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CFOs and Sustainability: Shaping their roles in an evolving environment

Deloitte Sustainability
Global Enterprise Risk Services

CFOs and Sustainability: Shaping their roles in an evolving environment

In the not-too-distant past, a CFO's attention rarely diverted from hard numbers around revenue, earnings, budget, and the like.

Today, these executives may look back nostalgically on those times, as they take on increasing responsibility for impacts well beyond financial performance.

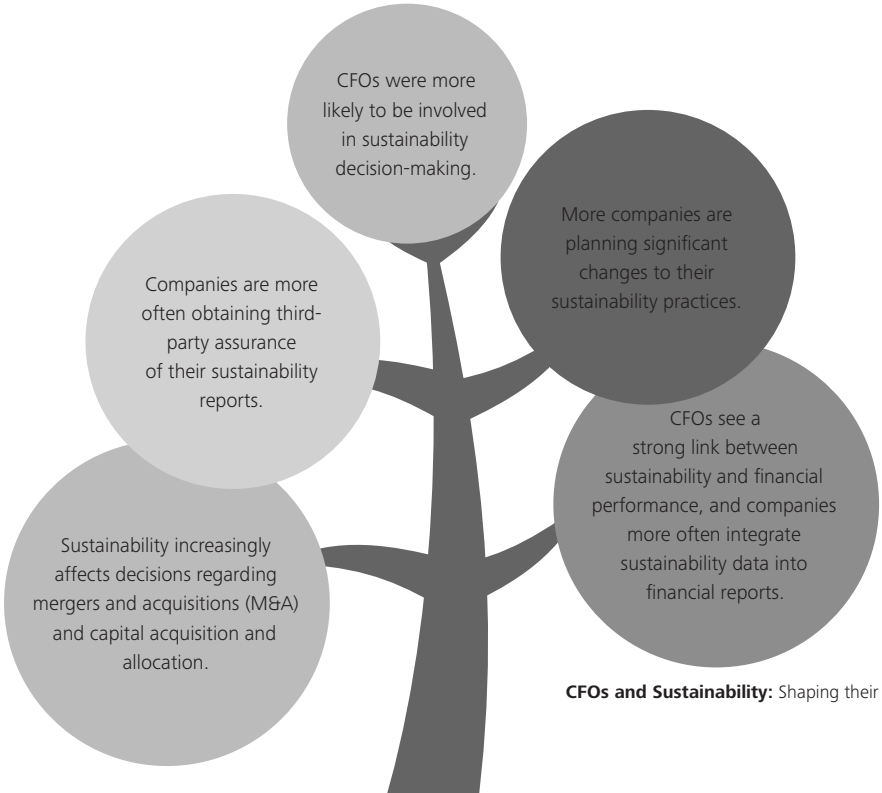
Among the notable areas within this broadened mandate is sustainability -- the environmental, health, safety, and social impacts of the enterprise. It's a challenge that CFOs – and the organizations they serve – will continue to grapple with.

In addressing sustainability issues many organizations tend to be reactive, susceptible to shifting priorities, and insufficiently aligned with strategic business considerations. Reactive approaches lead to start-and-stop initiatives, which waste resources and undermine organizational commitment. Lack of alignment with strategy leaves sustainability out of sync with business objectives, which can place programs in continual jeopardy or at cross purposes to business goals.

CFOs are uniquely positioned to correct these deficiencies and help set their organizations on a steady course. With greater involvement in sustainability, CFOs can provide a broad viewpoint informed by deep financial expertise while further shaping their executive roles. In the traditional roles of steward and operator, the CFO preserves assets, minimizes risks, and manages an effective, efficient finance function. In expanding to the complementary roles of strategist and catalyst, CFOs can assist in setting strategy and direction and instill a financial approach in all organizational activities – including sustainability. This calls for the CFO to play a role in making and reviewing the business case, and in most other financial aspects of sustainability.

Indeed, increasing CFO involvement stands among the key findings of Deloitte's 2013 CFO Sustainability Survey, which also revealed the following trends (relative to the 2012 survey):

This document summarizes the key findings of Deloitte's 2013 CFO Sustainability Survey, sets them in the context of the 2012 and 2011 surveys, and provides our observations on the findings as well as suggestions regarding potential action steps. Our aim is to enhance CFOs' understanding of their role in sustainability by providing a window on their peers' involvement in this area and on related opportunities and concerns.



About the Survey

On behalf of Deloitte, Verdantix interviewed the chief financial officers, finance directors, or, in non-English speaking nations, their equivalents in 250 companies in 15 different industries and 15 countries (including countries from the Middle East and the Benelux states). Each company had annual revenue greater than $1 billion. Average annual revenue was $11.5 billion. Total revenue of all companies exceeded $2.9 trillion.

Industries represented include automotive, basic resources, business services and media, chemicals, construction and materials, energy and utilities, financial services, food and beverages, hotels and leisure, industrial and high-tech engineering, personal and household products, pharmaceuticals and medical, retail, technology and telecommunications, and travel and transportation. A minimum of 12 interviews per industry were conducted.

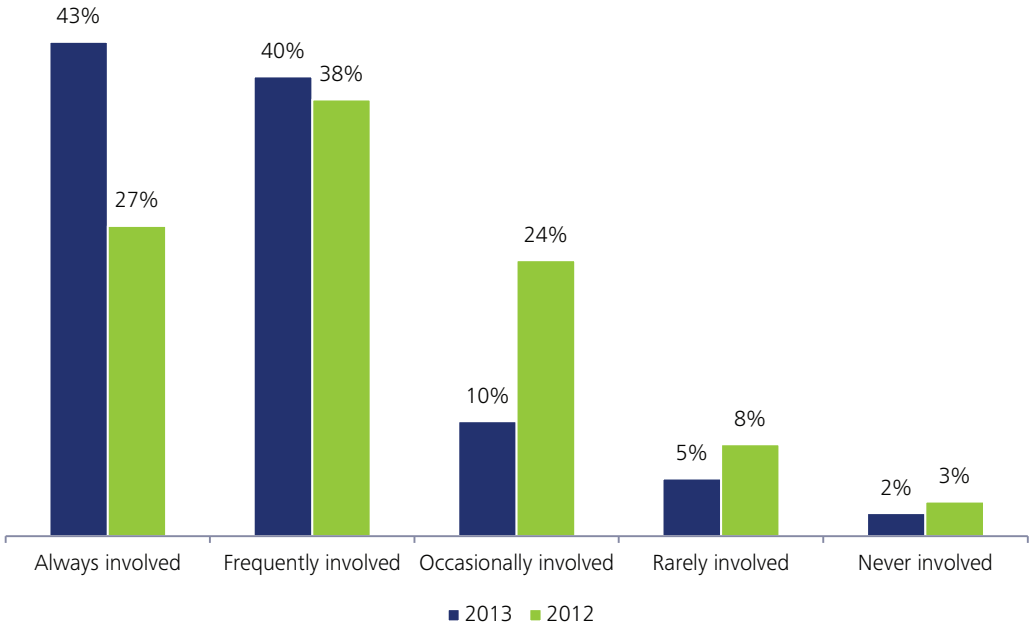
Interviewees were based in

About Sustainability

Sustainability aims to optimize the environmental, health, safety, and social impacts of enterprise activities while realizing operational efficiencies, cost savings, risk mitigation, increased cash flow, and other benefits. For most executive teams and boards, the drivers of these programs and practices have advanced from those rooted solely in good corporate citizenship to include significantly more emphasis on operational, financial, legal, and regulatory concerns. These concerns include resource availability and costs, compliance requirements, and potential risks (including reputational risk) and revenue impacts, in addition to environmental, health, safety, and social factors. Increasingly, they also extend to concerns of shareholders and other stakeholders, which include optimizing growth and enterprise value.

