

## **Small Business Sustainability: What is the CPA's Role?**

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### **Abstract**

*The purpose of this paper is to provide information for both small businesses and CPAs concerning the importance and possible impact of sustainability reporting and practices on each group. The sustainability reporting process not only considers the economic bottom line, but also includes consideration of how a business impacts society and the environment. The challenges involved in establishing sustainable practices and reporting will be significant. The push for businesses to become more sustainable is a market-driven phenomenon in which consumers are increasingly shopping for products and services provided by companies that practice sustainability. Large multinational corporations are placing greater pressure on small business supply chain vendors to adopt sustainability practices. The sustainability movement creates both threats and opportunities for both LMCs and SMEs, and businesses that fail to develop sustainable strategies could be negatively impacted. CPAs have traditionally provided SMEs with financial, tax and audit services. As sustainability demands increase for SMEs, small and medium-sized CPA firms must develop the knowledge and skills necessary to provide these clients with sustainability services.*

**Keywords:** Sustainability, CPA, SME, LMC, Environment, Society, Strategy, Consumer, Supply Chain

### **1. Introduction**

Sustainability reporting is a rapidly growing business trend found in large multinational corporations (LMCs) and a growing number of small and medium size enterprises (SMEs). Sustainable development has been defined as “development that meets the needs of the present without compromising the ability of future generations to meet their own needs” (World Commission on Environmental Development, 1987). In considering sustainability, business enterprises take into account not only the economic bottom line, but also the impact of the business upon society and the wider environment both currently and in the future. Sustainability reporting involves reporting this impact to a broader base of business stakeholders including customers, suppliers, local communities, employees, and society at large. The Global Reporting Initiative (GRI), an international organization whose mission is to promote global standards for sustainability reporting, defines sustainability reporting as:

“the practice of measuring, disclosing, and being accountable for organizational performance while working towards the goal of sustainable development. A sustainability report provides a balanced and reasonable representation of the sustainability performance of the reporting organization, including both positive and negative contributions.” (Global Reporting Initiative)

The sustainability movement is market-driven, and SMEs could be forced to adopt certain sustainability practices. Consumers, employees, large multinational supply chain customers and other stakeholders will create pressure on SMEs to become sustainable. Traditionally SMEs have engaged CPA firms to provide accounting services such as financial, tax and audit. CPA firms must be prepared to play an equally important role by providing sustainability services for SME clients.

## **2. Sustainability-Risk Management**

Since sustainability issues are a growing area of concern in the international community and are projected to significantly impact businesses of all sizes, the Big Four accounting firms have conducted numerous research studies to gain a better understanding of how sustainability will impact their clients. In one recent study, KPMG International analyzed more than two dozen forecasts from various international and national agencies, global think-tanks and noted futurists. Based on the findings of this study, ten sustainability mega forces were identified that will place increasing pressure on businesses over the next twenty years. For businesses that are unprepared these forces pose significant threats. Indeed, CPAs must be prepared to help SME clients deal with these threats. The ten forces identified are:

1. Climate change
2. Volatility in energy and fuel markets
3. Material resource scarcity as the global demand for material resources increases
4. Water scarcity which will lead to increased regulation
5. Potential water shortages will create price volatility
6. Population growth
7. Increase in wealth and growth in the middle class
8. Urbanization with virtually all population growth predicted to be in cities
9. Food security
10. Ecosystem decline and deforestation (KPMG International, 2012)

These forces are all interconnected and will bring additional complexity and unpredictability to the planning process. In addition to the ten mega forces, KPMG has identified six categories of sustainability-related business risks which could impact both SMEs and LMCs. These risks were identified as physical risks such as damage to physical assets and supply chains resulting from weather related events brought on by climate change. Competitive risks related to resource needs, as when key input resources become more scarce, competition for these resources will result in increased costs. Businesses will face increased regulatory risks as governments around the world implement additional environmental regulations. Regulations, and the anticipation of additional regulations, creates uncertainty while increasing costs and complexity for businesses. Corporate reputations and brand values could be at risk based on how the public perceives a business' response to sustainability issues. Businesses will face increasing litigation risks related to environmental damage and/or insufficient corporate disclosure. Social risks could produce serious disruption to business operations and supply chains brought on by societal reactions to sustainability issues. Many areas of the world could experience civil unrest due to population growth and wealth inequity. (KPMG International, 2012) Strategic planning will become a necessity, rather than an option, if SMEs are going to be prepared to address these risks.

