



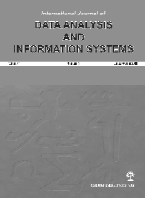
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# Sustainability Practices in European Versus U.S. Corporations - Is the Divide Getting Closer?

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### ABSTRACT

*Different initiatives have been taken to increase the levels of sustainability commitment and reporting of companies in the U.S. Using the 2012 Newsweek rankings, Romero et al. (2014) found that European companies were well ahead of American companies in this area. This paper examines the Newsweek sustainability rankings of 2015, to verify if the undergoing initiatives in the U.S. leveled the field for American companies. We find that although the number of companies in the ranking in the U.S. increased, while the number of companies in the European Union decreased, the European companies still have a leading role and are ahead of their U.S. counterparts on sustainability commitment.*

**Keywords:** *sustainability rankings, corporate social responsibility reporting, CSR reporting*

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### INTRODUCTION

For the past two decades, a host of governments, stakeholders, environmental groups and citizens have become more aware of the protection of the biosphere. This awareness has created a demand for more environmentally friendly products and services from corporations as well as a need for corporations to evaluate whether their sustainability initiatives add value to their corporations. Furthermore, stakeholders have been demanding information regarding social and environmental issues in corporations. However, this type of reporting has been sparse and in some cases non-existent, particularly among U.S. companies. A study conducted by Romero, Lin, Jeffers & DeGaetano (2014a) using 2012 data indicates that Europe has been at the top of sustainability reporting during the last decade whereas the U.S. has lagged behind in reporting as well as many other aspects of sustainability initiatives. In this paper, we examine whether the gap between European and U.S. Corporations with respect to sustainability practices have decreased. To this end, this paper looks at the differences between Europe and the U.S. in 2015, to see if the latter have reached a

similar level of commitment to Corporate Social Responsibility (CSR) than the former. Findings of this paper will lead to a better understanding of differences in evaluation and reporting of sustainability initiatives by U.S., as well as European managers and stakeholders. If U.S. companies reach the level of engagement and reporting in sustainability initiatives of the European ones, it will indicate an increase in the social consciousness of investors, customers and other stakeholders and it will lead to more informed decisions by financial statement users. Failure by companies to properly measure and report sustainability initiatives could result in material omissions in the financial statements of corporations. The following section presents a summary of prior research and the development of the hypothesis. It is followed by a description of the Newsweek rankings, research design and methodology, findings and conclusions.

### PRIOR RESEARCH AND HYPOTHESIS DEVELOPMENT

Sustainability reporting and its assurance are mostly voluntary all over the world. Countries like South

Africa, Finland, Canada, the U.S. and China as well as the E.U. (KPMG International, 2006; Ioannou & Serafeim, 2011) have some level of regulation. In South Africa for example it is mandatory (King III Report in Corporate Governance, 2009), while in the U.S it is required partially for companies in the oil and mining industries. In spite of the differences in legal requirements for reporting, no country requires the report to be reviewed by an independent party or any kind of assurance that would enhance the credibility of the report (Hodge, Subramaniam & Stewart, 2009).

The European Union (E.U.) proposed what is known as the “Europe 2020 Strategy” (European Commission, 2005, 2010), a new model of business based on sustainable growth (Martinuzzi, Gisch-Boie & Wiman, 2010), which elevated Europe to the highest levels of reporting according to the Global Reporting Initiative (GRI) standards. In the U.S., sustainability-reporting practices are non-existent or they are still in their infancy stage. According to Kaye (2011), “while companies around the globe have embraced CSR reports as a way to demonstrate transparency and articulate their effects on environmental, social, and governance issues, American companies generally lag behind. The GRI estimates that 45% of the companies that use its reporting framework are from Europe.”

Based on the sustainability reports submitted to the GRI by companies all over the world, KPMG prepares a report summarizing the global state of sustainability. The latest one was prepared in conjunction with the United Nations Environmental Program (UNEP) and the Centre for Corporate Governance in Africa (at the University of Stellenbosch Business School) (KPMG, 2016). It includes information from 71 countries and territories, the 60 top economies by GDP plus 11 countries that were included in previous reports or with known relevant reporting instruments (page 6). Canada and the U.S. are included in North America, and 28 countries in Europe. The report shows strong growth in Europe, Asia Pacific and Latin America from 2013 to 2016. The authors state that “Europe continues to have clear lead among the regions in terms of the overall number of instruments in place” (page 11). 78% of the reports in 2013 and 80% in 2016 in U.S. include mandatory disclosures. In the E.U., on the contrary, 64% in 2013 and 62% in 2016 were mandatory, which indicates a trend to increase the amount of voluntary disclosures.

