**Sustainability reporting and value creation**

Key words: Sustainability reporting, integrated reporting, value creation, SDGs, sustainable development.

*"…it would seem that the very tenets of the kind of society in which financial accounting plays a starring role are grounded in injustice masquerading as decency" Rob Gray (Gray 2006 p797)*

**Introduction**

The late Professor Rob Gray MBE published an analysis (Gray, 2006) of the state of sustainability reporting and its relationship with value creation in 2006 in a world top accounting journal, the *Accounting Auditing and Accountability Journal* titled 'Social, environmental and sustainability reporting and organisational value creation? Whose value? Whose creation?'. In the years that followed these questions have come under increased scrutiny and this year, the year of Rob's death, there has been a frenzy in the struggle for power between framework and standard setters, organisations representing business and the Big 4. All are seeking to provide the enduring answer to the questions Rob posed.

This paper examines the relevance of Rob's analysis today and critiques recent developments in the fields of sustainability reporting standard setting and current thinking on value creation in light of it.

With a title like this, and in such a prestigious journal, by one of the world's most cited accounting academics, it might be reasonable to expect Rob's paper to influence this current struggle and, before it, the thinking that led to the publication of the International Integrated Reporting Council's (IIRC) *International <IR> Framework,* the ongoing work of the Global Reporting Initiative and recent entrant - the Sustainability Accounting Standards Board (SASB).

Rob was a friend and co-author (to me and many others), a former colleague and a sounding board particularly in the early days of the *Sustainability Accounting, Management and Policy Journal* (SAMPJ) for which he generously agreed to write the first paper published (Gray, 2010a). Rob was also occasionally a source of frustration. He had an amazing, perhaps unparalleled in accounting academe, capacity to absorb and synthesise a vast array of ideas and research to form views that were at the same time evidence-based, opinionated and delivered with passion, whether in presentations or through his writing.

Rob's views were seemingly ignored by those with the power to effect change, likely because to do so was not in their interest. And yet change is coming, albeit slowly and perhaps too little, too late.

I appreciate the opportunity the editors of the *Social and Environmental Accounting Journal* have given me to retrospectively engage with Rob's views on questions that could have been addressed by the *International <IR> Framework* and should be addressed in the current flurry of statements about "harmonisation" of non-financial reporting (see, for example, CDP et al, 2020; IFRS Foundation, 2020).

**Rob's beef**

Rob (Gray, 2006) pondered whether social, environmental and sustainability accounting and reporting (just sustainability reporting from now on) can or should contribute to shareholder value and considers the challenge to conventional views of value that sustainability reporting can offer. But first he ponders whether that is a reasonable thing to ponder.

Tongue in cheek he presents the case for the moral authority of financial reporting by ensuring shareholders (p795): "move funds from less economically desirable ends towards more economically desirable ends and thereby encourage the development and innovation of "better" economic activities". And when shareholders spend money everyone is financially better off and so too must be their welfare. Except "that there is no direct evidence to support this precarious construction" (p796). And the key beneficiaries of financial reporting are, as intended, shareholders.

Chilling scientific data on the state of our planet is presented which leads Rob to the conclusion that (p803): "…tinkering with a "more accurate" financial accounting is irrelevant at best and, in all probability, irresponsible". This leads into a discussion of three possible, not mutually exclusive, approaches to sustainability reporting as possible solutions: "business-as(-almost)-usual"; triple bottom line; and, eco-justice informed; each examined from the perspective of whether they create value and, if so, for whom.

In short, Rob was concerned about the focus on profits, the short-term nature of that focus and that reporting is driven by a about with potential variations in the short-term profit figure.

**The contending solutions**

Rob put forward three approaches to sustainability reporting and its relationship with value creation.

The **"business-as(-almost)-usual"** approach, where sustainability data is selectively reported, Rob concludes, is only a viable solution, if the scientific data is ignored and one assumes that prevailing economic goals and having a planet that can support human life and happiness are compatible. Such assumptions, as he sees it, can only come with lack of imagination, ignorance, and/or the absence of intellectual energy. Sustainability reporting then is undertaken because managers assume it contributes to profit. But it can only do so if it is "accountability-lite" (p806). Rob argues that the Global Reporting Initiative (GRI) has been the dominant influence on this approach.

