The Impact of Management Control on Sustainability Reports

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Abstract

Nowadays sustainable development is no longer seen only as a way to reduce costs or increase efficiency, but also as a tool for competitiveness and development through product placement, services related to the preferences of the entity's stakeholders. Sustainability reports are designed to justify and present public policy actions of each entity. The holistic approach to the structure and content of sustainability reports lead us to notice their various features. Examining the content of sustainability reports of various national and international entities was based on the theory of corporate governance, agency theory and the theory of positive stakeholders. In order to ensure a full study we have examined various international bodies and position with respect to sustainable development.

Key words: theories of corporate governance, positive agency theory, stakeholder theory, sustainability report
J.E.L. classification: M00, M14

Introduction

Sustainability reports represent the managers' effort for the company's survival, given the tough market conditions. Management accounting should adjust its goals, as the cost is no longer the key element in determining the price. Most often, the price is determined by the market and the company must shape the system of allocation and use of resources so that the cost does not exceed the price and that it ensures the shareholders that the entity will obtain long-term profit and will be environment-friendly.

Under these circumstances, there arises the question: What is the role of sustainability reports? This type of reports has appeared as a result of market reorientation towards the clients' preferences and needs. Stakeholders of the entity are not limited to the various categories of shareholders but also to customers, employees, suppliers, etc., that require continuously complete and transparent information about the economic, social and environmental performances of the entity. According to data provided by the Governance & Accountability Institute, 53-57% of the entities listed on international exchanges included in the report for 2013 information on the environmental, social and governmental impact, compared with 19-20% of the entities for 2011. Sustainability reports strengthen the confidence of investors, employees, customers, suppliers and other stakeholders (Lee, M., 2014).

Sustainability reports are not only a function of external pressure. The entity's internal environment also plays an important role in the quality of sustainability reports. Particularly, the attitude of top management towards the external environment and the nature of relations between top management and stakeholders: the functionality of formal and informal management control systems related to sustainability reports.

Examining the relationship between sustainability reporting and management accounting is to investigate the nature of the actions taken by the entity to ensure value maximization, but also ensure transparency in informing other stakeholders. Searching response to the main research question is the very aim of the research: What is the role of management accounting in ensuring adequate sustainability reports? Analysis of the main theories considered theoretical and conceptual foundations of sustainability reports is the starting point in our research. The theory testing within the entity was carried out through the examination of corporate governance codes on the website of the European Corporate Governance Institute, in conjunction with the structure of sustainability reports at the national and international levels. Finally, we shall present the findings and limitations of the research.

Stakeholder theory result of corporate governance evolution

Stakeholder theory appeared in the early 80s as a result of the evolution theories in corporate governance and the positive theory of an agency. Managers' behaviour and relationships with shareholders is the key figure in the theories of corporate governance, while the positive agency theory focuses on organizational behaviour in terms of managers' rationality. The theory of stakeholders suggests that managers have ethical obligations towards other stakeholders, not only to shareholders. In other words, entities should offer part of their benefit to shareholders, register various responsibilities and to other interested parties.

In the early 30s of the twentieth century, theories of corporate governance found its sources in the reflections of Berle and Means (1932, cited Charreaux 2000). The theory of corporate governance is based on ideological support of property rights theory, organization theory and agency theory. Subsequently, a number of researchers have recognized that, in joint stock companies, management is performed by the organization's management and shareholders receive dividends without getting involved in managing the entity.

The positive agency theory is the result of an ambitious project of M.C. Jensen and W.H. Meckling (1976, cited Charreaux 2000) from the University of Rochester. The theoretical foundations of this theory are the result of the division of agency theory in two directions: positivist and principal-agent theory (Jensen, 1983). The ideological foundations of the positive agency theory are rooted in the organizational architecture theory, based on the allocation of decision rights within the organization (Fama, Jensen, 1983, cited Charreaux 2000). The theory of organizational architecture (Charreaux, 2000) is also based on two dimensions of positive theory: a) decision management rights, b) decision control rights. Decision management rights have the following functions: of initiative, of approval, of implementation and of supervision. E.F Fama and Jensen C. M. (1983, cited Charreaux 2000) combined the function of initiative and implementation, being merged to create the decision management. While the combination of the approval and the supervision functions aimed the creation of the decision control function. The decisions control rights are referred by the contemporaries as the internal control system and require the performance evaluation system and the motivational system.