Another interesting observation is that in the U.S. only 1 in 16 reports is related to general sustainability, while most of the reports are focused on environmental reporting (page 21). In the E.U., 38% of the reports are related to general sustainability, consistent with higher

levels of commitment. The authors argue that the proliferation of reports focused on specific topics in the U.S. may be related to legal norms instead of embracing general principles (page 21).

With the purpose of increasing the participation of U.S. companies from a mere 12%, the GRI opened an office in Lower Manhattan in January 2012. Furthermore, several established international accounting and consulting firms currently provide studies, surveys and other support related to sustainability. The AICPA has set up a reporting and assurance webpage on sustainability<sup>1</sup>. Additionally, research regarding environmental reporting is currently being undertaken by various CPA state societies. Special watchdog groups currently exist that monitor and report corporate and industry behavior related to sustainability initiatives in corporations. Examples include the GRI, which has a resources library and a disclosure database (GRI, 2013); the International Organization for Standardization (ISO)<sup>2</sup> and the International Integrated Reporting Committee (IIRC)<sup>3</sup>, which is working on the development of a comprehensive set of reporting guidelines to promote consistent standards. Despite all of these initiatives, without proper mechanisms and regulation, these standards will not be effective (Lin, Romero, Jeffers & DeGaetano, 2015b).

Of particular significance in the development of a framework for the measurement and reporting of environmental initiatives is the Sustainability Accounting Standards Board (SASB)<sup>4</sup>. The SASB is a private non-profit organization that states that its mission “is to develop and disseminate sustainability accounting standards that help public corporations disclose material, decision-useful information to investors” (SASB). Up to date, the SASB prepared a draft based on the performance indicators developed by Lydenberg, Rogers & Wood<sup>5</sup>. It includes environmental, social, economic and governance indicators.

Despite the strides made by the SASB, recent events have created a rift between the SASB and the Securities & Exchange Commission (SEC). In a statement made on March 27, 2014 regarding the SASB’s stated mission, the then Commissioner, Daniel Gallagher of the SEC stated that “it is the Commission’s responsibility to set the parameters of required disclosure standards” (SEC.gov, 2014).

To date, the SEC’s guidance concerning disclosure of sustainable and social issues has been limited to resource extraction issuers (oil, natural gas and minerals) and expanding the requirements to other industries has not emerged. Hence, there is still no uniformity and consistency of identification and

measurement of the incremental revenue and costs related to environmental initiatives.

Since sustainability initiatives are an important factor in corporate decision-making and users of financial statements are demanding more transparent reporting, there should be more standardized reporting and consistent information presented with some regulatory oversight to the public. Most major U.S. corporations currently self-report on environmental measures. However, since there are no authoritative or uniform requirements for reporting these initiatives, the usefulness of these disclosures may be diminished.

There are some previous studies showing the disparity between European and American companies in terms of sustainability reporting. Romero *et al.* (2014a) investigate how users perceive the quality of the assurance statement for sustainability reports (SR) through a survey conducted among 243 master-level students and advanced undergraduate accounting students in Spain and the U.S. They find that American students prioritize the existence of clear assignment of responsibility, while Spanish students value the disclosure of the level of assurance and the quality of the recommendations from the assurers, indicating different perception of accountability between the two groups. Kolk (2010) studies multinational-corporation sustainability reporting, and finds that European companies are frontrunners in many sectors, especially in terms of publishing verified reports. Hartman, Rubin & Dhanda (2007) conduct a cross-cultural analysis of communication of CSR activities in 16 American and European companies. They find that E.U. companies incorporate both financial and sustainability elements to justify their sustainability commitment. U.S. companies, on the contrary, focus more heavily on financial justifications. Boesso & Kumar (2007) examine the factors that drive voluntary sustainability disclosures in Italian and American companies. They analyze disclosures in the Management Discussion and Analysis section of the annual report of 72 companies. They find that the factors driving the voluntary disclosure appear to be common across both groups of companies; however, the quality of disclosure appears to be influenced by the country characteristics. Origin of the law, enforcement and institutional pressure are the determinants of legal system tradition most frequently used to determine a country effect (Kolk & Perego, 2010; Simnett Vanstraelen, & Chua, 2009).

