

# Theories in Accounting, and Sustainability and Environmental Accounting

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## Executive Summary

In the last 20 years, sustainability reporting has gained a lot of audience as consumers exert pressure on corporations to engage in sustainable business activities. In addition, governments and regulators are demanding sustainability reporting to enhance transparency and accountability. Big global companies such as FTSE 250 have integrated sustainability as part of their business strategy. Therefore, sustainability is mandatory in contemporary business setting. According to Fauzi (2009, p.1) empirical finding reveal that corporate sustainability is linked to improved business performance. Companies that have failed to pursue sustainability are experiencing diminished business performance, this is forcing corporations to reorient and incorporate sustainability in their business activities. As a result, accountant's role has been broadened to include sustainability accounting, sustainability reporting, sustainability assurance and sustainability management. Contemporary accountants go far beyond the presentation of financial information to include non-financial information. In addition, accountants help organizations incorporate sustainability issues into strategic planning and implementation. One facet of corporation sustainability has been on environmental conservation and preservations. Corporations are adopting Environmental Management System to enable them reduce their ecological impact.

Maier and Vanstone (2005, p. 2) assert that an implementation of an Environmental Management System involves the adoption of an environmental policy such as a certified Environmental Management System, ISO 14001 or Eco-management System (EMAS), or in house systems. The policy highlights the corporation's commitment to environmentally friendly business operations and environmental management. According to IBM (n.d), the global computer technology giant IBM uses Environmental Management System to identify and manage operations that pose environmental impacts. The global computer technology giant monitors and measures the effective implementation of Environmental Management System to ensure improved environmental performance. The measurement systems include professional self-assessment programs, environmental performance database, corporate internal audits and ISO 14001 surveillance audits, which improve environmental performance.

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## **Introduction**

### **Background**

Studies reveal that there is a strong relationship between corporate social performance and corporate financial performance. In their study on effects of sustainable business practices in both consumer and capital markets, Filbeck and Gorman (2004) observe that corporate sustainability practices are an indicator to both consumer and capital market of the company's quality products, increasing company's reputation and share price in the long term. Studies reveal that even if a company pursues business success at the expense of social and environmental degradation, the effects in the short will be damaging to the company's image and reputation and negative to the share performance in the long term. Therefore, there is a need for companies to entrench sustainable business practices. This has led to the emergence of another form of reporting besides financial reporting known as sustainability reporting. Sustainability reporting concerns presentation of non-financial information regarding the performance of a corporation. Corporations are measured based on social, economic and governance performance. This has expanded the scope of accountants beyond the preparation and presentation of financial and non-financial information, which is the mainstay of accountants.

### **Purpose**

This report seeks to explain what is sustainability reporting, role of accountant in sustainability reporting and the use of Environmental Management Systems in improving environmental performance and reporting.

### **Outline of the Report**

The report is divided into four questions linked to a case study. The first question seeks to discuss what is sustainability and methods used to report sustainability and environmental performance. The second question is on highlights sustainability issues a company need to consider to arrive on the decision to close a business mired in sustainability controversies. The third question is on an

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accountant's role in addressing sustainability issues. The fourth question highlights the use of Environmental Management Systems in improving environmental performance and reporting.

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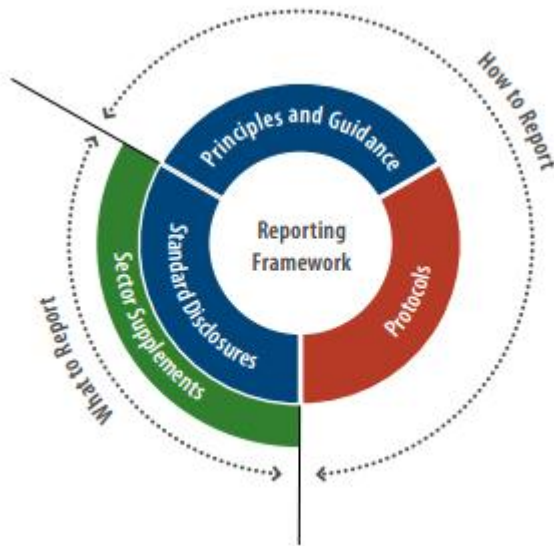
## Sustainability Reporting

Of late, Companies are increasing adopting the practice of reporting non-financial information that is relevant to stakeholders' welfare. This has been a result of clamour by the society and governments for businesses to adopt sustainable business practices. Iannou and Serafeim (2012) observe that reporting of non-financial information is taking root in corporations across the globe. Iannou and Serafeim (2012) continues further to highlight the exponential growth in sustainability reporting by firms by stating that in 2000 only 44 corporations reported sustainability information using the Global Reporting initiatives (GRI) guidelines, the number has since risen to 1,973 corporations by the year 2010. The widespread adoption has partly been spurred by governments and regulators who have made it mandatory for firms to prepare sustainability reports. Sustainability reporting gives information beyond economic performance to include social, environmental and governance performance by the firm in its operation. This holistic reporting of performance by firms is underpinned by the fact that even as corporations engage in their day-to-day activities they have a social and moral obligation to sustain the environment, contribute to the society and improve governance structures. For instance, miners at Kakadu National Park, an area rich in metals such as Uranium, have an obligation to conserve the environment and wildlife found in the World Heritage Site. In addition, the miners are supposed to support the surrounding Aboriginal community that inhabits the area.

