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Toward greener pastures:
How to leverage sustainability initiatives for finance transformation

Reporting on sustainability is no longer just an effort to portray good corporate citizenship alongside 'normal' business operations. Today, being a sustainable business – an organization that integrates environmental and social performance with financial results – is a growing imperative, and reporting should reflect this new reality.

The finance function has a central role in supporting sustainability – a role that is expanding as sustainability requirements evolve. Historically, finance was called upon to provide analytical support for overall assessment of sustainability initiatives. Now finance is often charged with measuring, and reporting sustainability performance – the range of impacts on the environment and society as well as financial performance.

These new responsibilities can be catalysts for finance transformation initiatives intended to help the business grow, improve efficiency, and manage risk and compliance. Through our work with global finance organizations, Deloitte has identified a number of areas in which sustainability-related requirements can trigger finance transformation and ways that those triggers can create opportunities to improve reporting, transparency, and business performance, as well as mitigate business risk.

Sustainability and finance – where and how do they intersect?

Sustainability embodies some of the great challenges facing us, including the impacts of population growth, increased energy demand, resource depletion, water scarcity, and waste-stream management. Businesses are feeling pressure to address sustainability issues from many quarters, including shareholders, supply chain partners, customers, nongovernmental organizations, regulators, and lawmakers.

Sustainability's emergence as a core business issue adds a new dimension to finance, including setting finance strategy and vision and designing and implementing changes across the finance organization. Transformation can help improve finance executives' – and finance functions' – contributions to overall company value through four critical, interdependent activities: serving as a catalyst, a strategist, a steward, and an operator. In each of these roles, finance executives would have sustainability-related responsibilities:

- **Catalyst** – Identifying opportunities and risks from the wider, long term perspective that sustainability brings and incentivizing behaviors and investments that support high-ROI sustainability efforts through strategic opportunity identification and risk management.
- **Strategist** – aligning investments and returns with sustainable business planning and budgeting, and developing tax planning strategies related to sustainability focused regulations, incentives, and credits.
- **Steward** – developing metrics, key performance indicators, and external and management reporting processes to report how sustainability initiatives are performing and how they translate into shareholder value.
- **Operator** – delivering capabilities, talent, and service levels to fulfill the finance organization's responsibilities in supporting business sustainability.

Each of these critical finance roles take on additional importance as sustainability considerations grow in relation to revenues, costs, and margins. Deloitte has identified six key areas in which sustainability initiatives can prompt finance transformation:

Enterprise value. Sustainability initiatives can be evaluated as investment opportunities rather than just costs, with payback in revenue, cost savings, and enhanced asset value. Sustainability considerations can be incorporated into finance strategy, and the finance organization can provide input into sustainability investments decisions and maximizing potential returns.

Stakeholder relations. Scrutiny of corporate sustainability performance continues to grow among investors, employees, customers, non-governmental organizations, and other stakeholders. Having a strategy to communicate sustainability initiatives to key stakeholders can help position the company as a sustainability leader, which can influence its investment opportunities, recruiting and retention, and product and brand loyalty.

Leading companies recognize it is critical to define and develop internal and external reporting strategies, processes, and controls to communicate sustainability information accurately and consistently.

Reporting. A growing number of outside organizations are seeking sustainability information from companies today. Leading companies recognize it is critical to define and develop internal and external reporting strategies, processes, and controls to communicate sustainability information accurately and consistently. Best practice is for a consistent data set between how the non financial performance is managed and external reporting.

Tax and regulatory drivers. Governments have influenced private-sector sustainability initiatives for years, notably, through tax laws and regulatory requirements. In the face of converging government actions, leading companies are beginning to incorporate sustainability considerations into tax planning, risk management, and operational performance assessments.

Greenhouse gas and waste stream impacts. Greenhouse gas (GHG) regulations effectively introduce a cost of carbon and monetize an organization's GHG reduction efforts. Leading organizations are factoring carbon pricing and GHG and waste stream emissions into financial planning to mitigate the impact of cap and trade legislation and to profit from efficiency advantages over industry peers.

Enterprise risk management. Reduced energy, commodity, and resource consumption in the face of fluctuating prices can lower the business risks of dramatic price increases. Mitigation and adaptation strategies can help control climate change risk. Leading organizations are incorporating sustainability-related risks into their risk maps, and they are accounting for the impact of fluctuating resource prices in their planning, forecasting, and treasury activities.

Two key triggers – a closer look

All six of the sustainability-driven triggers can have an impact on finance transformation and warrant consideration. However, sustainability reporting and tax and regulatory drivers, in particular, have risen to the top of many CFO agendas.