(Romero *et al.*, 2014b) study the differences between corporations in Europe and the U.S. with respect to sustainability initiatives and company value. Their study is based on 2012 data from the annual

environmental ranking of the 500 largest publicly traded companies in the world (Newsweek, October 22, 2012). They find that companies in the E.U. are ranked higher than the rest of the world in sustainability reporting in areas related to regulation, and have a weaker relationship between sustainable initiatives and profitability. Companies in the U.S., on the other hand, have a stronger relationship between sustainable initiatives and profitability than the rest of the world, and are ranked higher in areas related to disclosure of carbon emissions and footprint.

Given the aforementioned efforts from different parties in the U.S. to increase the levels of commitment and reporting in sustainability, we expect that companies in the U.S. have reached the level of commitment of their counterparts in Europe. The hypothesis is stated as follows:

H: Companies in the U.S. have reached the level of commitment and reporting in sustainability of their counterparts in Europe.

### **NEWSWEEK RANKINGS**

Newsweek (Newsweek green ranking, 2015) publishes the annual environmental ranking of the 500 largest publicly traded companies in the world. The Newsweek Green Rankings follows six core principles:

#### **Transparency**

Newsweek discloses the methodology of the ranking, which is replicable by a third party, and the results of the process.

#### **Objectivity**

Companies are assessed by KPI and quantitative data.

#### **Public data**

Only data publicly available are used.

#### **Comparability**

Companies are compared against their industry group peers based on the KPI.

#### **Engagement**

Companies eligible for the ranking are informed in advance to make them able to prepare the data.

#### **Stakeholders**

Stakeholder feedback requested from different stakeholders, including an expert advisory panel.

The 2015 ranking measures the environmental performance of large public companies using eight key performance indicators (KPI)<sup>6</sup>:

**Indicator 1: Combined Energy Productivity.****Weight:** 15%.

This indicator is calculated in three steps. In the first one, each company's Energy Productivity (Revenue (\$US) / Total Energy Consumption (GJ)) is calculated for 2013. Each company's Energy Productivity is then percent-ranked against that of all Industry Group peers and multiplied by 0.75. In the second step, the change in each company's Energy Productivity from 2011-2013 is calculated and percent-ranked against that of all same-Industry Group peers. Different weights are given depending on the change and then multiplied by .25. In the third step, the values from the first and second steps are totaled.

**Indicator 2: Combined Greenhouse Gas (GHG) Productivity****Weight:** 15%

In the first step, each company's GHG Productivity (Revenue (\$US) / Total Greenhouse gas (GHG) Emissions-Scope 1 and 2) is calculated for 2013. Each company's GHG Productivity is then percent-ranked against that of all Industry Group peers and multiplied by 0.75. In the second step, the change in each company's GHG Productivity from 2011-2013 is calculated and percent-ranked against that of all same-industry group peers within the CKC research universe. Different weights are given depending on the change and then multiplied by .25. In the third step, the values from the first and second steps are totaled and then multiplied by 0.9. In the fourth step, if the company disclosed Scope 3 GHG emissions in 2013, a score of 100 percent is attributed and then multiplied by 0.1. Otherwise, a score of 0 percent is given.

In the final step, the scores from the third and fourth steps are added.

**Indicator 3: Combined Water Productivity.****Weight:** 15%.

In the first step, each company's Water Productivity (Revenue (\$US) / Total water use in cubic meters) is calculated for 2013. Each company's Water Productivity is then percent-ranked against that of all Industry Group peers multiplied by 0.75.

In the second step, the change in each company's Water Productivity from 2011-2013 is calculated and percent-ranked against that of all same-industry group peers. Different weights are given depending on the change and then multiplied by .25. In the third step, the values from the first and second steps are totaled.

