which, depending on the sector which the professional is managing, need to be quantified and managed. Water resources are particularly material for beverage companies and many process industries. The quality of the ecosystem, in terms of plant-pollinating biodiversity, is important to agricultural and horticultural industries.

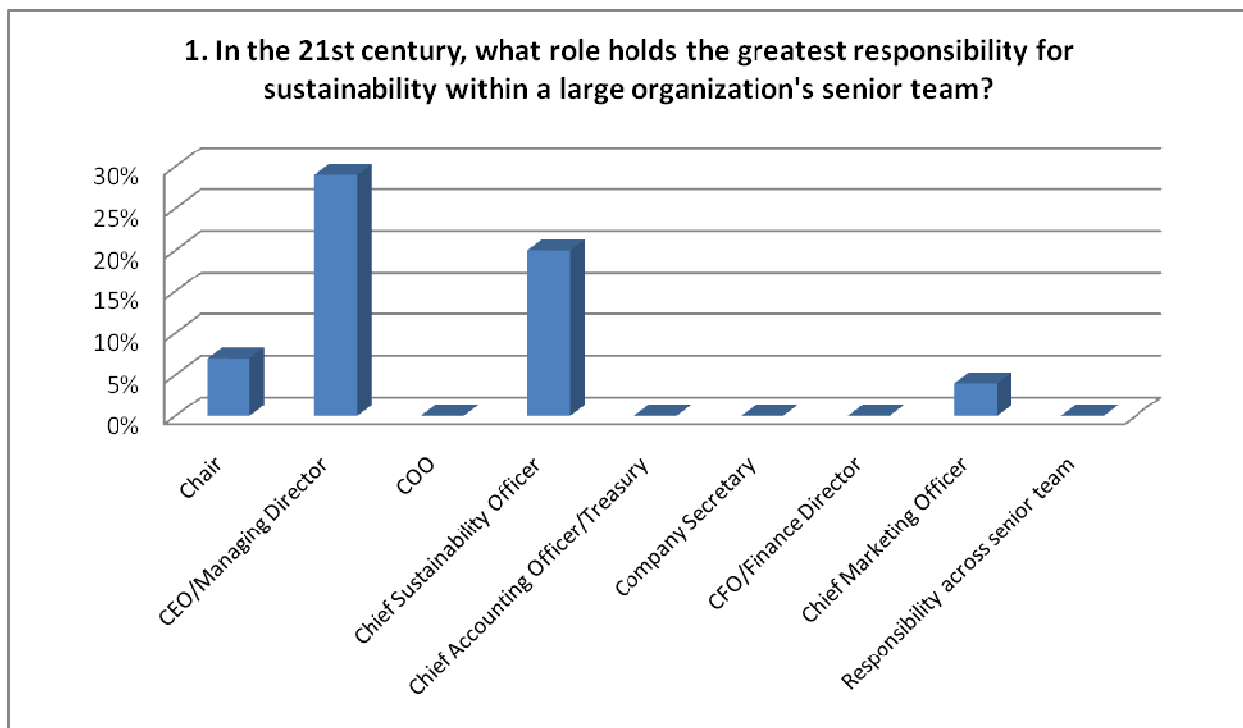
Assessing the systemic risks and opportunities behind these variables relies on numerically-minded people, with the dogged determination to bring the enterprising plans of leaders and idealistic tendencies of sustainability experts back to earth.

At the end of 2009 Net Impact and Trucost brought together a focus group and speakers – consisting of professional accountants, MBAs and sustainability experts – to assess whether accounting and finance professionals are comfortable with this role. We entitled the event “Called to Account” and gathered group views using the Impact Monitor voting system. These are shared below, supplemented by case study examples from speakers at this and other Net Impact events:

## Sustainability is still outside the finance and accounting comfort zone

Lisa Scott is Head of Corporate Governance and Performance Reporting at the UK government's Highways Agency. Lisa is responsible for leading the Agency's sustainable development action plan, a plan which is required of every UK central government department. She also helped to draft the new UK Treasury's Sustainability Reporting in Public Sector Annual Reports, a mandatory sustainability reporting requirement for all central government Annual Reports. Lisa, as a professional accountant, perceives limits in the way the accounting discipline is set up, which makes it inadequate, on its own, to tackle challenges like climate change. "Implementing accounting for sustainability will never be enough. What really counts are the ensuing changes that it drives in decision making and behaviour."