CPAs who possess sustainability knowledge and skills can help their SMEs strategically prepare for both current and future sustainability business risks. CPAs should gain sustainability knowledge in order to help SMEs clients identify, understand and plan for these risks. Although each of these risks has the potential to threaten business operations, threats can also force SMEs to develop innovation solutions. Knowledge and strategic planning can drive innovative ideas and creative solutions, thereby enabling SMEs to turn these risks into strategic opportunities. SME clients will require the assistance of CPAs in the development and implementation of a sustainability strategic plan.

### **3. Benefits of Sustainability Practices**

SMEs can realize significant benefits by incorporating sustainability practices and reporting as part of their overall business strategy. Last year a joint survey of SMEs was conducted by the American Institute of CPAs (AICPA), the Chartered Institute of Management Accountants (CIMA), and the Canadian Institute of Chartered Accountants (CICA). SME participants identified several benefits of sustainability reporting including appealing to more environmentally conscious customers, strengthening relationships with suppliers, positioning their brand as a good corporate citizen, generating greater loyalty and commitment from employees, and reducing operating costs resulting in improved profitability (CICA, AICPA, CIMA September, 2011).

Initially sustainability was viewed primarily as a cost reduction and risk management measure, but is increasingly being viewed as a source of innovation and growth. In the past, the primary drivers for sustainability have been regulatory compliance, brand enhancement, risk management, and cost reduction. A 2011 report by KPMG International indicates that sustainability offers a new strategic lens through which business should be viewed (KPMG International, 2011). SMEs desiring to gain a competitive advantage in the marketplace should not view sustainability simply as a defensive measure but rather as a window to new opportunities and growth. This requires SMEs to take a long term approach and to treat sustainability as an investment rather than a cost. As SMEs address sustainability issues from a strategic perspective, changes in operational strategies could reveal new opportunities to pursue.

Significant customer-related benefits can accrue to SMEs when sustainability is incorporated into the business culture. Customers are becoming increasingly concerned with global sustainability issues and make buying decisions based upon these concerns. Indeed, SMEs can utilize sustainability to differentiate themselves from competitors. Consumers are buying products and supporting companies that assume accountability for their social and environmental responsibilities. As consumers search for companies and products that practice sustainability, SMEs will have significant opportunities to enhance revenues (Witt, 2011). Suzanne Fielden, co-founder of Rocky Mountain Flatbread Co., found that “people are looking for meaning, for companies that are doing something positive. Sustainability differentiates us (Scott, 2011).”

Adam Carrel, Senior Manager with Ernst & Young’s Climate Change and Sustainability Services Group believes that a “consumer awakening” will emerge as the “sleeping giant” of sustainability. More and more consumers will actively adapt their buying practices to incorporate sustainability information (Goodman, 2012). Sustainability strategies are important to the younger workforce and can strengthen employee recruitment and retention for SMEs. The younger workforce will often search for employment with businesses that share their sustainability values. A 2011 Ernst & Young survey found that employees were ranked as the second most important stakeholder group for a company’s sustainability programs, and the younger generation workforce is beginning to pressure companies to improve their sustainability performance (Goodman, 2012).

CPAs are very competent in the areas of tax planning and tax compliance. In fact, many CPA firms are currently assisting SME clients with green tax benefits. Some of the tax benefits involve solar energy, green buildings and Energy Star rated equipment. A number of states have passed legislation to provide state tax credits as part of energy incentive programs for businesses. Oregon recently passed an energy incentive program that provides a tax credit based on 50 percent of the project costs to install certain high efficiency equipment and renewable energy related projects (Oregon Department of Energy, 2011). In addition to tax incentives, many business owners are discovering that going green can pay for itself and increase profitability by implementing energy conservation measures and reducing waste through reusing and recycling.

### **4. Sustainability and the Supply Chain**

One of the most pressing sustainability issues facing SMEs could be the push for sustainability throughout the LMCs supply chains. In 2008, the Organization for Economic Co-operation and Development (OECD) reported that 100 million businesses worldwide fell within the SME category and these businesses were a vital component of the supply chain of LMCs (Plugge, 2008). Furthermore, as MNCs strive to improve their own sustainability performance, they are beginning to focus on the sustainability of the businesses in their supply chain. SMEs could be facing the alternative of implementing certain sustainability practices or losing significant amounts of revenue. In 2009 Wal-Mart began assessing the sustainability efforts of vendors in their U.S. supply chain.