While the managers' rationality is the key figure of the positive theory of an agency, **the theory of stakeholders** suggests that managers have ethical obligations for other stakeholders as well. The term "stakeholder" is at the origin of the theory of interested parties, that was introduced in the specialty literature by E. Freeman by publishing the book "Strategic Management*:* A Stakeholder Approach*"* (Stanford Research Institute, 1984, cited Mercier ,2001). E. Freeman, in turn, was inspired by the research of Dodd (1932, cited Mercier ,2001) and Barnard (1938, cited Mercier ,2001). Strategic analysis of stakeholders recommended the following instruments: stakeholder map, matrix on the responsibility of stakeholders and interested parties typology. The above mentioned methodology of analysis is possible only by taking into consideration the following five factors (Frooman, 1999; Weiss, 1994; Freeman, 1984):

- identify stakeholder interests: What they want and what relative power they have?
- analyse the opportunities and challenges that can generate for the entity: How each stakeholder can affect the entity and how the entity can affect the stakeholders?
- responsibility analysis (economic, legal, ethical and discretionary), according to the Carroll (1989) typology of the organization to its stakeholders;
- develop a strategic plan to take advantage of opportunities and avoid threats.

The stakeholders' map refers to various stakeholder categories divided in a subjective manner, in accordance with various opinions of researchers. Mitchell et al (1997, cited Bouglet, 2005) suggest that there are 7 categories of stakeholders that have one, two or three attributes: the power to influence the decisions of the entity, the degree of legitimacy in dealing with the entity, the right to speed up specific stakeholders transactions. Carroll and Buchholtz (2000; Weiss, 1994, Clarkson, 1995; Gibson, 2000; cited Bouglet, 2005) operate with two categories: a) **primary stakeholders**: owners, employees, suppliers and customers (have a contractual and a formal relationship with the entity); b) **secondary stakeholders**: media, consumers, pressure groups, government, competitors, public and other companies (could have a potential influence). Carroll and N*ä*si (1997, cited Bouglet, 2005) also propose their two categories, but different in content: **internal stakeholders**: owners, managers, employees and **external stakeholders**: competitors, consumers, government, pressure groups, the media, the community and the natural environment. The last two classifications have some similarities with the exception of suppliers and customers that are included in different categories.

The previously examined theories represent the theoretical part of the research, conducted in order to indicate the theoretical roots of sustainability reports. An absolutely indispensable element in the development of sustainability reports is the specific normative basis. In this regard, we examined the position of various international bodies on the content of sustainability reports.

Position of international organizations on sustainability against management control

Corruption is the proof misconduct or reveals a distancing from strategic concerns of the entity management. In this regard, we would like to mention that this process is very old and is specific not only for our country. The USA was one of the countries with a explicit anti-corruption sentence adopting the Law on corruption practices abroad (Foreign Corrupt Practices Act, FCPA) of 1977 which stipulated two-way control of corruption: anti-bribery clauses, accounting and internal control. The accounting notes of the FCPA laws are the result of investigations conducted by the US Securities and Exchange Commission (SEC). Many US companies distorted the accounting data in order to pay bribes both to domestic and foreign officials and political parties.

The management responsibility for maintaining an effective internal control structure was not new. Subsequently to FCPA law, were issued further rules and laws; *Treadway Report* (The National Commission on Fraudster Financial Reporting, 1987), *the COSO model* (Committee of Sponsoring Organizations, 1992), *COBIT standards* (Information Systems Audit and Control Foundation, 1996), aiming to further improve the system of internal control. Sections 404 and 302 of the Sarbanes-Oxley have consolidated the internal control by requiring the submission of financial reporting of internal control, both by the CEO and CFO, and by the listed entities. These factors were one of the elements of sustainable development of the entity.

Today, sustainable development is no longer seen only as a way to reduce costs or increase efficiency, but also as a tool for competitiveness and development by positioning products, services and brands that appeal to stakeholders of the entity. It evolved from the strategic imperatives, focused on economic, environmental and social risks, to the opportunities which must be constantly monitored ensuring long-term success, sustainability strategies and business models.

While working in the reporting of sustainability should be taken into account both economic and social factors, as well as the environmental factors that may affect the performance of the entity. In order to achieve the objectives of sustainability, reporting entities must develop strategies and interdependent objectives. Integrated Framework COSO on Enterprise Risk Management assigns the following structure on strategies and objectives: ***strategies***, ***operations***, ***reporting*** and ***compliance***. These categories create a powerful context for risks examining.

Strategic risks require entities to consider the problem aspects regarding sustainability, which may have a significant strategic impact. They range from market position and changing consumer preferences, to strategic investments, stakeholder communication and relations with investors. Most often, the management of these risks calls for management to focus on actions that go wrong. In order to change the circumstances, the management entity must consider the actions favourable to the entity all the time. Shareholders' expectations may constitute a factor of pressure on organizations. The rapid technology development and consumer demand determines strategic sustainability initiatives. Consumers care about the social impact on the environment, products or services they are buying and eating, and a number of independent organizations publish this information online. This may provide new opportunities for creating revenue for companies wishing to enter the market by developing new lines of organic products or improving the existing ones. However, these opportunities can foster a form of strategic risk (Faris, Gilbert, LeBlanc, Ballou, Heitger, 2013, p.3).