Sustainability reporting considerations

Sustainability reporting has two dimensions – internal and external reporting. External reporting includes both regulatory compliance reporting and reporting to investors, shareholders, business partners, non-governmental organizations, and other constituencies. Internal reporting supports the ongoing development, performance, and analysis of sustainability initiatives and processes across the enterprise for management decision making and other purposes.

In most organizations, sustainability reporting has yet to achieve the level of quality and consistency found in other types of reporting. It is often compiled and provided on an ad hoc basis by health and safety offices, facility management, or sustainability teams. Even in companies that have made sustainability reporting an enterprise-level priority, it typically does not reflect the rigor supporting other types of management and financial reporting.[1]

Differences in the way a company reports sustainability information to distinct audiences can create significant exposure to regulatory sanctions, shareholder actions and reputational risk. Sustainability disclosures are subject to monitoring by environmental and financial regulators, including the SEC, the Federal Trade Commission, and the Department of Justice, as well as shareholders and other key stakeholders. Sustainability results are put on public view through scorecards such as the Global Reporting Initiative, the Carbon Disclosure project, and NEWSWEEK's Green Rankings.

Reporting requirements can drive activities across the four dimensions of finance transformation:

Strategy and vision. Defining metrics and key performance indicators around sustainability initiatives to help communicate progress and status to key stakeholders.

Organization. Staffing the finance organization with practitioners who can monitor sustainability activities, analyze relevant data, and report results with accuracy and clarity.

Processes. Developing leading external and management reporting processes for reporting specifically how sustainability efforts translate into shareholder value.

Systems. Implementing technologies to enhance management reporting capabilities and integrating systems and migrating to a "one report" design for issuing financial and nonfinancial results.

A key to establishing consistency across sustainability reporting is to establish a single source of data, a master information resource for fulfilling disparate information requests and demands. The finance organization is uniquely equipped to create and manage such a resource. It serves a strategist role in aligning sustainability initiatives with business planning and budgeting. And it is the steward of metrics, indicators, and processes linking sustainability to shareholder value.

One effective approach to creating a structured, consistent, and sustainable approach to compiling and reporting sustainability information is to create a "center of excellence" for sustainability policies, procedures, and communications. Such a center can become the focal point of responsibility for coordinating internal and external sustainability reporting and aligning it with financial reporting, supported by the appropriate infrastructure. This infrastructure includes technologies and systems that reduce manual reporting associated with sustainability matters, the latter can result in multiple versions of data, which creates risk if action is brought against the company.

Because sustainability is still an emerging criterion of corporate performance, relevant reporting standards and appropriate metrics for communicating environmental risks and liabilities will likely remain largely in flux until regulatory bodies define precisely what metrics should be used and how they should be measured and reported upon. With many different agencies involved in regulating environmental matters and disclosures, companies must be vigilant in identifying and working with all agencies to which they must report.

Since 2005, Cisco has published an annual Corporate Social Responsibility Report, which describes initiatives directed at improving the health, welfare, and sustainability of its business. Topics included in the report align with those in the Global Reporting Initiative, including GHG emissions, materials, waste, water, land use, and biodiversity.[2] Cisco has received a significant amount of positive press, including recognition by the EcoStrategy Group as being one of the top-rated companies of its size for the quality of its sustainability communications for. Per the EcoStrategy Group, Cisco has made a concerted effort to engage customers, partners, and employees in efforts to manage its impact on the environment.[3]

Tax and regulatory drivers

Companies that engage in sustainability initiatives and practices are usually aware of the potential to receive tax credits and incentives for such activities. However, they often don't fully capture these benefits. Opportunities are pursued on a one-off basis – a biofuel project at a New York plant, an office renovation to achieve LEED certification, a solar array installation at an Arizona facility. Also, sustainability incentives often are a low priority of the tax department, typically dealt with after the fact – not for lack of interest, but because decisions are often made within "the business" without input from the tax department.[4]

A powerful premise underlies the argument to elevate tax as a sustainability consideration – the potential for bottom-line financial benefits stemming from tax savings.

The finance organization, through its tax function, can lead the transformation from an ad hoc to a strategic approach to sustainability-related tax opportunities. This may seem an unenviable task given the importance historically assigned to such matters. However, a powerful premise underlies the argument to elevate tax as a sustainability consideration – the potential for bottom-line financial benefits stemming from tax savings.