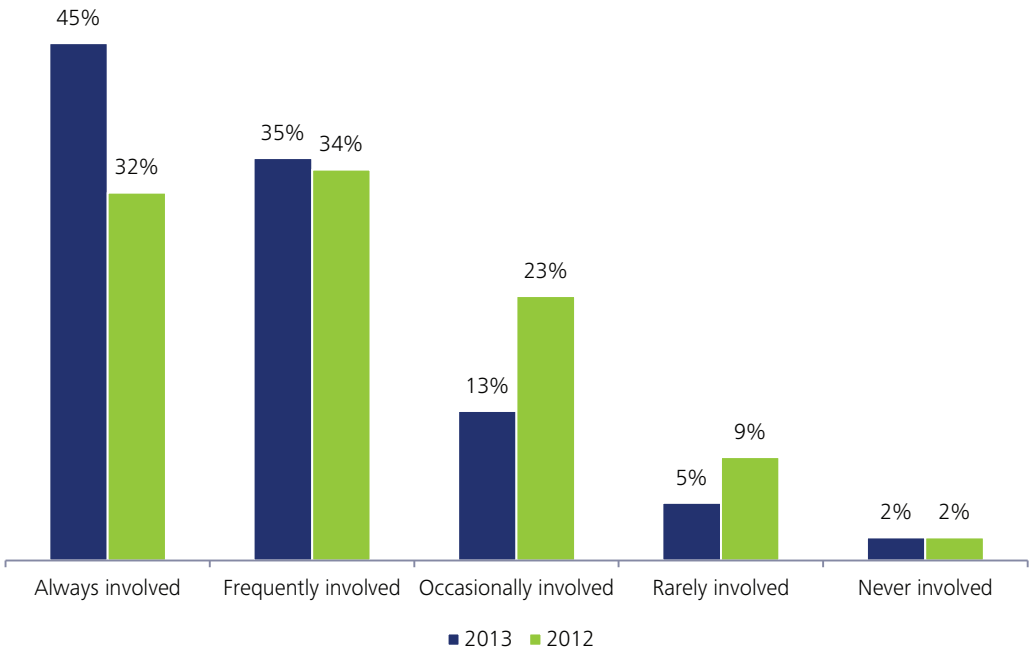
Key Findings
CFO involvement has increased ...

What best describes your current involvement in setting sustainability strategy at your firm?



Note: Due to rounding, chart totals throughout this document do not always equal 100%.

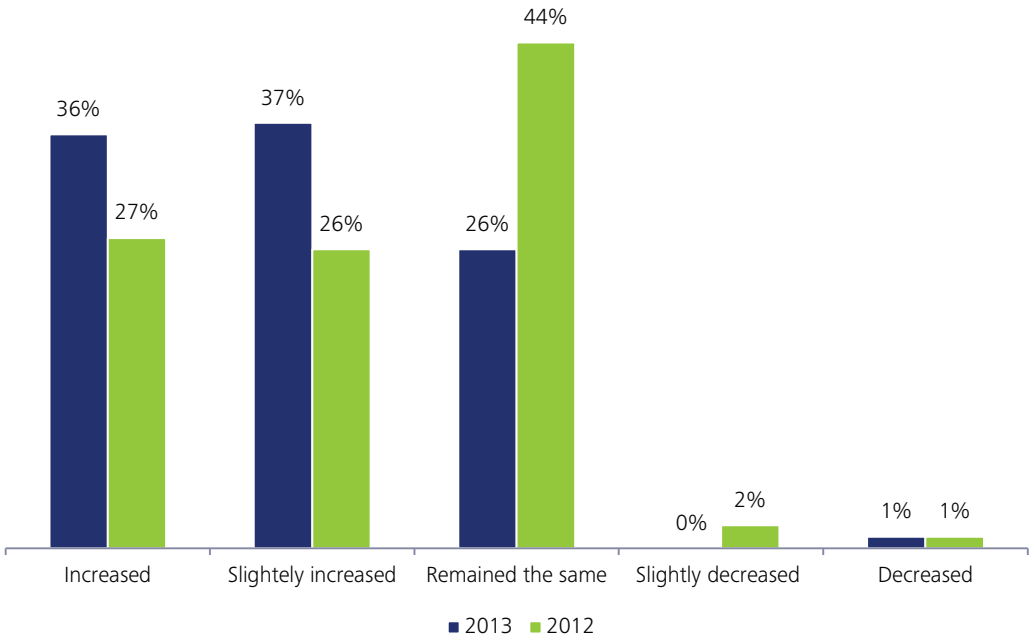
To what extent are you involved in driving organizational execution of your firm's sustainability starategy?



CFOs are becoming more involved in sustainability, with a total of 83 percent of respondents stating that they are always involved or frequently involved in setting sustainability strategy (up from 65 percent in 2012) and 80 percent stating that they are always involved or frequently involved in executing sustainability strategy (up from 66 percent in 2012) at their organizations.

The percentages stating that they are occasionally involved or rarely involved in sustainability strategy both decreased substantially.

How has your involvement in sustainability strategy at your firm changed over the last year?



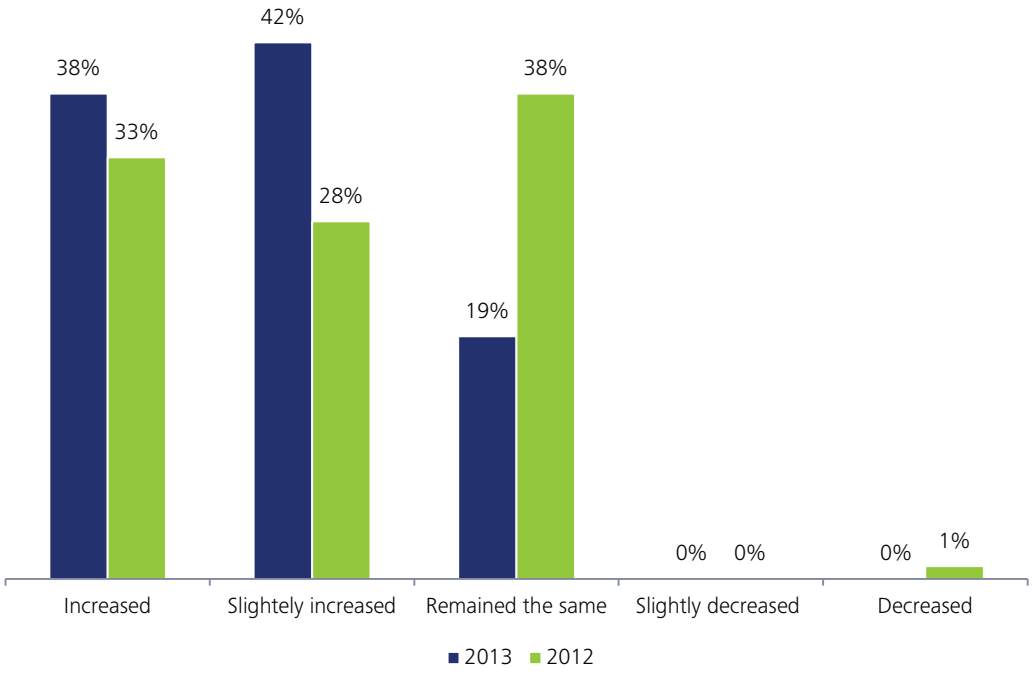
73%

A total of 73 percent of respondents said that their involvement in sustainability had increased or slightly increased during the last year

53%

In the 2012 survey, only 53 percent of respondents reported increased or slightly increased involvement.