A great part of entities associate the supply chains with environmental and safety performance. The burden of ***operational risk*** is moving towards suppliers and is designed, first, to prevent disruptions in economic activity. Entities are required to provide customers the manufacturing cycle and reveal their plans to improve environmental features of their products and processes. Thus, entities focus on supply chains because it represents a risk area and an opportunity to enhance operational efficiency. In the context of operational risk, sustainability factors often have a disproportionately large impact on corporate reputation and business results. Reputation or brand of an organization can live or die based on what users say about its sustainability performance. (Faris, Gilbert, LeBlanc, Ballou, Heitger, 2013, p. 4).

Under the high pressure of users of transparent information, entities have started ***reporting on sustainability***. Sustainability data can be provided through commercial services to institutional investors and individual investors through mass media. The presented data demonstrate that financial analysts listed entities that promote an active policy of sustainable strategies benefiting from favourable positions in stock exchanges. NASDAQ, Brazil, Singapore and other stock exchanges have announced that they encourage listed companies to publish annual sustainability reports that can be combined with the financial statements (Faris, Gilbert, LeBlanc, Ballou, Heitger, 2013, p.6).

Entities face a number of ***compliance risks***, which regulate international, national and regional programs. Risk key-areas arise directly or indirectly from regulatory measures are diverse and can include environmental risks, health and safety, human rights and labour law, the anti-bribery etc. Regulators can also help increase compliance risk; for example, in 2009, the Securities Commission (SEC) issued a bulletin by shareholders who asked to include financial risk, when discussing environmental issues and indicators related to sustainable development. In February 2010, the SEC published interpretive guidance guide, which recalls the disclosure requirements of risk caused by climate change (Faris, Gilbert, LeBlanc, Ballou, Heitger, 2013, p. 5).

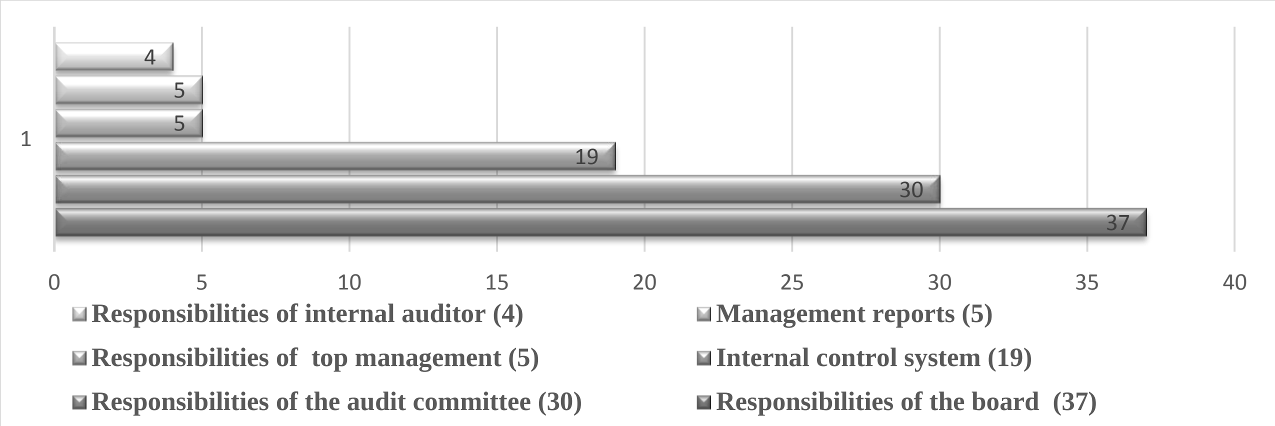
Research methodology

The population that we studied represents the Code of Corporate Governance (Code) taken from the website of the *European Corporate Governance Institute* (http://www.ecgi.org/codes/all_codes.php). Out of the 97 codes, only 79 were selected, symbolizing the fact that they are from a particular country. Codes of various international bodies and Codes that lacked the English version, a total of 18 codes, were excluded from the sampling. Conceptual content analysis is considered the most useful qualitative method used in investigating issues with a large amount of text and allows the study of remote objects, revealing the messages that are difficult to be noted otherwise. Codes examination was meant to know the current situation at international level. Investigation of the international sustainability reports structure was performed through sustainability reports within the Governance & Accountability Institute (http://database.globalreporting.org/search) and, at the national level, on the website of the Bucharest Stock Exchange (http://www.bvb.ro).