The performance of the company in the social, environmental and governance facets are measured and reported in sustainability reports prepared by the management. The sustainability reports are intended to enhance transparency, augment accountability, boost internal processes, communicate with stakeholders and attract investors. According to Bristow (2011), corporations are preparing and presenting sustainability reports for numerous reasons, but the core reason is to be “vessels of transparency and accountability.” Sustainability reporting is, therefore, not a

generation of data and information that is reported for formality reason, but information that is driving performance, contributing to the development of society and driving sustainable future. For example, in the case of Jabiluka Uranium Mine, the management of the mine can use sustainability reporting to reduce public opposition by highlighting their contributions to the society and the environment around the mine. The method that miners at the Kakadu National Park can report sustainability and environment is through sustainable reports. Sustainable reports are prepared according to the GRI Reporting Framework, UNGC and MDG. However, the GRI Reporting Framework is the generally accepted reporting framework for economic, social and environmental performance.

Figure 1. GRI Reporting Framework



Source: GRI (2011, p.3)

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## Sustainability Reporting Issues

Contemporary business performance cannot be dissociated from sustainability. Consumers and shareholders have gained more voice in the sustainability discourse; as a result, the survival of the business is heavily determined by the ability of the business to pursue sustainable business practice, failure to practice sustainable business practices is a peril to the survival of the company. Empirical findings reveal that firms that practice sustainable business practices are able to achieve competitive advantage over companies that ignore or fail to adopt sustainable business practices. According to Gray, Collison and Bebbington (1998, p.1), in the last 20 years, a firm's interaction with both the environment and the society has become central, dictating the future prospects of the firm and the society in which the firm is operating. The author continues to assert that therefore firms have a social, moral, legal and economic obligation to affect positively the society and the environment in an attempt to cement the social contract between the society and the business. Achievement of business success should not be at the expense of environmental and social degradation instead business success should contribute to the sustainability of the society and the environment.

Therefore, continuing of operations of the company should center on the implications the business has on the environment and the society. Alvarez, Burgos and Cespedes (2001) argue that due to the positive relationship between financial performance and environmental performance, corporations and business enterprises that pursue business strategies ingrained with environmentally conscious measures to enhance their business and financial performance, achieving competitive advantage in a competitive marketplace. As a result, the mining company should ensure that it pursues business strategies that entrench social and environmental sustainability in Kakadu National Park. The decision to continue operations of the mining



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company should be based on ecological sustainability and anthropological-cultural sustainability.

Ecological sustainability requires that the company meet the following:

- i. The mining company should not use renewable resources faster than the rate of regeneration.
- ii. The mining company should not use nonrenewable resources faster than renewable substitutes.
- iii. The mining company's pollution levels should not exceed the absorption rate of natural systems.

Failure by the mining company to achieve any of the sustainability approaches means that the mining company is generating business success at the expense of environmental degradation in Kakadu National Park. The last measure is anthropological-cultural sustainability. The company need to assess whether its operations are interfering with the cultural group of Aboriginals within their Kakadu national Park ecosystem and land.

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## Accountants' Role in Sustainability Reporting

The role of accountants has evolved from presenting and evaluating financial information into presenting and analyzing both financial and non-financial information. Due to the increased prominence of sustainability in business and political agenda, there has arisen the need for increased accountant role in preparing, dissemination and evaluation of non-financial information, as it has evolved to be as critical as financial information. In addition, most corporations including the large and respected corporations in the world such as IBM, HSBC, and Roche among others are pursuing sustainability as a business strategy. This has forced other business enterprises, big and small, to follow suit and incorporate sustainability in their business strategy. Adams, Thornton and Sepheri (2010) observe that corporations that perform well in sustainability practices increase shareholders' value.

IFAC (2006) observes that accountants have a role to play in helping business enterprises achieve efficiency through sustainable business practices. The report goes further and states that accountants can help business enterprises by generating, analyzing, reporting and assurance of accurate financial and non-financial information. For example, accountants in the mines can quantify into monetary terms the impacts of the mine to the environment and society, which is the first step for management to understand the mining activities on sustainability. If the social and environmental costs of the mine exceed the business contributions to the Aboriginal community and the Kakadu National Park, the management will either need to wind up mining or reassess the how they can minimize social and environmental costs of the mining activities. Consequently, the mining company will assess whether its business case is undermining sustainability or if it is pursuing business case for sustainability. Another vital thing that accountant and management of, for example, the mining company is the reputation and brand visibility of the company continued operations. Increased public opposition and other activism

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activities against operations by a corporation is detrimental to the brand and reputation of the corporation, which will be detrimental to its business performance in the future. Therefore, accountants through sustainability management roles should identify key challenges facing the mining company in pursuing sustainable business activities in order to save its reputation. The recommendations, which are presented, to the management help the mining company achieve sustainability by pursuing the business case for sustainability. Therefore, the role of accountants is indispensable in achieving business case for sustainability.