Wal-Mart requested that suppliers answer a 15 question self-assessed questionnaire covering energy and climate, material efficiency, natural resources, and people and community (Wal-Mart Corporation). Starting in 2013, Microsoft will require suppliers to report on their compliance with Microsoft's Vendor Code of Conduct which sets standards covering legal compliance, business ethics, labor and human rights standards, environmental protection, and respect for intellectual property. Microsoft's initiative to compel supply chain sustainability improvements was in part due to a shareholder proposal (Microsoft Corporation, 2011). In 2011, Apple published a list of over 150 companies that comprise over 97% of its procurement supply chain (Apple Corporation, 2011). Apple has stepped up efforts to make its supply chain more sustainable and transparent. A new specialized environmental audit program has been implemented to address environmental concerns relating to certain suppliers located in China (Apple Corporation, 2012).

Wal-Mart, Microsoft and Apple are not alone in their efforts to improve supply chain sustainability. Indeed, in reporting its 2010 environmental profit and loss, PUMA SE included the impact of not only its own operations but also those of its supply chain. Jochen Zeitz, executive chairman, states that "if PUMA is to successfully reduce its environmental impact, we have to address the activities of our supply chain partners that generate 94 percent of our total environmental impact" (Wheeland, 2012). Based on this statement, PUMA will be expecting their suppliers to address sustainability issues within their own operations.

Why are Wal-Mart, Microsoft, Apple and other LMCs concerned with the impact of their supply chain partners? Some sustainability observers believe the significant emphasis on sustainability in Europe and other parts of the world, coupled with the possibility of further action by the EPA will result in additional carbon emission disclosures. In 2010 the SEC released guidance on situations where climate change could trigger disclosure requirements. Indeed, SEC Chairman Mary Schapiro said,

"We are not opining on whether the world's climate is changing, at what pace it might be changing, or due to what causes. Nothing that the Commission does today should be construed as weighing in on those topics. Today's guidance will help to ensure that our disclosure rules are consistently applied" (SEC January 27, 2010 Press Release).

As large multinational companies adopt more transparent sustainability reporting practices, the sustainability impact of their supply chains will require SMEs to provide reports on their sustainability efforts. CPAs will be required to deal with the impact of supply chain sustainability as more and more SME clients are required to provide sustainability information.

### **5. Sustainability - Impact on CPAs**

Currently much of the global sustainability reporting is conducted on a voluntary basis. Indeed, a majority of U.S. small businesses do not include sustainability as part of their business strategy. One primary objective of a recent AICPA, CIMA, and CICA joint survey of SMEs was to determine the level of sustainability practiced by SMEs. While only one-third of the companies surveyed had a sustainability strategy, 23 percent of the businesses without a current sustainability strategy had plans to develop one in the next two years (Coffey, 2011). This study provides additional evidence that SMEs are quickly realizing the importance of sustainability strategies.

Should SME owners voluntarily implement sustainability strategies? Businesses are currently required to comply with government environmental regulations or face significant fines and penalties. In contrast, the driving force behind sustainability is very different. Indeed, sustainability is market driven, which means more and more customers will make purchase decisions based on SMEs demonstrating a serious commitment to sustainability. In fact, market forces when compared to the legislative process, could prove to be a much more effective and efficient change agent. Bob Bunting, president of the International Federation of Accountants and a partner in Moss Adams LLP, CPAs stated,

"Moss Adams, for instance has one major client with 10,000 suppliers, each of which will require a sustainability audit. Don't be mistaken: Sustainability reporting is not a diabolical regulator's scheme. *It is market driven. It's customer-driven capitalism.*" (Bunting, 2010)

From a strategic planning perspective, CPAs must analyze each SME client and ask, "how could customer-driven sustainability impact my client. As sustainability gathers momentum the potential impact on SMEs clients could be significant.

Perhaps many SME clients are not providing goods and services for a LMC supply chain, however, as more consumers make purchase decisions based on a SME's commitment to sustainability, even small businesses could be affected. Many SME clients do not have the resources required to undertake large sustainability commitments. These SMEs should begin with small efforts such as reusing, recycling and energy conservation efforts. No matter how small the sustainability efforts might be, SMEs should make customers and others aware that sustainability is important to their firm.

CPAs with SME clients should take time to visit the Big Four accounting firms websites and discover how these firms are addressing sustainability issues. Based on the wealth of information you will find, it becomes very apparent that the Big Four accounting firms are committing significant resources to prepare for the impact of sustainability. Each firm has conducted research studies, collected data and implemented strategies to provide their clients with the best possible sustainability services. As sustainability reporting continues to evolve these firms will continue to add new services and modify the services they currently offer.

## **6. The CPAs' Role**

CPAs should play a vital role in helping their SME clients discover how a viable sustainability strategy makes good business sense. Sue Coffey, AICPA senior vice president of public practice and global alliance stated,

“One of the lessons from the case studies is that finance professionals often play a key role in defining and guiding sustainability strategies, in part because they are used to navigating different parts of a business and keeping an eye on the big picture. It's one more example of the value the finance function can bring to an organization” (Coffey, 2011).