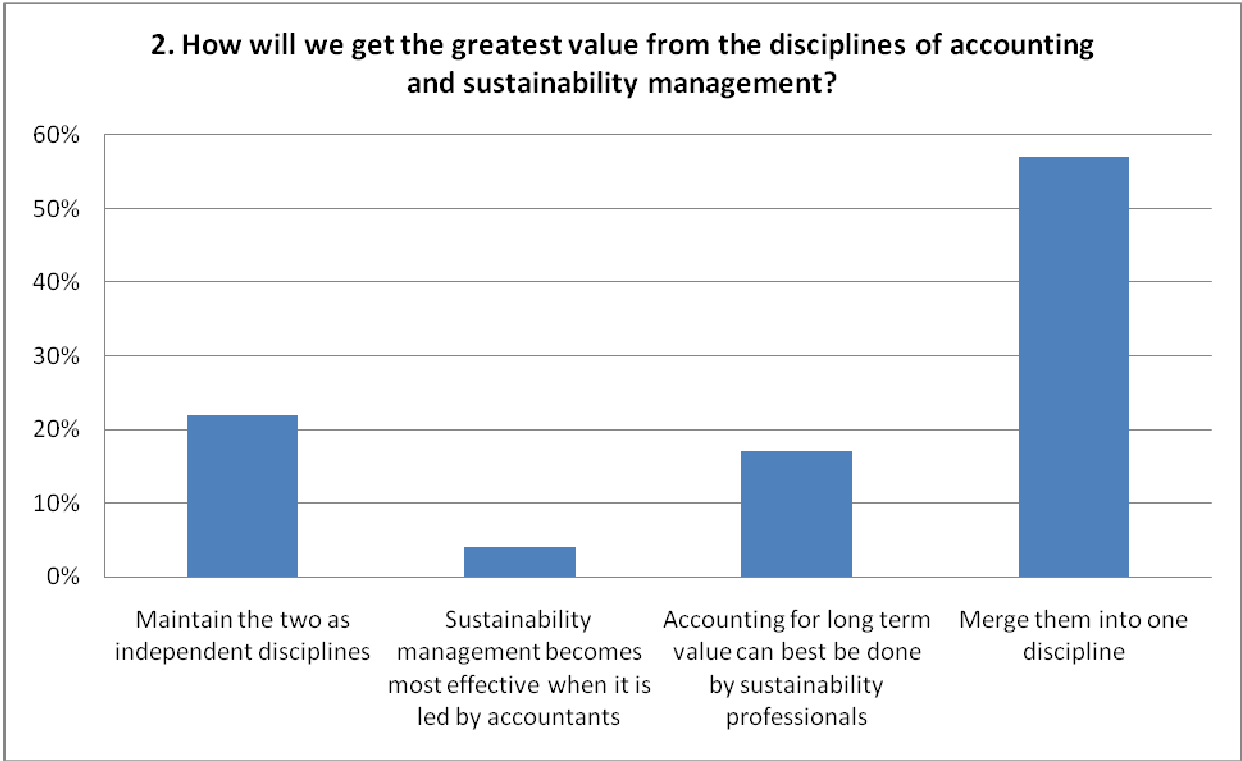
A survey result from our Called to Account focus group shows clearly where Net Impact members and event attendees see the responsibility for the large organisation's sustainability – over a quarter of respondents cited the CEO/MD (or equivalent) while just under one in five thought a sustainability specialist would hold the greatest responsibility. There were notable mentions for the Chair and Chief marketing Officer. What's more interesting is that, despite the group including a number of finance professionals, neither the accounting/finance roles or the company secretary were deemed responsible for sustainability.