How do you expect your role in sustainability strategy to change in the next 2 years?



80%

Moreover, a total of 80 percent of respondents expect their involvement in sustainability to increase or slightly increase in the next two years.

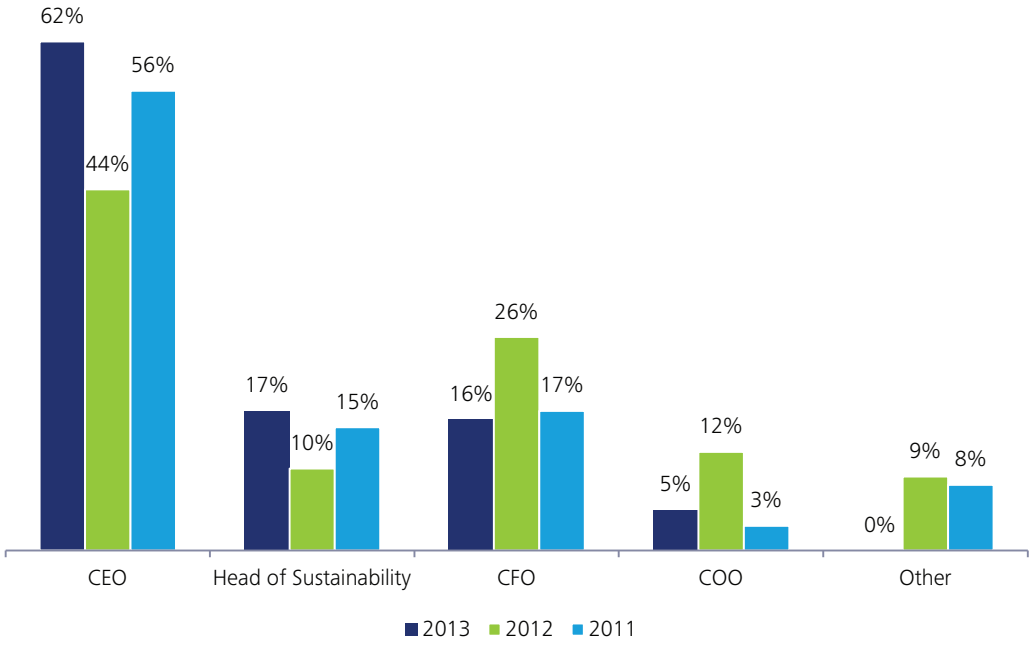
61%

In the 2012 survey, a total of 61 percent expected an increasing role in sustainability.

(Note that some variability exists in the geography and industry breakdown of survey respondents year over year, which could introduce challenges re comparability. However, based on our analysis and experience, we believe the trends noted herein are directionally correct.)

… Although accountability to the board has shifted

Who is accountable to the board for your firm's sustainability strategy?

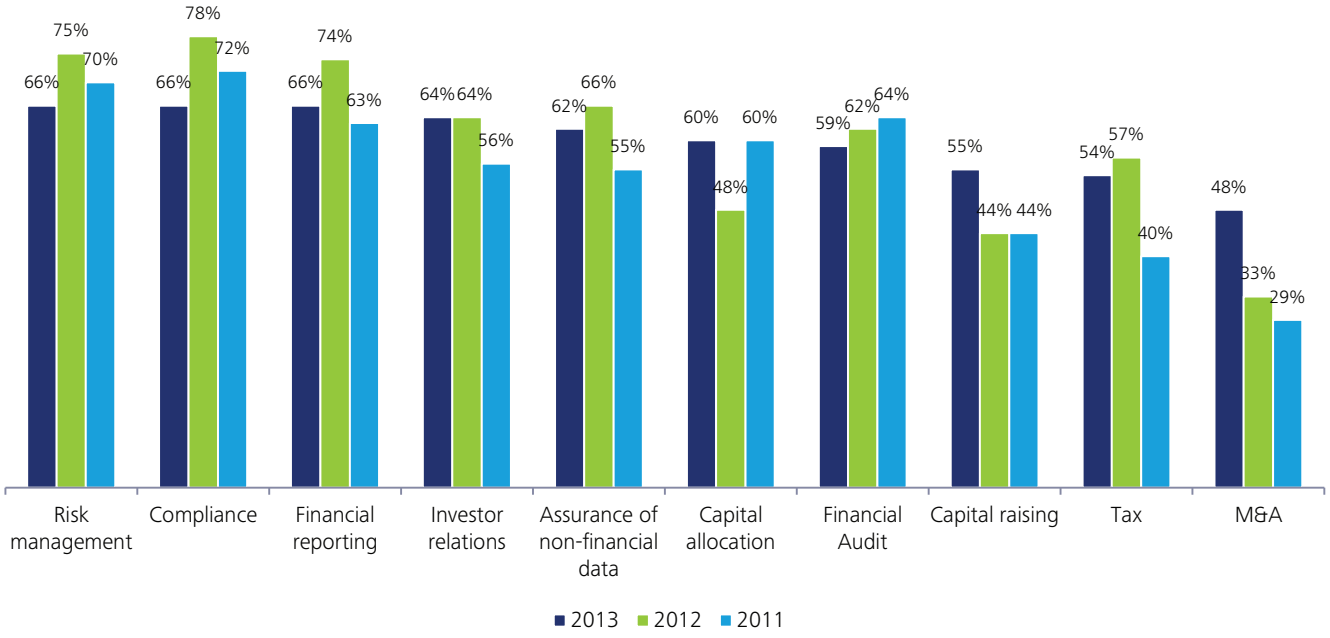


In a seemingly anomalous trend, accountability for sustainability to the board has shifted from the CFO and chief operating officer (COO) to the chief executive officer (CEO) and the chief sustainability officer (CSO). In 2013, 16 percent of CFOs reported that they are primarily accountable to the board for sustainability – down from 26 percent in 2012 (but very close to the 17 percent of 2011).

Greater reported CFO involvement in sustainability coupled with reduced CFO accountability to the board may be the result of a shift toward the CEO being more often accountable (62 percent in 2013, up from 44 percent in 2012) and the CSO being more often accountable (17 percent in 2013, up from 10 percent in 2012) to the board. This in turn may reflect a maturation of sustainability programs or the higher profile of the function, to the point where the CEO or CSO holds direct accountability to the board for the program or initiative.

CFOs have seen multiple impacts of sustainability

Which of the following aspects of financial management have been impacted by sustainability issues at your firm? (multiple responses)



The impact of sustainability on key financial decisions has increased in M&A (to 48 percent in 2013, up from 33 percent in 2012), capital allocation (60 percent, up from 48 percent in 2012), and capital raising (55 percent, up from 44 percent in 2012).

The relatively sharp increase in the impact of sustainability on M&A decisions appears to be due to increasing M&A activity, and thus an increase in sustainability-related issues. Among those issues is the need to review sustainability considerations when screening and selecting M&A candidates; otherwise, companies may find themselves unpleasantly surprised by the actual valuations of candidates or by costs of post-transaction integration.