**Indicator 4: Combined Waste Productivity.****Weight:** 15%

In the first step, each company's Waste Productivity (Revenue (\$US) / [Total waste generated in metric tonnes – waste recycled/reused in metric tonnes]) is calculated for 2013. Each company's Waste Productivity is then percent-ranked against that of all Industry Group peers and multiplied by 0.75. In the second step, the change in each company's Waste Productivity from 2011-2013 is calculated and percent-ranked against that of all same-industry group peers. Different weights are given depending on the change and then multiplied by .25. In the third step, the values from the first and second steps are totaled.

**Indicator 5: Green Revenue Score. Weight: 20%.**

The Green Revenue Score is calculated by breaking down a company's revenue into segments to determine the percentage of a company's revenue that is green.

**Indicator 6: Green Pay Link. Weight: 10%.**

Mechanisms that link senior executive pay to corporate environmental performance. Yes = 10 percent. No = 0 percent.

**Indicator 7: Sustainability Board Committee.****Weight:** 5%.

A committee at the Board of Directors level whose mandate is related to the sustainability of the company, including but not limited to environmental matters. Yes = 10 percent. No = 0 percent.

**Indicator 8: Audited Environmental Metrics.****Weight:** 5%

Audit of 2013 environmental metrics by a third party. Yes = 10 percent. No = 0 percent.

To arrive at an overall ranking, companies are sorted in descending order based on their final score.

**RESEARCH DESIGN/METHODOLOGY**

We collected data from Newsweek (Newsweek green ranking, 2015). We compared the overall green score between U.S. and E.U. companies, to test if U.S. companies have increased their commitment to CSR since 2012. If they did, they should have improved their position in the rankings as well as their participation in the top 500 sustainability companies. To determine if there is a change in the composition of European and U. S. companies, we compared the top and the bottom 100 companies in the rankings. As an additional analysis, we compared the changes in the rankings of the companies included in 2012 with respect to 2015.

The methodology to calculate the ranking scores is different in these two periods; therefore, the evolution (or not) of U.S. companies in the overall ranking may be due to the calculations of the rankings rather than to the changes in their levels of commitment to sustainability. In spite of that, we report these results because it broadens the picture of the state of reporting in the U.S. The methodology of the 2012 rankings is included in the appendix.

In the present study we used the Newsweek rankings because it is the ranking that was used in our original paper (Romero *et al.* 2014b), which is the baseline for the comparison with the present. In addition, this ranking is appropriate because it is independently produced by Newsweek, a highly recognized source for rankings in different areas. It was also used in previous research (e.g. Lyon & Shimshack, 2012; Lin *et al.*, 2014).

## FINDINGS

### Descriptive Statistics

Table 1 presents the geographical distribution of companies by continent for the years 2012 and 2015. Our sample includes 337 companies located in the U.S. and Europe. The number of U.S. companies increased 30% from 162 in 2012 to 210 in 2015, while the number of European companies in the ranking decreased 21% from 160 to 127 in 2015. The increase in the number of U.S. companies in the top 500 rankings indicates per se an increase in the commitment to sustainability during the 3-year period. It is interesting that the number of companies in the other regions made to the top 500 global list did not change much; therefore, the variations of U.S. and E.U. rankings are more meaningful.

**Table 1: Distribution of companies in the top 500 Newsweek ranking by continent**

Companies in the top 500	2012			2015		
	Frequency	Percent	Cumulative Percent	Frequency	Percent	Cumulative Percent
United States	162	32.4	32.4	210	42	42
South America	15	3	35.4	10	2	44
Europe	160	32	67.4	127	25.4	69.4
Asia	127	25.4	92.8	115	2.3	92.4
Other	36	7.2	100	38	7.6	100
Total	500	100		500	100	

Table 2 presents the distribution of companies by industry. Companies in the financial industry are the leaders in the Newsweek ranking in terms of frequency. Fernandez-Feijoo (2015) attribute the importance of CSR for companies in the financial industry to the fact that they have greater visibility and a greater need to demonstrate that they are socially responsible to legitimize their role in society.