**Accountants and Sustainability professionals add more value when their disciplines are closely connected**

Evaluation of assets and liabilities, and the flow of resources into and out of an organisation needs to be done consistently and in a way which allows comparison across years and between companies. Accountants have done this, effectively, for millions of companies, over decades. Yet accountants are often focused on quarterly or annual reporting, whereas the sustainability mindset is, of necessity, longer term.

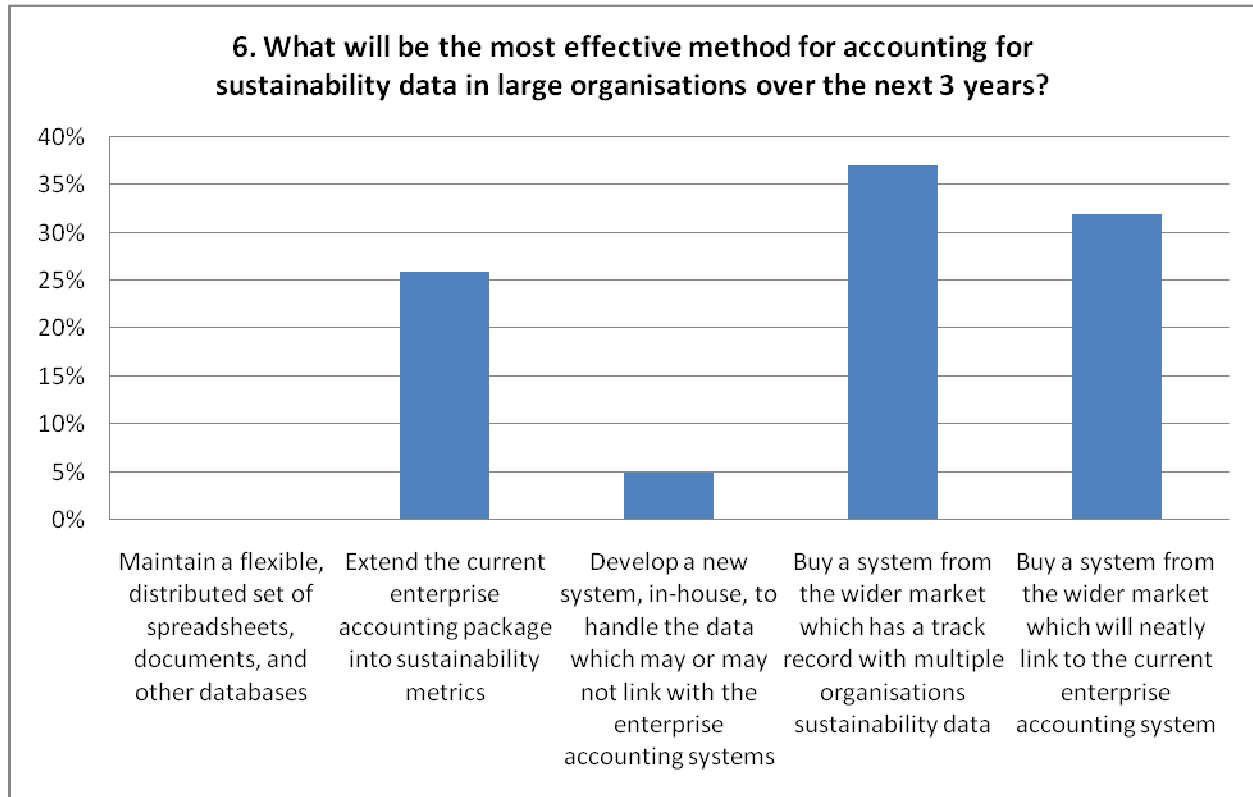
Lisa Scott admits that, “one of the key areas for any organization to address is for finance teams to be closely aligned with sustainability teams.” In this way the management of value over long, medium and short term becomes better articulated. For example, the Highways Agency has incorporated Accounting for Sustainability not only into its monthly reporting processes but also its year-end annual report in order to show its taxpayer stakeholders that “what gets measured gets done.”