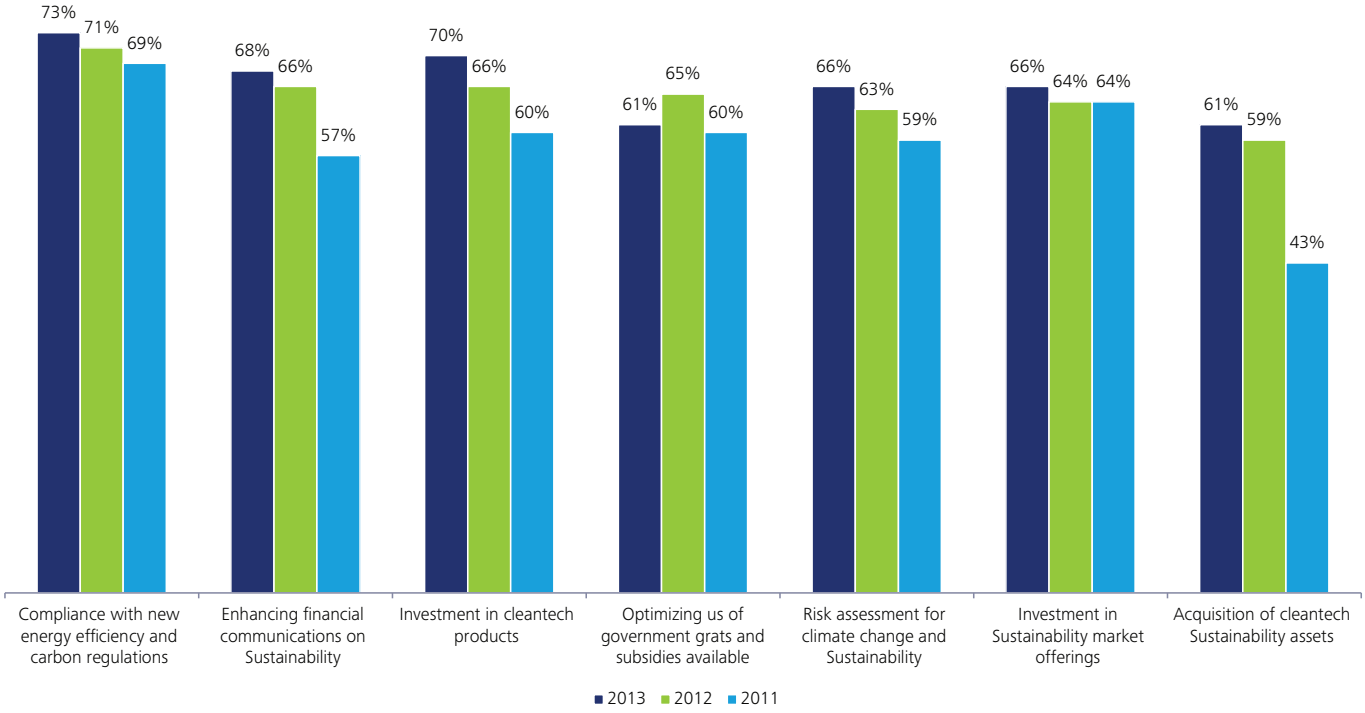
Activities relatively unchanged by sustainability issues in the past year include investor relations, financial audit, and tax.

Risk management, compliance, and financial reporting were clearly impacted less in 2013 than in 2012, perhaps reflecting a change in priorities after greater attention to those areas during the previous year.

That said, both the broad range of financial management decisions impacted and the extent to which they are impacted clearly reflect the integration of sustainability issues in organizational functions and activities.

Compliance tops sustainability-related finance initiatives

In the next year, how important will the following sustainability-related finance initiatives be for your firm?
Percentage of respondants who answered "very important" or "important."



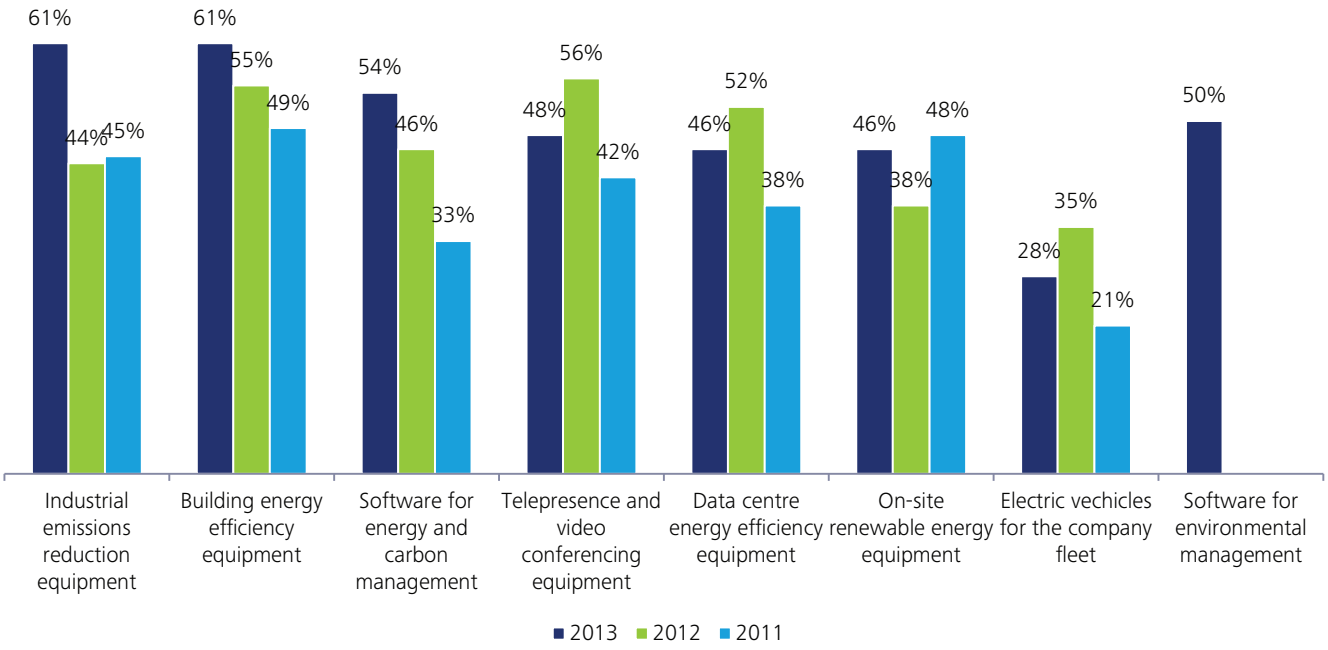
Compliance with new energy efficiency and carbon regulations was most often cited as a very important sustainability-related finance initiative in 2013. This was also the case in 2011 although, in the 2012 survey, compliance was edged out (by one percentage point) by investment in cleantech products. Investment in cleantech products – perhaps related to compliance with new energy efficiency and carbon regulations – placed among the top three initiatives in each year.

Interestingly, initiatives related to "Enhancing financial communications on sustainability" have risen in priority (as measured by "very important" citations) from 2011 to 2013. In the 2011 survey this initiative placed fifth, then third in 2012, and then second in 2013. This trend indicates that CFOs see communicating on sustainability as increasingly important – a finding supported by their companies' increasing use of external assurance of sustainability reports (covered later in this report).

In general, all of the sustainability-related finance initiatives on which respondents were surveyed remained important in 2013, with these seven all garnering a total of at least 60 percent in combined "very important" and "important" citations.

Emissions reduction and energy efficiency lead investment priorities in the next two years ...