**Table 2: Distribution of companies in the top 500 Newsweek ranking by industry**

	Frequency	Percent	Cumulative Percent
Security	1	.2	.2
Basic Materials	22	4.4	4.6
Communications	52	10.4	15.0
Consumer, Cyclical	55	11.0	26.0
Consumer, Non-cyclical	89	17.8	43.8
Diversified	3	.6	44.4
Energy	47	9.4	53.8
Financial	134	26.8	80.6
Industrial	51	10.2	90.8
Technology	28	5.6	96.4
Utilities	18	3.6	100.0
Total	500		100.0

Companies in the top 100 belong mostly to the Communications, Consumer non-cyclical, Technology and Utilities industries. Companies in the bottom belong mostly to the Energy and Financial industries. Therefore, financial companies are in the lead in number, but not in quality of initiatives and commitment.

### Test of Hypothesis

To test if the increase in U.S. companies in the ranking (quantity) is followed by a better positioning in the ranking (quality) we run a *t*-test comparing the rankings of U.S. companies with those of European companies. Table 3 presents the results, which indicate significantly higher rankings for E.U. than for U.S. companies, even when the majority of the companies (62%) are from the U.S.

Finally, we divide the rankings in the top and bottom 100 companies to compare the geographical composition of both groups. Although there are more E.U. (53) than U.S. (30) companies in the top rankings and more U.S. (38) than E.U. (6) companies in the bottom rankings the difference in rankings is not significant for both groups.

**Table 3: Comparison of rankings between U.S. and E.U. companies**

		<i>N</i>	<i>Mean</i>	<i>Std. Dev.</i>	<i>t-value</i>	<i>p-value</i>
Rankings 2015	US	210	0.4048	.18750		0.002
	E.U.	127	0.5526	.15440		

This partial result shows that companies at the top and bottom have rankings that do not differ between the U.S. and E.U., indicating some level field between the two groups at the ends of the rankings.

### Additional Tests

Although the methodology for the calculation of the green rankings has changed in 2015, we looked into the variation of the order in the ranking of the companies that were included in the ranking in 2012. For that purpose, we select from the sample those U.S. and E.U. companies that were in the list of both 2012 and 2015 rankings. The sample includes 124 U.S. companies and 68 European companies. Similar to the general sample, the number of companies is larger for the U.S.

The mean change in ranking scores is -0.12504 for the U.S. companies and - 0.062601 for the E.U. companies. This result indicates that E.U. companies decreased their rankings less than the U.S. ones. The difference in the change of two ranking groups is significant ( $p = 0.012$ ), and adds to the findings on the test of main hypothesis.

**Table 4: Comparison of Change in Rankings between U.S. and E.U. Companies**

<i>U.S. vs E.U. change in rankings</i>	<i>N</i>	<i>Mean</i>	<i>Std. Dev</i>
U.S.	124	-0.1250	0.162166
E.U.	68	-0.0626	0.161929

### IMPLICATIONS OF FINDINGS

Our findings have important implications for investors and other stakeholders, given that it shows differences in U.S. and European companies' commitment and reporting in sustainability issues. As citizens have become more aware of sustainability issues, financial statement users have been demanding better reporting of revenues and costs associated with sustainability initiatives in corporations.

Though our study shows that more U.S. Companies have made to the Global Top 500 list, they are still lagging the European Union in their commitment to sustainability as well as in their reporting, this also has implications for U.S. Corporations.

Our findings also have implications for U.S. regulators and standard setters in their quest to develop a framework for measuring and reporting of environmental initiatives as well as to identify and measure the related variables in corporations. Our study demonstrates the need for the development of such a framework.

As previously noted, we are seeing more activity accelerating the evolution from an atmosphere of CSR report "storytelling" toward disclosing accurate relevant information. Standard frameworks, reporting and independent assurance help investors understand the potential impact of risk and evaluate managements' success at mitigating these risks. With increased reliance on this information, the differential in companies' CSR ratings and scores should result in adjusted risk premiums.

This is evident when examining a topic such as climate change, a risk which is systematic and cannot be diversified away. According to a SASB working draft "Climate Risk SASB Technical Bulletin 2016-01", "Although climate risk is ubiquitous, cutting across every sector, it manifests itself differently from one industry to the next. These industry-specific impacts can be grouped into three primary types of risk to a company and its investors: physical risk, transition risk, and/or regulatory risk. .... Where industries face unique risks and opportunities related to climate risk, SASB's standards include industry-specific metrics to capture company performance in those areas." <sup>7</sup>

Several questions can arise from these observations.