In discussing the triple bottom line (TBL) or, as Rob puts it, **"there-is-a-common-ground"** (p806) approach, Rob displays his knowledge of reporting innovations by leading companies. This approach will not achieve the reform required because it fails to recognise that financial/economic considerations "will always dominate" (p804). Rob argues that GRI is a step towards a TBL approach but notes that the environmental data required in the 2002 guidelines could not be used to assess environmental sustainability. Nevertheless, Rob was slightly optimistic due to (p808): "tantalising glimpses it *[TBL]* offers us of the decreasing importance placed on financial information and a significant increase in the data relating to an organisation's interactions with society and the natural environment" *[emphasis added]*.

In setting out the "**eco-justice informed"** approach, Rob used arguments that would come to justify the 2015 United Nations Sustainable Development Goals. Causes of un-sustainability are related and integrated, that is, the result of systemic failure. As such, the solution requires drastic change. This could be at the entity (corporate) level and/or at the region, possibly local eco-systems level. Entity based reporting for sustainability, Rob argued, would need to consider the organisation's ecological footprint relative to sustainable levels and how to address social injustice.

Rob called for more imagination, engagement and active reconstruction on the part of researchers – and surprisingly cited Adams (2004) as an example of such. [I say surprisingly because on this, and other ideas I introduced he was often initially at least, critical. The approach in Adams (2004) seems to have been one he warmed to – after a robust debate. Perhaps this is because, like his work, it focusses on environmental sustainability whereas much of my work to this point was on social justice issues.]

**What has happened since**

I agree with Rob's analysis of the GRI as being an influence on "business-as(-almost)-usual" *at that time*, but not the "dominant" influence. (That failing is down to corporate leaders and investors.) However, over the last few years and through my involvement on the GRI Stakeholder Council through 2013-2019, various engagements with GRI prior to that and through input to the development of the GRI Standards, I have seen a shift. In Adams (2004) I argued that more information on internal processes needed to be include in the GRI guidelines and these and other research findings influenced my contribution to the GRI Standards. The guidelines have since been replaced by Standards and companies have to disclose their processes for engaging stakeholders and determining material issues, governing body oversight of the sustainability report is required, external assurance is encouraged, and impact on broader stakeholders must be considered. The blame for lack of accountability for social and environmental impact and a "business-as(-almost)-usual" approach falls on the companies concerned, their investors for allowing it and heavy reliance on the backward looking nature of conventional financial reporting. The conservative approach of assurance providers resulting in assurance scopes focussing on key data has failed to encourage robust processes. Corporate executives have been slow to integrate sustainability considerations into strategy and boards have only recently shown any interest.

The recent report by the World Economic Forum (WEF) and the Big 4 (WEF et al, 2020) will not facilitate that process, and there is a danger it will slow it down. It proposes 21 core indicators and 34 expanded indicators providing little incentive for businesses to focus on adapting their strategy to make a positive contribution to sustainable development (see Adams, 2020 for an expanded critique). In today's terms this is a pretty much a "business-as-usual" approach i.e. without the "almost" in Rob's "business-as(-almost)-usual". The addition of the fourth "pillar" (governance) to the triple bottom line approach has unconvincing pretences to creep slightly into the "there-is-a-common-ground" approach. (The bar is surely higher now than it was in 2006).

That recent Board (governing body) interest has been tickled by the way in which some (by no means all) companies are using their integrated reports to highlight the importance of non-financial performance, and even the preservation of natural capital, to their success. That, and the IIRC's requirement that Boards make a public statement concerning their involvement in integrated reporting.

The *International <IR> Framework* defines value creation in relation to six capitals, including natural capital and social and relationship capital, as:

> "The process that results in increases, decreases or transformations of the capitals caused by the organization's business activities and outputs." (IIRC, 2013, p33)

This, coupled with the requirement for Board involvement has played some part in changing corporate thinking and decision making (Adams, 2017). They must now have at least some focus on natural and social capital. Under the framework, value is created for a) the organisation and its providers of capital and b) "others (i.e., stakeholders and society at large") (p10). The link between a) and b) is said to come through activities, relationships, and interactions which, when material to an organisation's ability to create value *for itself* should be included in an integrated report. This is perhaps, on the face of it, somewhere between a "business-as(-almost)-usual" and "there-is-a-common-ground" approach. But I am optimistic that some organisations are taking it further and seeing the preservation of natural capital and the resolution of social justice issues as essential to their long-term success. They are aligning their initiatives on these issues with their strategy to create value (see, for example, Adams, 2017). (Long-term thinking is also emphasised through the *International <IR> Framework,* although in practice long-term is quite short: "the long run is unlikely to be beyond the next stock market upsurge and the next merger/takeover talks" Gray, 2006, p 805).