In which of the following areas does your firm plan to make capital investments in the next 2 years? (multiple responses)



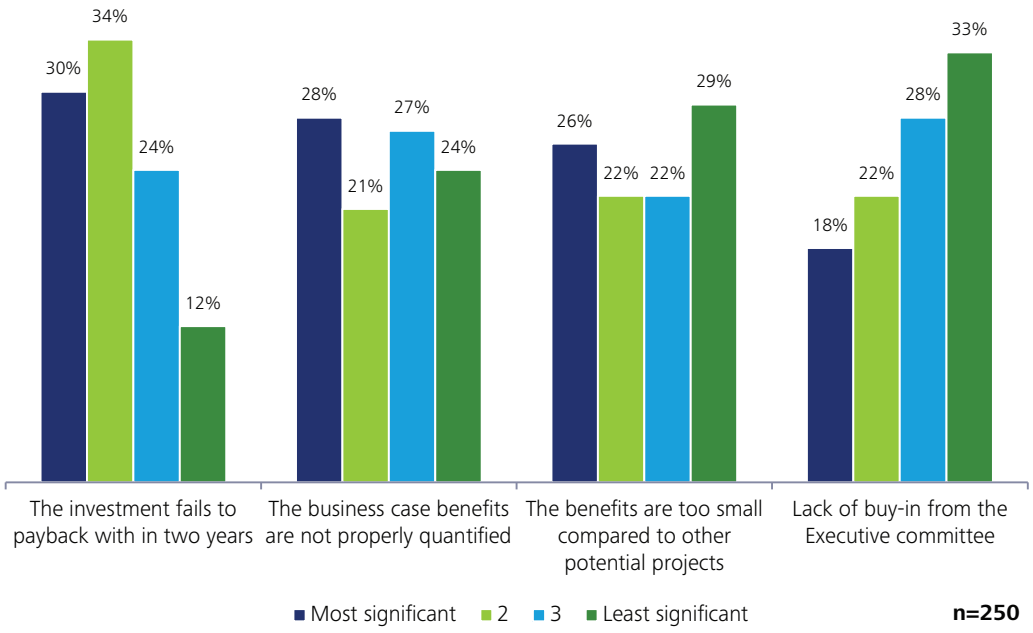
***Note:** 2013 is the first year we included "Software for environmental management" as an option.

Key areas cited by CFOs as being those in which they "plan to make capital investments in the next two years" include industrial emissions reductions equipment (61 percent), building energy efficient equipment (61 percent), software for energy and carbon management (54 percent), and software for environmental management (50 percent). (This was the first year the latter was included as an option.) Each of these areas was cited by at least half of respondents in 2013, while 46 percent cited onsite renewable energy equipment.

Areas registering decreases in plans for capital investment in 2013 relative to 2012 included video conferencing equipment, data center energy efficiency equipment, and electric vehicles.

... While CFOs cite barriers to investments in sustainability

Please rank the significance of the following barriers to signing off capital investments in sustainability initiatives?

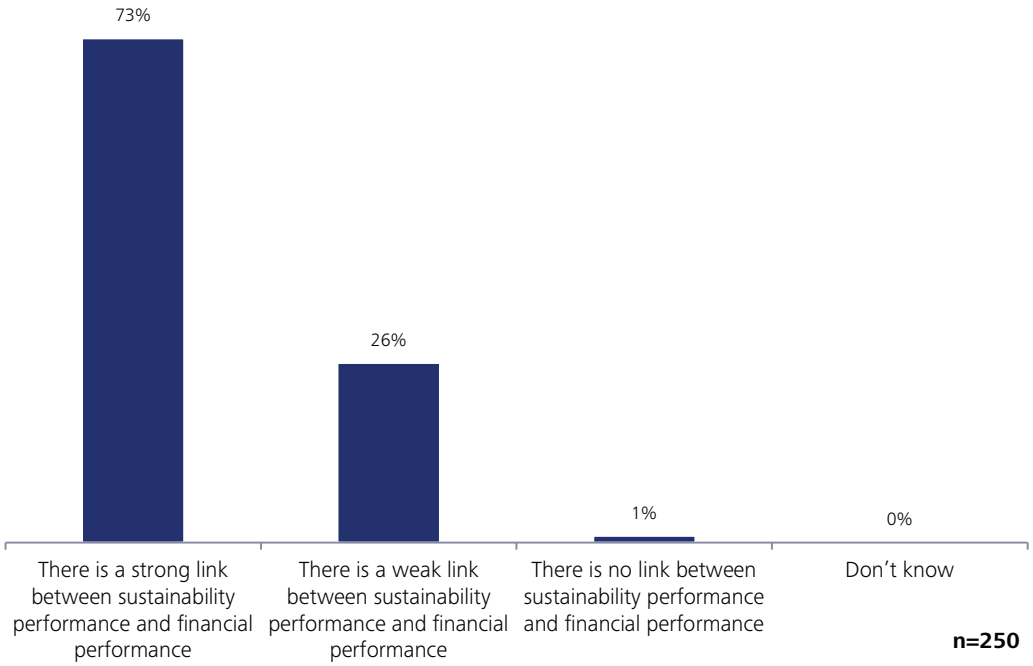


When asked to select among barriers to capital investments in sustainability initiatives, CFOs most often noted failure to pay back within two years – cited as first or second most significant by a total of 64 percent – and the business case benefits not being properly quantified – cited as first or second most significant by a total of 49 percent, followed very closely by the benefits being too small compared with those of other potential projects (at 48 percent).

This highlights the fact that many sustainability initiatives by their nature simply take more time to recover the initial investment and yield attractive returns. This in turn argues for looking beyond a two-year horizon when evaluating certain sustainability investments. These findings also underscore the need to translate benefits into monetary terms – and to develop a clear business case for sustainability initiatives. This is particularly true of those investments in which the case is not as straightforward as it is regarding, say, the lower costs associated with reduced energy, water, and materials usage.

CFOs see links between sustainability and financial performance ...

Which of the following statements best describes your perspective on the link between sustainability performance and financial performance?



An impressive 73 percent of respondents noted a strong link between sustainability performance and financial performance. In contrast, only 26 percent noted a weak link between the two (while 1 percent saw no link).

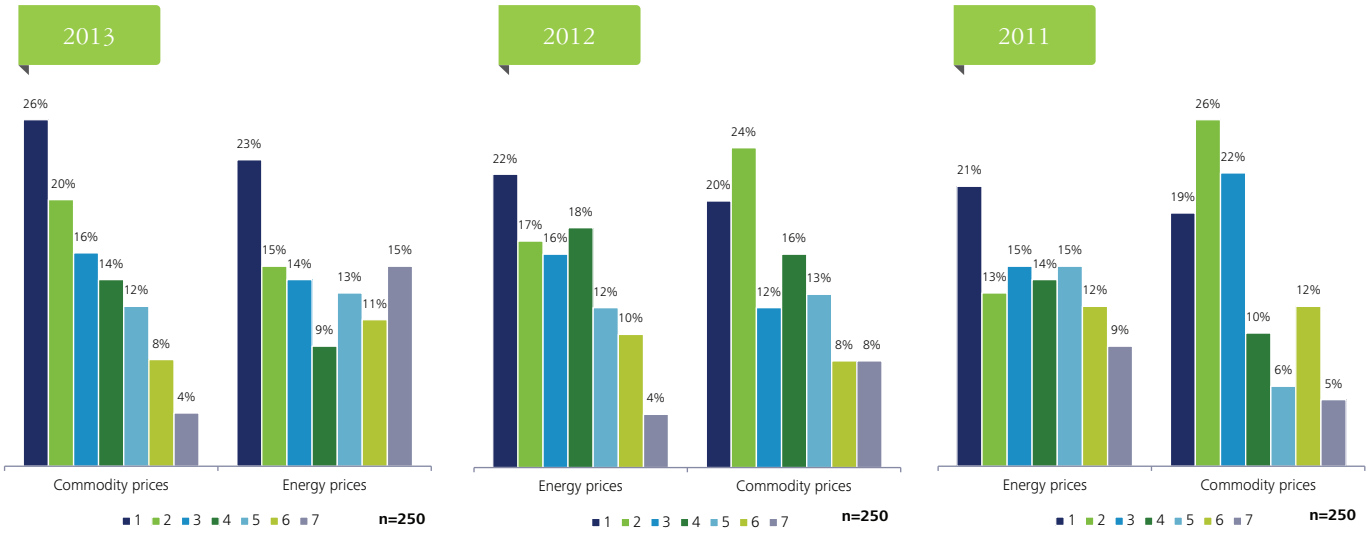
Why do almost three-quarters of CFOs see a strong link between sustainability and financial performance? One interpretation would be that despite relatively longer payback periods in some cases, investments in sustainability do generate positive financial impacts. For example, process and operational changes related to sustainability, such as using less energy, water, and materials improve financial performance by reducing costs and mitigating risks.

