What is sustainability accounting? What does ESG mean? We have answers

By Leanne Keddie

3 Feb 2021

Sustainability is a hot topic today due to increasing awareness of climate change and inequality, among other pressing issues.

Image source: Gallo/Getty

The Earth just recorded a seven-year hot streak and we're approaching the Covid-19 pandemic's first anniversary. The crisis has had enormous implications on our mental health, the economy and income inequality. Post-pandemic, we need to build back better, and sustainability will be the key to success.

What is sustainability?

There is no universal definition of sustainability, but many point to the United Nations' 1987 Brundtland Report that calls for sustainable development that meets our needs today without compromising the needs of those in the future.

This idea of meeting our needs without sacrificing the needs of our children, or our children's children, tends to form the basis of most sustainability definitions.

The definition focuses on the planet's capacity to meet our needs. Without a healthy planet, we will be unable to meet our needs for food, clean air, shelter and other basics. Those of us who live in the developed world — high income earners in particular — are far more likely to be contributing disproportionately to climate change, while those who live in less affluent parts of the world are more likely to suffer the consequences.

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Who's responsible for sustainability?

We all have a role to play in achieving sustainability, and these roles are interconnected. As consumers, we can make changes to our lifestyles to reduce our waste and use cleaner energy sources, but that's not enough.

We buy products and services produced by companies, so they need to be responsible too. It's estimated that 71% of all greenhouse gas emissions come from just 100 companies, including ExxonMobil and Shell. If these companies produced sustainable goods and services while consumers also took individual responsibility, it could have a powerful impact.

Governments play an important role too, creating and enforcing regulations such as putting a price on carbon to disincentivise its use.

Regulators like the Securities and Exchange Commission in the United States and the Canadian Securities Administrators in Canada also set rules around what information publicly traded companies are required to disclose. These regulators require audited, financial information from public firms, but the same cannot be said for sustainability information that's mostly voluntary and typically not audited.

As a result, we are left with missing information, or subject to volumes of information about what firms *want* to talk about, likely in an effort to enhance their reputation.

What is sustainability accounting?

Sustainability accounting is the practice of measuring, analysing and reporting a company's social and environmental impacts.

Various stakeholders have different interests. Employees may be interested in wage inequality — for example, how much more the CEO makes than the average worker. In the 1970s, CEOs made 20 to 30 times more money than the average employee — today, they make 300 times more.

Communities may be interested in how much pollution or greenhouse gases a firm is producing so that their neighbourhoods remain clean and safe. Investors are usually interested in a firm's financial performance, including ESG.

What is ESG?

ESG refers to the environmental, social and governance information about a firm. There is growing evidence that companies that take their environmental and social responsibilities seriously perform better financially. This has naturally made investors sit up and take notice.

Sustainable responsible investing (SRI), or ESG investing, uses this information about a company to inform investment decisions.

ESG investors are attracted to companies that meet certain ESG criteria while they avoid investing in companies they believe are unethical, like tobacco or gun manufacturers (known as sin stocks). They also pressure firms to improve their ESG performance, or they divest from some companies completely.

How do we measure sustainability?

Measuring sustainability is where it gets tricky. Much of the information used to gauge a firm's sustainability is provided by the company itself, and it's not always audited. This makes it very different than financial information, which is subject to detailed audits.

Third-party organisations use this company-provided information as the basis to create different ratings and assessments, meaning there are serious issues with their analyses. While many firms provide this information voluntarily, many say one thing but do another, burnishing their reputation, for example, while continuing to pollute.

This means that a company's true sustainability performance is difficult to accurately gauge. Because their ESG disclosures are voluntary, businesses don't have to divulge anything they don't want to, and there are few consequences for grand, baseless claims or non-disclosure.

The need for sustainability accounting

There is huge potential here, however, for sustainability accounting to play a key role.

There are currently a number of different ways to report ESG information. Among the most popular is the Global Reporting Initiative, which takes a multi-stakeholder perspective. That means that information on how a company's actions affect many different parties — not just shareholders — is reported.

This can include local communities and employees. This approach captures many different elements of a company's business operations. That's more in line with a long-term view of sustainability itself and is one of the features that differentiates the Global Reporting Initiative from other measures.

There are other frameworks and proposals, including a current proposal by the International Financial Reporting Standards (IFRS) — followed by companies in many countries — to create their own sustainability accounting standards. The issue? While the proposal would focus on providing pertinent information to investors, those same investors tend to be short-term thinkers and sustainability is inherently a long-term concept.

So while ESG has piqued their interest in making more money, that won't necessarily lead to the broader, enduring societal sustainability that's urgently needed in the midst of the climate crisis.

Right now, the current measurement systems are inconsistent and incomparable. Unlike the financial information for public companies that we can compare and rely upon, we do not have the same reliability for sustainability accounting information.

Why does it matter?

Sustainability accounting, ESG investing and SRI are not going away any time soon as pressure grows on companies to measure and report their sustainability information.

In terms of environmental sustainability, long-term efforts are critical for the sake of humanity and the planet. Sustainability accounting can help companies do business differently because what gets measured, after all, gets managed.

To achieve environmental sustainability, we need strong corporate standards that are quantifiably enforced, accountants trained to accurately and comprehensively measure sustainability — and we all need to play a role in changing how we live.

Our words and actions matter. As consumers, we can change our lifestyle, our investments and demand change from our governments. Together — along with accountants — we can get there.

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