In addition, Bob Bunting recommends that CPAs develop the skills base beyond those normally associated with small and medium-sized CPA firms. Part of the sustainability movement involves renewable energy tax credits and grants. Small and medium-sized CPA firms are the recognized experts that SMEs turn to for tax, audit and financial accounting services, however, in the very near future business consulting will become the high growth area for these firms. To take advantage of these growth opportunities, CPAs must gain the expertise to help small business clients design and implement sustainability strategies (Bunting, 2010).

CPAs should be prepared to help their SME clients improve the efficiency with which they gather, combine and report their sustainability data. CPAs are in a good position to help their clients define metrics for measuring the effectiveness of their sustainability strategies. Accurate measurement is necessary for both the credibility of sustainability reporting and the assurance services needed to add credibility to this information. Although the lack of authoritative guidance continues to be a huge problem for firms implementing sustainability reporting and assurance, CPAs have the knowledge and expertise to provide valuable input as this process continues to evolve. In fact, a report released by the International Federation of Accountants points out that,

“Professional accountants should be well placed to bring the discipline and application of accounting rigor to the collection, analysis, and reporting of ESG (environmental, social, and governance) data, and support the incorporation of ESG factors into an organization's management processes and systems” (International Federation of Accountants, 2012).

A recent California Society of CPAs article identified several ways in which CPAs can provide value to their SME clients including advising clients in setting up proper controls, measurement and reporting systems to track sustainability information; advising management on establishing and implementing sustainability practices; providing assurance services for sustainability information; and identifying software and hardware solutions for sustainability data tracking and reporting (Monterio, 2010). Helping clients with their measurement and reporting systems presents a strategic opportunity for CPAs. This area is a noted weakness for U.S. companies, particularly when compared to the European companies whose sustainability practices are more mature (Goodman, 2012).

The AICPA, CICA, and CIMA study identified ten elements that are essential to embedding sustainability within an organization. Three of the ten elements relate to performance and reporting, which fall clearly within the expertise of CPAs. The study found that SMEs need to clearly establish the link between sustainability and profit, to develop clear metrics and monitor their progress, and to invest in the future (CICA, AICPA, CIMA, 2011). It is important that SMEs have the ability to utilize their sustainability data in conjunction with their financial data, which will facilitate better decision making.

Both financial and non-financial data will be utilized, and the balanced scorecard provides a good method for integrating nonfinancial measures into business operations and assessment. CPAs can help their SMEs align their sustainability efforts with their business strategy by incorporating sustainability as part of a balanced scorecard performance measurement (Butler, Henderson, Raiborn, 2011).

### **7. Sustainability Knowledge**

In order to assist SME clients with sustainability services, CPAs will need to acquire knowledge relating to various aspects of sustainability. The level of knowledge needed by CPAs will depend on how significantly SME clients will be impacted by sustainability. The AICPA and state CPA societies are very competent in developing and administering continuing professional education for CPAs. As the demand for sustainability continuing professional education increases, these professional organizations will take the lead in providing these courses.

Several state CPA societies provide sustainability articles on their web sites. In fact, the New Hampshire CPA Society is considering the development of online continuing professional education materials on sustainability. In addition, the AICPA has sponsored two-day sustainability workshops to help CPAs acquire additional knowledge. The next AICPA sustainability workshop will be held in New York City on September, 20-21, 2012, and is titled, "AICPA Workshop on Sustainability-Evaluating the Risks for Long-Term Viability." The AICPA also offers a self-study 8 hour CPE course, titled "Business Sustainability: Keeping Lean but With More Green for the Company's Long Haul." The AICPA website has a "Sustainability Accounting" section with free information and links to numerous articles on sustainability.

### **8. Conclusion**

Sustainability risks can create both threats and opportunities for SME clients. CPAs must be prepared to assist clients as they face these threats and opportunities. One of the major issues currently confronting CPAs and SME clients is the lack of authoritative guidance involving the reporting and assurance processes for sustainability reporting. In order to determine how sustainability might impact SME clients, CPAs will need to keep informed as sustainability reporting continues to evolve. CPAs must have sustainability knowledge and expertise in order to provide input as this evolutionary process takes place.

Since revenue growth for some CPA firms has declined or leveled off in recent years, a sustainability practice could present an opportunity for these firms to provide much needed services for their SME clients while developing new sources of revenues. SMEs have always considered CPAs to be trusted business advisors and the challenges of sustainability will not change that role.

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