Another potential link may be that excellent financial performance itself positions a company to invest in sustainability. In that sense, the ultimate "sustainable practice" may be to sustain the company's growth in revenue and profitability. Yet there appears to be growing sentiment in many industries that sustainable practices are themselves useful business practices and, as this survey indicates, linked to financial performance.

In any event, CFOs must perceive a link between investments in sustainability and their organization's financial performance in order to support those investments.

... As well as risks to financial performance ...

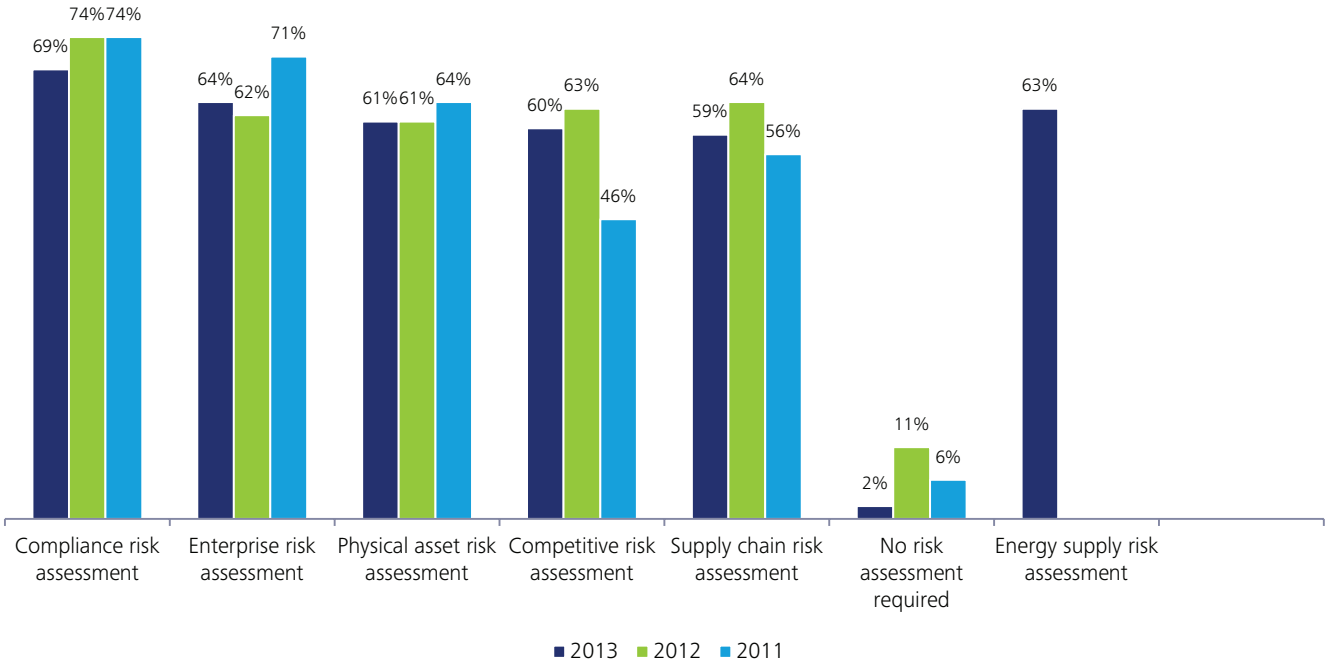
In the next 2 years, how significant will the following risks be to your firm's financial performance? (Rank 1 to 7 with 1 being most significant)



CFOs see the greatest risks to their companies' financial performance in the areas of commodity prices and energy prices. Both are cited as the most significant risks to financial performance in each of the three years of the survey, well above the percentages of respondents noting other factors.

... And companies plan to manage the risks

In the current year what actions will you take to manage the sustainability and climate change risks your business faces? (multiple responses)

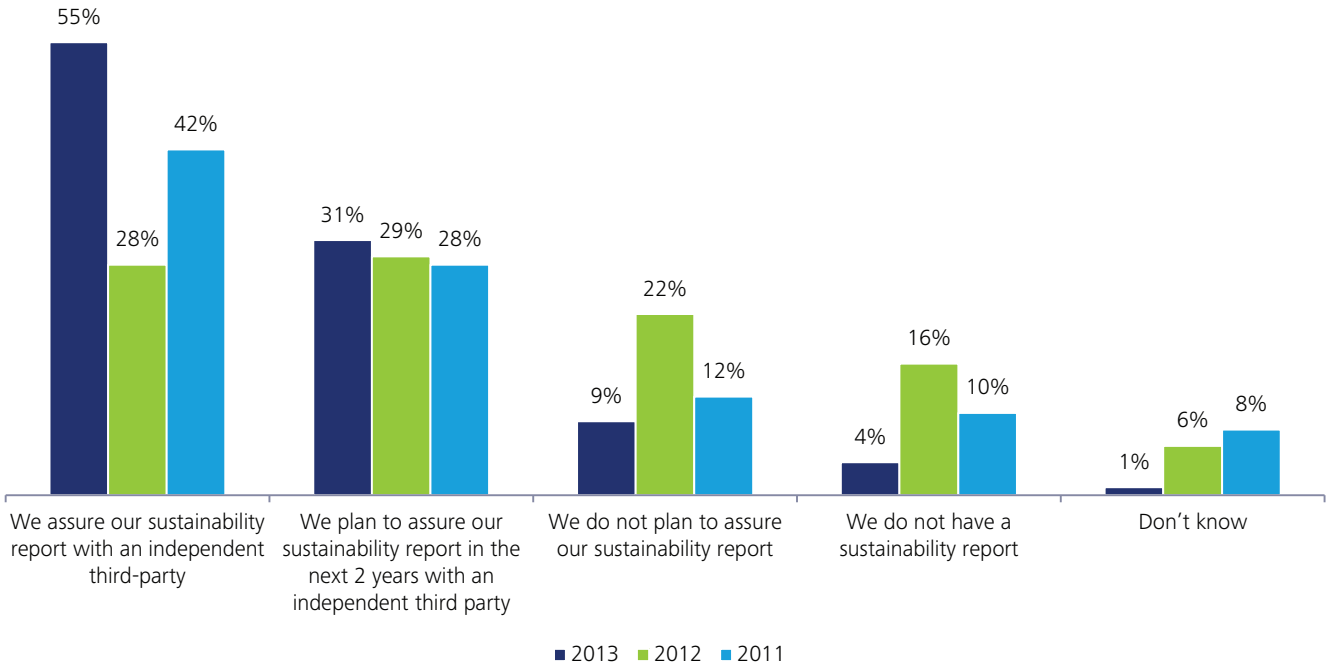


***Note:** 2013 is the first year we included "Energy supply risk assessment" as an option.

As to which actions CFOs intend to take to manage sustainability and climate change risks, the most often-cited were compliance risk assessment, enterprise risk assessment, and energy supply risk assessment. Only 2 percent stated that they did not require a risk assessment related to sustainability and climate change.