The UN SDGs agreed in 2015 acknowledge that the causes of un-sustainability are related and integrated (criteria for Rob's eco-justice informed approach). They are not a reporting framework, but they do draw attention to (globally agreed through a consultative approach) sustainable development risks and opportunities that can affect long term value creation. And organisations can change their business model and strategy to make an impact on contribution to the SDGs and report on that impact aligned to the International <IR> Framework, GRI Standards and the TCFD recommendations (see, Adams, 2017; and the SDGD Recommendations, Adams et al, 2020). I believe that the achievement of the SDGs is critical to creating long term value for providers of finance.

Any "harmonisation" (sic) effort to retrospectively align current reporting frameworks and standards that fails to make achieving the SDGs central, will likely trigger the end of the human race. Yet that is exactly what the framework/standard setting bodies have proposed (CDP et al, 2020).

The CDP et al (2020) statement uses the term 'enterprise value creation'. A visual (their Figure 1) indicates that this is narrowly defined in that the organisation's significant impacts on the economy, environment and people do not influence 'enterprise value creation'. This is not only false; it also does not encourage organisations to operate within planetary boundaries. In fact, it will discourage many. The framework and standard setters might consider developing a conceptual framework aligned with Rob's "eco-justice informed" approach that defines long term value creation this way:

> "Organisations create (or destroy) value for their providers of finance through the value they create (or destroy) for the organisation and society. Through the process of creating (or destroying) value, organisations have an impact (positive or negative) on the achievement of the SDGs. **The achievement of the SDGs is critical to creating long term value for providers of finance**." [Emphasis added] (Fundamental concept of 'Long term value creation for the organisation and society' in the SDGD Recommendations; Adams et al, 2020, p9)

At the time of writing, the IFRS Foundation (2020) have put out a consultation paper which seems pre-determined (from the hype/frenzy leading up to it) to lead to the creation of a Sustainability Standards Board under their auspices that sets sustainability reporting standards. It will develop a conceptual framework and use the existing frameworks and standards as "building blocks". It proposes focussing on information most relevant to investors and later broadening its scope:

> "…the SSB *[Sustainability Standards Board]* would initially focus its efforts on the sustainability information most relevant to investors and other market participants. Such information would more closely connect with the current focus of the IASB… The SSB could consider how to broaden its scope as it proceeds…" (IFRS Foundation, 2020, p14, paras 50-51) *[emphasis added]*

All of this is very vague and depends on what is considered relevant to value creation for investors. If we rely on their view, we are all in trouble. Investors and the corporations they invest in have proven over and over that uninformed views and biases result in them not knowing what is good for them, let along others (see, for example, Adams and Harte, 1999; Gray, 2006, 2010a, 2020b).

So it seems we are at a cross roads – if we go in one direction, accounting might save the people of the planet; and, if we go in another, the one the IFRS Foundation are leaning towards, accounting might destroy the planet as we know it. It all hinges on the definition of materiality. While the preferred one has been made clear, a few other contesters are mentioned (para 44). I prefer, of course, the one in the SDGD Recommendations (Adams et al, 2020, p9) where materiality is defined as:

> "Material sustainable development information is any information that is reasonably capable of making a difference to the conclusions drawn by:
>
> • stakeholders concerning the positive and negative impacts of the organisation on global achievement of the SDGs, and;
>
> • providers of finance concerning the ability of the organisation to create long term value for the organisation and society."

This definition of materiality addresses Rob's concern regarding the emphasis on financial materiality. Would he like it? Probably not, at least at first, but I think it is moving close to his eco-justice informed approach.

Time will tell whether the urgency delivers the change that Rob said was needed in 2006. In the meantime, we must all continue what Rob started - be heard and engage in the debate. There will be no point in under-fed, uncomfortably hot accounting researchers writing in a few decades time about how corporate (under)-reporting on sustainable development impacts reflected the greed, self-interest and a bias against future generations as Ken McPhail and I did about the employment of ethnic minorities in the UK last century (Adams and McPhail, 2004). It would be too late. Noting my earlier reference to Rob's almost superhuman ability to remember and make sense of vast amounts of academic (i.e. evidence based) literature, please remember these words of his:

> "I have been unable to discover any evidence at all which provides any kind of links between any aspect of planetary sustainability and the corporate behaviour which is being lauded. If the leading edge of corporate behaviour on social and environmental issues is truly contributing to sustainability – somebody would appear to be keeping the evidence secret." (Gray, 2010, p 17-18)

Dedication: For Sue, Chris, Michael, and all future generations.

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