### Do investors care?

According to a 2014 PwC report entitled "Sustainability goes mainstream: Insights into investors views", reasons why investor consider sustainable issues matter include risk mitigation, avoiding firms with unethical behavior and enhance performance.<sup>8</sup>

In a 2016 study published in MIT Sloan Management Review it was found that "Investors see a strong link between corporate sustainability performance and financial performance — so they're using sustainability-related data as a rationale for investment decisions like never before." (Unruh, K. K., 2016).

### Is there market impact?

The answer is positive. The marketplace for sustainable and responsible investing has been expanding. The U.S. SIF Foundation's Report on Sustainable and Responsible Investing Trends in the United States has identified \$6.57 trillion in total assets under management at the end of 2013 using one or more sustainable, responsible and impact investing strategies, because investors believe companies' sustainability commitment will enhance their financial performance in the long term, while at the same time contribute to the society and environment positively<sup>9</sup>

### Do sustainable practices increase financial performance?

Indeed the link between company value/performance and good sustainable practices is becoming more substantiated. Recent studies provide positive evidence that companies that take steps toward sustainability increase their profits substantially. Hence enacting sustainability initiatives can lead to increased shareholder value as well as numerous other benefits to companies (e.g. Jeffers & DeGaetano, 2011; Lin *et al.*, 2015b).

### FUTURE RESEARCH

The difference between the E.U. and U.S. with respect to sustainability commitment and reporting demonstrates the need for further research in this area from academia as well as in the profession. One such study could be to extend this paper using other CSR rankings, given that ranking differ among rating companies (Lin *et al.*, 2016).

### CONCLUSIONS

During the last three years, different initiatives have been aimed at increasing the levels of corporate social responsibility, engagement and reporting in the U.S. For example, there have been major efforts by the GRI and the AICPA with respect to sustainability. Of particular significance also in the development of a framework for the measurement and reporting of environmental initiatives is the Sustainability Accounting Standards Board (SASB). Further, most major U.S. corporations currently self-report on environmental measures. However, since there are no authoritative or uniform requirements for reporting these initiatives, the usefulness of these disclosures may be diminished.

The purpose of this paper was to assess if U.S. companies have increased their levels of engagement and reporting on sustainability during the period from 2012 to 2015, as measured by their positioning in the top 500 Newsweek global companies.

We find that although the number of U.S. companies in the Newsweek's list has increased, and the number of European companies has decreased, the E.U. companies still hold the highest rankings. This result indicates an advance of the U.S. in the direction of sustainability and it is expected that engagement and reporting on sustainability will soon rise to the level of European companies in the near future.

### Notes

1. [http://www.aicpa.org/InterestAreas/Business Industry and Government/Resources/Sustainability/Pages/Sustainability%20Accounting,% 20Reporting,% 20Assurance%20and%20Other%20Services.aspx](http://www.aicpa.org/InterestAreas/BusinessIndustryandGovernment/Resources/Sustainability/Pages/Sustainability%20Accounting,%20Reporting,%20Assurance%20and%20Other%20Services.aspx)
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## Appendix

### How are the 2012 Rankings Calculated?

Companies are ranked by their overall Green Score, which is derived from three components: Environmental Impact Score (45%), Environmental Management Score (45%), and Disclosure Score (10%). The weightings were determined in consultation with our advisory panel.

**Environmental Impact Score:** Based on data compiled by Trucost, this is a comprehensive, quantitative, and standardized measurement of the overall environmental footprint of a company's global operations. The score factors in more than 700 metrics—including emissions of nine key greenhouse gases, water use, solid-waste disposal, and emissions that contribute to acid rain and smog.

**Environmental Management Score:** Derived from analysis compiled by Sustainalytics, this score is an assessment of how a company manages its environmental footprint. The Sustainalytics scoring model measures the quality of each company's environmental policies, programs, targets and initiatives, on the basis of company operations, suppliers and contractors, as well as products and services.

**Disclosure Score:** It assesses company reporting and transparency on environmental impacts and performance. This score evaluates the adequacy, completeness, and quality of company sustainability reporting including measurement and disclosure of environmental impacts and involvement in key transparency initiatives such as the Global Reporting Initiative and Carbon Disclosure Project.