Assurance of sustainability reports has increased ...

Which of the following statements best describes your approach to the assurance of your sustainability report?



Fifty-five percent of organizations surveyed obtain third-party assurance of their sustainability reports, up from 28 percent in 2012. Another 31 percent plan to obtain such assurance in the next two years, up slightly from 29 percent in 2012.

In the same vein, only 9 percent do not plan to obtain third-party assurance, down from 22 percent in 2012.

Only 4 percent do not have a sustainability report, down from 16 percent in 2012 (while just 1 percent of CFOs answered "don't know" – down from 6 percent in 2012).

While these numbers indicate increasing use of third-party assurance providers, we have insufficient historical data to opine whether this represents a lasting trend or a temporary fluctuation.

About External Assurance of Sustainability Reports

For sustainability reports issued to the public, many organizations turn to an external assurance provider for an objective review as evidenced by the sharp increase in external assurance of sustainability reports indicated in the findings of this survey. However, professional standards applicable to the various types of assurance providers vary, as does the level and quality of assurance they provide.

In general, an assurance provider forms a conclusion about the reliability of the reported information, the process that produced it, or both. This provider requires suitable criteria for evaluating the reported information, underlying processes, and related assertions.

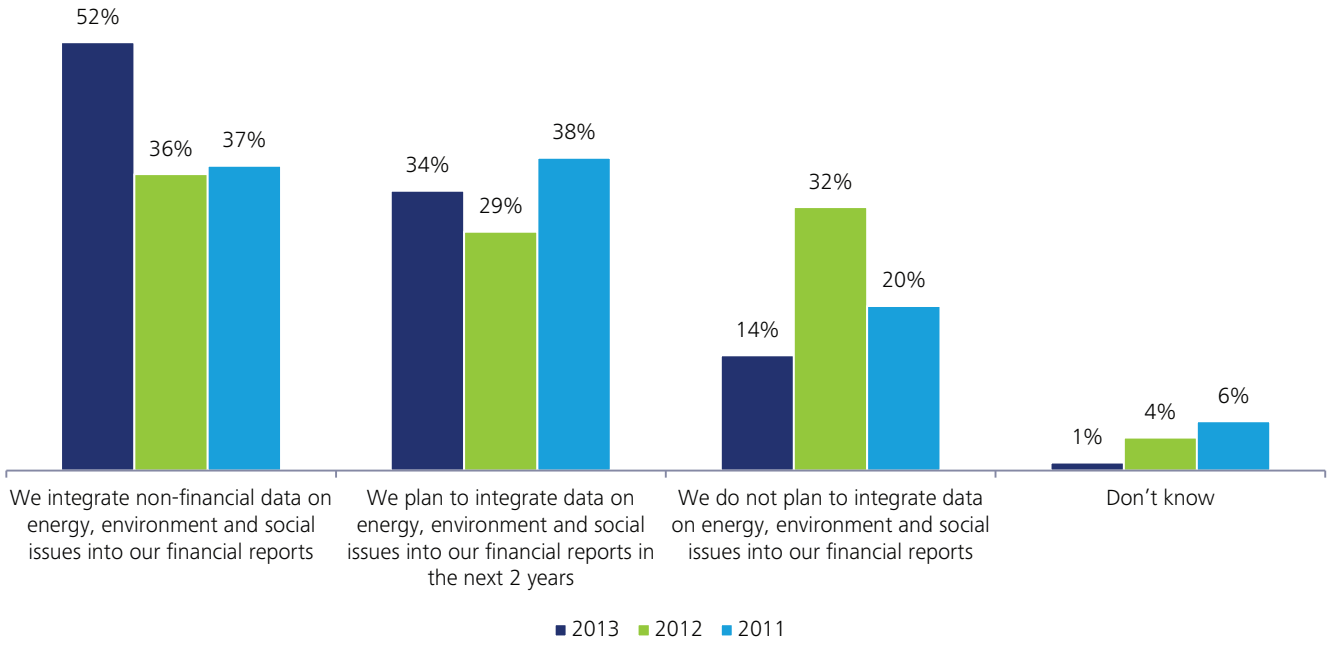
Choice of an assurance provider, which includes consideration of the professional standards applicable to the particular type of assurance providers (including for independence, ethics and quality control standards), represents a critical decision. Assurance providers also vary widely in their experience, capabilities, rigor, and reliability.

External assurance engagements are typically similar to those of an audit or a review of financial statements in that assurance is provided regarding the accuracy and reliability of data and management's commentary presented based on specified criteria. In determining the level of assurance engagement desired, management should consider whether any requirements for assurance exist and the expectations and needs of stakeholders who will use the information

CFOs can play a key role in determining the level of assurance desired and in evaluating providers' credentials and qualifications.

... And more companies are integrating nonfinancial data into corporate reporting

Which of the following statements best describes your approach to integrate non-financial data into financial reports?



Despite the challenges of integrating nonfinancial data on energy, environmental, and social issues into financial reports, the percentage of companies doing so increased significantly in 2013, to 52 percent, from 36 percent in 2012 and 37 percent in 2011. Similarly, the percentage of companies not planning to integrate that data into financial statements fell to 14 percent from 32 percent in 2012, after rising from 20 percent from 2011 to 2012.

It appears that organizations are recognizing the need to integrate nonfinancial sustainability data into financial reports. Note the increased percentage of respondents planning to integrate such data in the next two years: 34 percent in 2013, up from 29 percent in 2012. Recognition of this need is further evidenced by the "don't know" percentage dropping to 1 percent in 2013 from 4 percent in 2012.

When considering integrating nonfinancial information into financial reports, CFOs might review suggestions from third-party organizations that issue sustainability guidelines (see sidebar).

Landscape of standard-setters and reporting initiatives

CFOs should be aware of several organizations and initiatives that promulgate sustainability reporting guidelines. Among the most recognized are the following:

- Global Reporting Initiative (GRI) is a network-based organization committed to improving sustainability reporting, with participants from business, social, labor, and professional organizations. GRI's Sustainability Reporting Guidelines, called the GRI Guidelines (or G4 in the most recent, 2013, release) present a sustainability reporting framework widely used by large companies. The GRI Guidelines include reporting principles and standard disclosures, indicator protocols, and economic, environmental, and social performance measures. The latest release stresses "material aspects" to assist in identifying issues significant to stakeholders.[1]
- Sustainability Accounting Standards Board (SASB) is developing sustainability accounting standards for voluntary use by publicly listed companies in the United States for use in disclosing material sustainability issues to investors and the public. SASB is developing standards for more than 80 industries in 10 sectors. The organization researches material issues within industries, convenes industry working groups to establish accounting metrics, and provides education on recognizing and accounting for material nonfinancial issues[3].