Leading companies involve their tax departments upfront in sustainability decision making, with the expectation that they will, among other things:

- Conduct analyses required to understand the tax dimensions of investment business cases and return on investment calculations, including fixed asset decisions.
- Implement internal controls and reporting mechanisms needed to determine eligibility for and appropriately respond to tax-saving opportunities.
- Stay abreast of federal, state, local, and international tax regimes to identify potential additional benefits, as well as opportunities related to sustainability master plans in particular regions.
- Coordinate and leverage tax-related activities across jurisdictions and geographies.

It is important to recognize that sustainability initiatives are not one-time efforts but commitments over time. In many instances, companies must continue to comply with the requirements for earning tax benefits, or risk losing them with balance sheet and reporting implications. As with sustainability reporting, tax activities may benefit from creation of a center of excellence for sustainability policies, procedures, and communications.

Along with tax issues, another major consideration for companies in planning and carrying out sustainability programs is uncertainty regarding the future course of regulation.

The finance organization can take a lead role in preparing for the future, however hazy. It can conduct earnings and risk analyses on a range of potential cap and trade and tax scenarios. It can assess the impact of energy and carbon price changes on the company's core business.

Accomplishing these tasks requires both technical and financial understanding – how carbon markets operate, how regional emission schemes and greenhouse gas initiatives are evolving, how carbon offsets are traded and validated by the United Nations Clean Development Mechanism. The finance function is a logical place to nurture and expand these skill sets.

As noted earlier, sustainability claims raise the potential

GE was awarded a $25.5 million tax credit through the American Recovery and Reinvestment Act of 2009 to support the $150 million renovation of an existing manufacturing facility in New York dedicated to energy storage – i.e., battery technologies for the rail, marine, mining, telecommunications, and utility industries. New York State also pledged $15 million in tax incentives for the initiative. The renovation project attracted state and federal support because it created 350 jobs in addition to its focus on critically needed next-generation energy storage devices.[5]

exposure of companies to regulatory sanctions, litigation, and government investigations. For example, sustainability-related business impacts, risks, and disclosures may be subject to accounting and reporting guidelines and regulation from agencies and organizations such as the SEC and the Financial Accounting Standards Board. The SEC has undertaken a number of activities recently related to corporate sustainability reporting, including its core disclosure project – creation of an Environmental, Social, and Governance Investor Advisory Committee – and issuance of interpretative guidance on climate change disclosure.

Companies also face possible litigation over alleged misrepresentations in sustainability reporting. Regulatory bodies including the SEC and FTC are continuing to evaluate the issues related to integrating social and environmental performance in reporting, labeling, etc. The risk associated with inaccurate sustainability disclosure will likely continue to increase as companies seek to align such reporting with financial reporting.

As with sustainability reporting, tax and regulatory requirements can drive activities across the four dimensions of finance transformation:

Strategy and vision. Incorporating sustainability-associated tax and regulatory perspectives into the development of finance strategy and the related operating model.

Organization. Staffing the finance organization with practitioners who understand tax and regulatory issues, and who can analyze relevant data and report results with accuracy and clarity.

Processes. Developing leading practices to leverage the potential for tax relief for sustainable capital investments; performing tax planning related to sustainability regulations; enhancing tax and other regulatory compliance processes to account for sustainability; and completing required calculations, disclosures, filings, and related reporting.

Systems. Assessing and deploying technology tools to track tax benefits and compliance requirements.

Promoting a sustainable future, including transformation of finance

Conducting business in a sustainable manner is a growing priority for corporations, with financial, operational, and compliance implications. The finance function is uniquely equipped to take a lead role in this emerging area of corporate activity. Finance can bring increased focus, rigor, and consistency to sustainability efforts, while adding value to the organization as a whole by transforming itself to meet tomorrow's demands and opportunities.

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The Greenway is a a newsletter featuring insights and stories related to Sustainability. Register to receive this communication at http://www.deloitte.com/us/greenway/subscribe.

Endnotes

1 The information contained herein is based on the experiences of our Deloitte Consulting LLP professionals.

2 *2010 Cisco Corporate Social Responsibility Report*, http://www.cisco.com/web/about/ac227/csr2010/index.html.

3 "Trends in Sustainability Reporting," Karen "KJ" Janowski and Kathleen Gilligan, page 5, EcoStrategyGroup.com, http://ecostrategygroup.com/trends.pdf.

4 The information contained herein is based on the experiences of our Deloitte Consulting LLP professionals.

5 GE January 2010 Investor Update, page 2, http://www.ge.com/pdf/investors/monthly_update/2010/ge_monthly_update_january2010.pdf.