The somewhat more radical view of the Called to Account focus group is that the disciplines need to be merged, so instead of two telescopes being trained on different goals, the organisation becomes equipped with a set of binoculars, focused on a single objective.

In our second article we will come back to this question.

## Data needs to be collected and processed in a consistent and comparable way



Sustainability data collection and systems integration poses a challenge and for quickness and ease of use businesses continue to resort to spreadsheets. In the long-term, availability of data and systems integration will be a bottleneck as the number of sustainability metrics reported through management and financial accounting routes increases and is normalised. The Called to Account focus group was clear on abandoning spreadsheets but less decisive about integrating sustainability metrics into an existing accounting system or buying an accounting system which includes a track record of sustainability data.

For example, at Northern Foods the management team met for a period of four months and the result was that the number of measures originally put on the table doubled in size by the final version, resulting in double the measures deemed meaningful to publish to the business community and shareholders. This process involves the corporate social responsibility team working with experts in each department who focus on the key measures and ensure the validity of the data.

Similarly at the Highways Agency, spreadsheets are used to track all the sustainability metrics. According to Lisa Scott, "They're everywhere – used to collect carbon accounting information from our suppliers and used to collect travel information from travel claims, etc. These bring challenges in their own right in terms of robustness and auditability."

## **Sustainability accounting must make the data actionable and relevant**

Customers of Alliance Boots could be forgiven for thinking the company's biggest sustainability issue is its choice of shampoo ingredients. The sale of pharmaceutical, nutritional and personal care products is what is distinctive about the Boots brand. Is this where the company needs to account for its sustainability impact?

Of course it does. But the product arrives in the stores with an extensive R&D, manufacturing and logistical distribution footprint.

Bringing together the right data sets in one place allowed the Boots "back office", in 2007-8, to tackle multiple costs and opportunities - e.g. better routing, double-deck trailers, telemetrics and backloading. This reduced 8.5m road km, 4.87% of total transport emissions and £1.8m of fuel costs.

In Boots view it is reasonable to expect a cost of road fuel to increase in future, and a requirement to track CO2 in the supply chain. Now it is systematically collecting that data, and linking to other retailers with complementary challenges, Boots is prepared to take further action in different scenarios.

Giles Hutchins, Global Director and Head of Sustainability Solutions at Atos Origin, addressed his decade of organizational consulting experience to the Called to Account audience. "Accounting for sustainability is about internalising externalities and gaining a true picture of the business environment the organisation is operating in. Those organisations that can gain effective insight into their value chain and operational effects on people, profit AND planet will be better equipped to future-proof their businesses in these turbulent times."

He recognised the problem of a "plethora of data sets related to sustainability". Tools and techniques to enable intelligence to be drawn from them will enable organisations to navigate future success. This is a business transformation as well as a financial reporting issue, and connected reporting needs to be coupled with connected thinking if the business is to transform effectively."