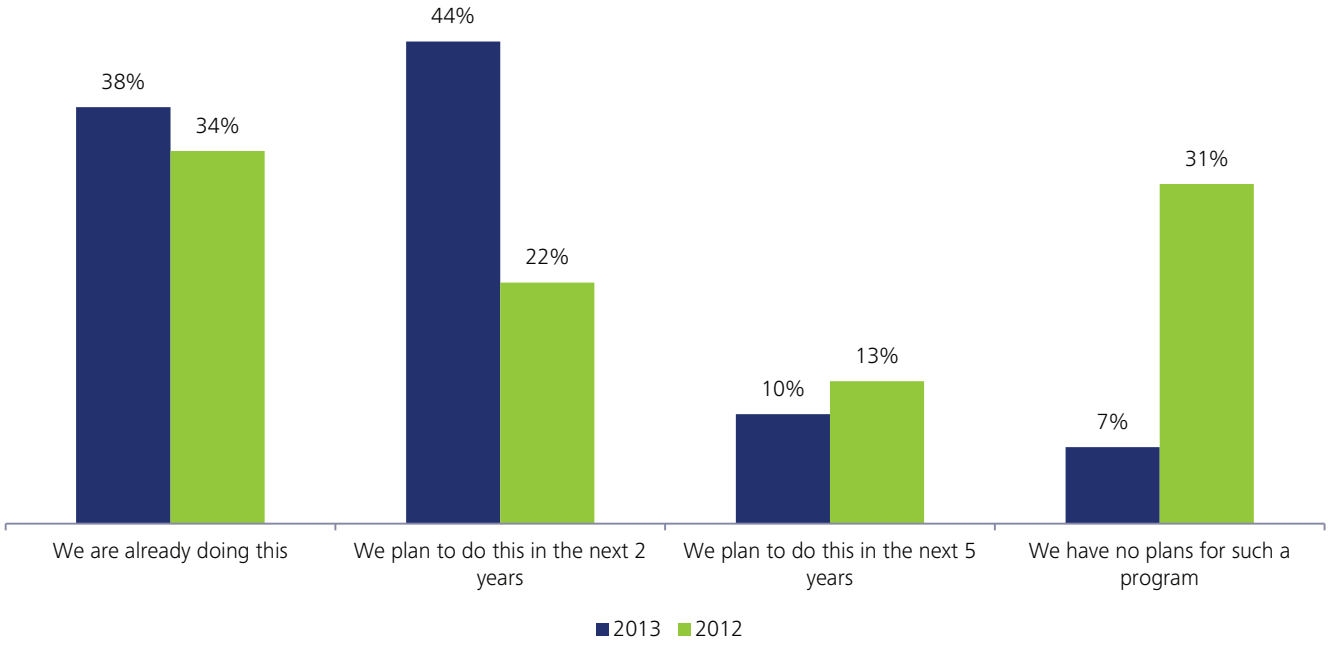
The future of corporate reporting

International Integrated Reporting Council (IIRC) operates on the premise that reporting influences behavior, and promotes periodic, holistic reporting about value creation over time. IIRC aims to help organizations to consider how strategy, governance, performance, and prospects, in the context of the external environment, lead to the creation of value in the short, medium, and long term. A key goal of IIRC is to help create a reporting environment that promotes understanding of strategy, drives performance internally, and attracts investment.[2]

[1] www.globalreporting.org
[2] www.theiirc.org
[3] www.sasb.org

Most companies either have or are planning sustainability-related transformations

Do you plan to implement an organizational transformation related to energy, environment and sustainability?



An impressive 38 percent of respondents are already implementing an organizational transformation related to energy, environment, and sustainability, up slightly from 34 percent in 2012. More impressively, 44 percent of CFOs state that their organizations plan to implement such a transformation in the next two years, double the 22 percent of 2012. Another 10 percent plan such an effort in the next five years, down from 13 percent in 2012.

Only 7 percent of companies have no plans for such a program – down from 31 percent in 2012 – a strong indication that companies are strengthening their commitment to sustainability.

Next Steps

These survey findings imply an increasingly important role for CFOs in sustainability. This is evidenced by indicators of greater CFO involvement and of their awareness of the impacts of sustainability on financial decisions, increasing integration of nonfinancial information into corporate reporting, and upticks in external assurance. In addition, many organizations are engaged in or planning sustainability-related transformations.

Given this, the question becomes: How can CFOs most productively focus the time and effort they allocate to sustainability?

Based on the CFO survey findings and Deloitte's global experience in assisting major enterprises with most facets of sustainability, CFOs should consider taking the following actions:

- **Grasp the key issues, and define your role.** Just as the risk management function alone cannot manage risk and human resources alone cannot win the war for talent, sustainability cannot be achieved by a single function. The CFO – and other functions – must understand the organization's broad Sustainability impacts and play their role in fostering it. Issues such as energy and water usage, emission controls, and customers' demands will vary by industry and company. But whatever the specific issues, CFOs can assist their organizations and boards in making the related business case, cost-benefit analyses, and investment decisions.
- **Help align sustainability initiatives and business strategy.** CFOs' deep financial knowledge and enterprise-wide perspective can assist the organization in aligning its sustainability activities and business strategy. As key executives, CFOs can help to resolve the inevitable conflicts between sustainability and economic goals and short-term financial goals. However, not all sustainability considerations can be translated into monetary terms, so CFOs may have to expand their view to encompass consumer sentiment, media attention, and other nonfinancial considerations that can negatively (or positively) impact reputation, brand, and value creation.
- **Understand the risks.** Issues around sustainability can generate strategic, operational, and financial risks, as well as legal, compliance, and reputational risks. CFOs should participate in sustainability-related risk assessment and management decisions. Their knowledge of insurance, hedging, diversification, and other risk management tools can only benefit the organization in this area.
- **Monitor investor sentiment.** CFOs are well-positioned to monitor and interpret attitudes and behavior of shareholders, investors, and other capital providers vis-à-vis sustainability. Monitoring the influence of sustainability indices would also be potentially useful.
- **Provide guidance on reporting practices and disclosures.** CFOs should track reporting practices related to financial statements, lend a financial perspective to sustainability reports, and support the CEO, CSO, and COO in their interactions with the board regarding sustainability. In particular, CFOs can provide guidance regarding disclosures of nonfinancial information and preparation for integrated reporting, which is on the horizon for many companies. CFOs should also assist in assessing the materiality of sustainability impacts and in focusing disclosures on material impacts to the organization and its stakeholders.
- Participate in charting the sustainability roadmap. An enterprise roadmap to sustainability will typically define the nature, scope, and priorities of the sustainability program, and specify program funding, resourcing, measurement, reporting, and timeframes.
- The CFO's contribution to the roadmap may include assistance in the following activities:
  - Aligning sustainability goals, activities, and metrics with strategic business goals across the enterprise
  - Reducing costs of energy, water, materials, labor, and other inputs, as well as waste, through supplier selection and contract management
  - Controlling program costs by identifying efficiencies and eliminating duplicative or overlapping efforts and enhancing compliance and reporting
  - Improving coordination of investments in sustainability with other financial decisions
  - Improving the enterprise's ability to understand supply chain impacts and risks and to achieve or maintain a sustainable business model

Granted, CFOs already have full schedules. Yet sustainability is here to stay and is presenting opportunities and decisions, posing costs and risks, and influencing regulators and investors. The question therefore is not whether CFOs have a role to play in sustainability but rather what that role will be. Now is the time for CFOs to consider, define, and fulfill that role.

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