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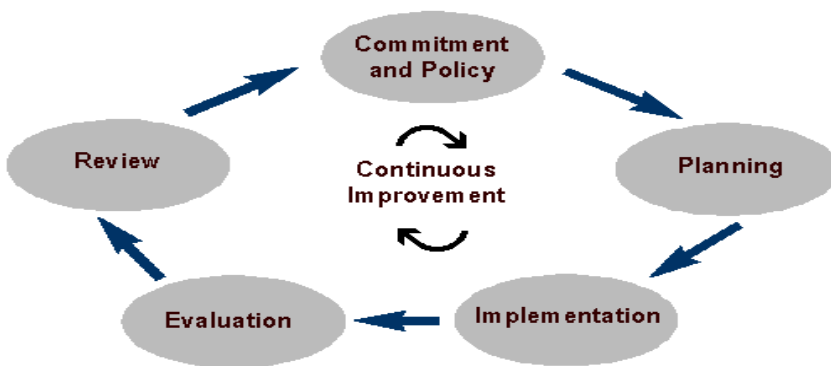
## **Environmental Management System**

According to EPA (2013), environmental management system or EMS is a framework that outlines processes and practices that help a corporation reduce its environmental impact and enhance operational efficiency. An Environmental Management System helps corporations realize their environmental goals and objectives through control of a corporation's activities that affect the environment. This is underpinned by the assumption that controlling a firm's operation will in turn improve environmental performance. Maier and Vanstone (2005, p. 2) observe that the policy sets out commitment of the organization to reduce pollution and waste, set environmental objective and keep on reviewing against environmental performance. Developed countries are placing great emphasis on corporations to implement Environmental Management Systems, for example, the United Kingdom's Environment Agency and the Environment Protection Agency in the United States of America encourage implementation of EMS. The two regulators believe that implementation of EMS leads to better compliance and improved environmental performance, however, Maier and Vanstone (2005, p. 1) observe that some quarters dispute the ability of EMS to improve environmental performance.

Maier and Vanstone (2005, p. 2) reveal that correlation test performed between a firm's environmental management system and environmental performance reveals that firms with good environmental management systems show improvements in their environmental performance. It is evident that adoption of environmental management system by the mining company will help improve environmental performance and reporting. This is so because an EMS will help the mining company set environmental objectives and targets to reduce environmental impact, establish activities to achieve the targets, monitor and measure progress in achieving environmental objectives, ensuring employees involvement, commitment and competence in environmental issues and making improvements to achieve environmental goals and objectives.

For instance, the mining company can set to reduce carbon emission to the environment to a certain measurable level during its mining activities by adopting advanced technologies powered by solar energy. The mining company through set benchmark indexes can monitor its carbon footprints in the environment, forming the basis for improvement. Additionally, EMS will contribute to environmental performance through encouraging the mining company to improve continuously environmental performance through a repeating cycle, which is a 5-step cycle, commitment and policy, planning, implementation, evaluation and review. Management commitment by the mining company will encourage employees and the management to devise ways of reducing adverse environmental impact over set targets.

Figure 2. EMS repeating cycle



Source: EPA (2013)

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## Conclusion

Human activities over the years have threatened the future generations as natural resources are fast depleting. Companies have pursued business success at the expense of environmental degradation, posing serious dangers to the ecosystem. In the last 20 years, governments, non-governmental organizations, consumer groups and environmental activists have pushed for sustainable business activities that conserve and preserve natural resources for future generations. Among the measures being pushed, include the reduction of waste, carbon emission into the environment, recycling and reusing. Besides environmental concerns, corporations are encouraged to adopt transparency and accountability in other spheres of operations and interaction with the society such as in social and governance spheres. As a result, companies are adopting non-financial reporting framework to report sustainable information.

Sustainability reporting is a reporting framework that provides information to internal and external stakeholders for organizational performance towards sustainable development.

Sustainability report contains non-financial information on social, governance and environmental performance of an organization. The report should provide accurate and balanced information on positive and negative outcomes of the sustainable business performance. Sustainability reports are prepared and presented using numerous methods that include GRI Reporting Framework, UNGC and MDG. However, the GRI Reporting Framework is the generally accepted reporting framework for reporting on economic, social and environmental performance. With the increased prominence of non-financial information on performance of corporations, accountants' role has broadened to include sustainability reporting. Nowadays, accountants quantify into monetary terms social and environmental impact of business activities to assess the sustainability of the environment and the surrounding community. In addition, accountants help organizations incorporate sustainability issues into strategic planning and implementation. A company that is

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not environmentally or socially sustainable may be forced to close its operation because of the clamour by the government and society for sustainability. It is evident, therefore, that organizations are striving to improve on their social and environmental performance.

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