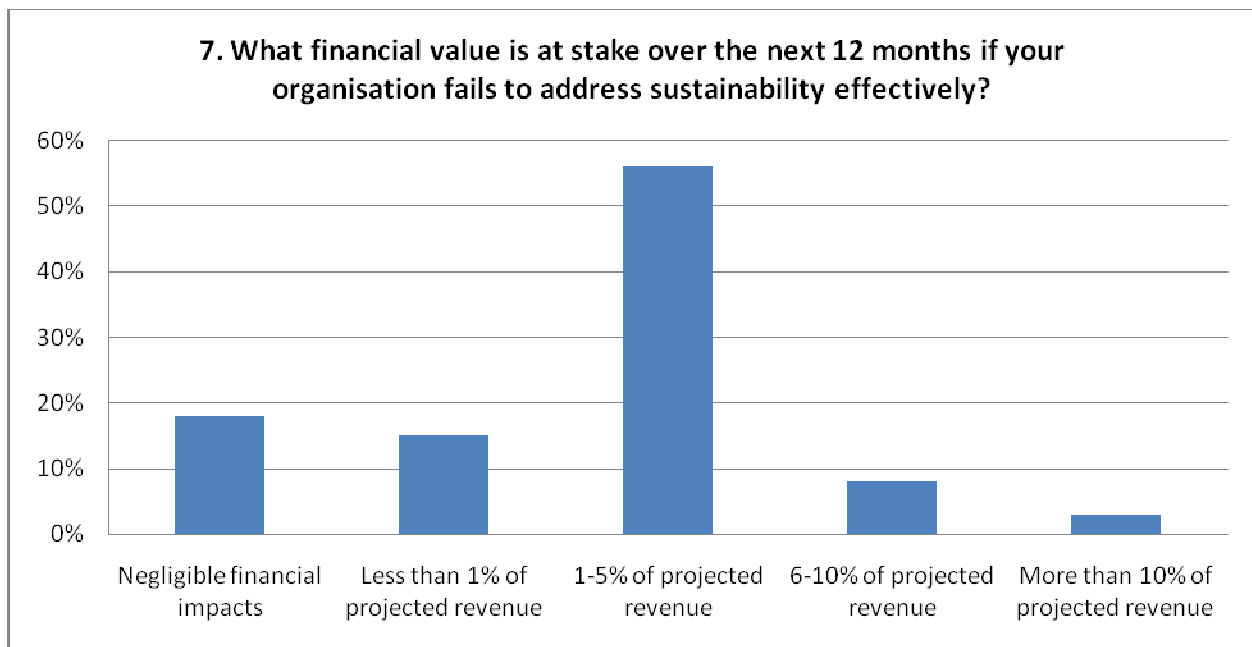
Giles identified the Prince of Wales Accounting For Sustainability Project as a good source of insight on connected reporting and thinking, drawing on the experience of leading organisations across all sectors.

## Wherever possible, sustainability activity needs to be expressed in financial terms

Northern Foods has a significant global footprint. Each year the company buys over £600m of ingredients, raw materials and services from over 3,000 suppliers. They make food in 17 production sites and deliver to over 1,000 supply points. In 2008 they spent \$21m on energy consumed in the UK. Paula Widdowson, responsible for Corporate Social Responsibility strategy, shared a number of lessons at a recent Net Impact event, saying, in particular, that “measuring the impact is necessary and publicly declaring our impact, both non-financially and financially, is an important step in enabling the business to better understand the value of this work.”

At the end of 2009 Paula was able to claim upwards of £2 million of additional contribution to the bottom line, through effective sustainability accounting over the preceding 12 months. She also forecasted an additional £10 million in the upcoming 12 months.

The majority of the Called to Account focus group confirmed that failing to account for their organisations’ sustainability would lead to a loss of revenue. Around two thirds claimed the impact would equate to 1% of revenue, or more.



## Conclusion

The disciplines of Accounting and Sustainability disciplines need each other to get an accurate view of value and risk, yet Sustainability is still outside the finance and accounting comfort zone. This means that the two add more value when they work together, traditional financial and management accounting allowing better return on investment calls to be made by sustainability advocates, and sustainability experts helping accountants to understand better the long term and systemic risks and opportunities within the wider environment. The wider environment includes variables like greenhouse gas emissions, but also water resources, biodiversity and the social environment.

To enable an informed exchange of expertise, data - financial, social and environmental - needs to be collected and processed in a consistent and comparable way. There are IT tools which facilitate this and a variety of ways to apply them. But the critical element to derive value from that data is ensuring it is actionable and relevant at the operational level. This, in itself, may drive organisational change.

Meanwhile, to keep senior decision makers and resource holders engaged, wherever possible, sustainability activity should be expressed in financial terms. If this is done well it improves the probability that the ultimate leader will engage the issue and allow the organisation to fully explore the implications and potential of “sustainable business”.

*Jeremy Leggett is speaking on 22 April at the Net Impact London Professional event “Green Business Leadership”.*

*For details of this and other upcoming events go to <http://london.netimpact.org.uk>*

*To see the full Called to Account event report by Marissa Blankenship, including the full set of Impact Monitor data graphics, go to <http://london.netimpact.org.uk/>*