Research results

Having analysed the content of the Corporate Governance Codes in 79 countries we can state that the board (council) is a key element in corporate governance, confirmed by 37%, according to the information selected from the content of the Codes. The board appoints and dismisses top management, provides adequate incentives and sets the tone for the company's global strategies. It should be noted that the full name differs from country to country and fluctuates between Board of Directors and the Supervisory Board.

Figure no.1. The components of corporate governance integrated control system



*Source: elaborated by the author, based on (*http://www.ecgi.org/codes/all_codes.php*)*

Data from the figure 1 prove that in most countries the board has the responsibility to **ensure a prudent and effective control environment which enables risk assessment and management**. The share of 30%, given to the audit committee, comes to explain that the responsibility for monitoring the control system of the entity is given to this Committee is appointed by the Board.

Examining various definitions of sustainability reports allows us to say that the greatest part aimed at social assistance and economic elements and that accounting practice focuses on environmental issues. ACCA believes that the definitions attributed to the process of sustainable development at national and international levels must take into account the UN definition of 1987, known as the Brundtland Report. In this sense, sustainability aims at the development current needs without impacting the ability of satisfaction of the needs of future generations.

Position of the Governance & Accountability Institute on sustainability reports is as follows: "Starting with technology and working toward the improvement of every life on the planet allows us to think holistically about addressing global challenges". Thus, this institute during 1999-2016 posted on its web page 3621 sustainability reports, access is free. In order to analyse the state of the reports of Romanian entities, we have extracted a report for 2015 (Table 1).

Table. 1. Structure of the sustainability report of ACACIA MINING PLC

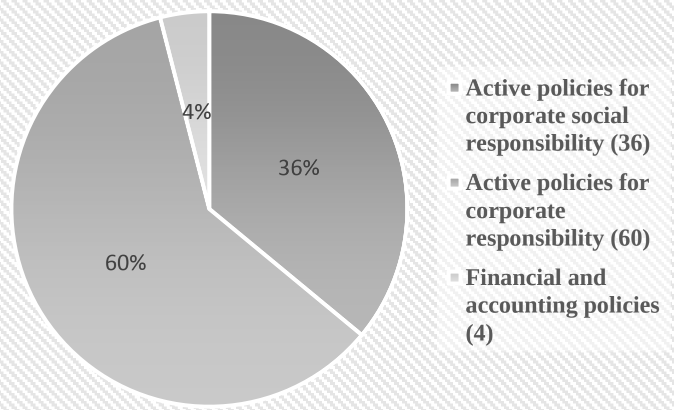
Annual Report & Accounts 2015, *ACACIA MINING PLC*, Great Britain, *172 p.* *is* Tanzania's largest gold miner and one of the largest producers of gold in Africa.	**Strategic report:** 1. A leading asset portfolio in Africa: maximising value through efficient operations 2. Focused on free cash flow as our primary driver of value 3. Creating shared stakeholder benefit: through becoming the partner and employer of choice 3.1. Stakeholder engagement 3.2. Key performance indicators 3.3. Risk management
	Performance review 3.4. Operating review 4. Growing our footprint through an expanded exploration portfolio 5. Disciplined capital allocation ensuring a strong balance sheet 5.1. Financial review 5.2. Our relationships and commitment to stakeholders 5.3. Sustainability review
	Governance 5.4. Governance overview 5.5. Board of directors 5.6. Executive leadership team 5.7. Corporate governance report 5.8. Audit committee 5.9. Remuneration report 5.10. Principal risks and uncertainties 5.11. Reserves and resources
	Financial statements 5.12. Independent auditors' report 5.13. Consolidated statement of comprehensive income 5.14. Notes to the financial statements

Source: elaborated by the author, based on http://database.globalreporting.org/search

Having analysed the sustainability reports published on the website of Governance & Accountability Institute, noteworthy in their components is the holistic approach promoted by this institution. Their structure is different, even the name of the reports is not identical from one entity to another. For example, ACACIA MINING PLC report, although considered as a sustainability report is called Annual Report & Accounts.

We have examined the state of sustainability reports of Romanian entities based on the reports for 2015 found on the website of the Bucharest Stock Exchange. In November 2016, 50 reports belonging to entities from the regulated market were selected. Using content analysis we have identified the main features according to the Annual Report & Accounts of ACACIA MINING PLC, UK (Table 1).

Figure 2. Ranking of the largest listed companies regarding sustainable development



60%	ALUMIL ROM INDUSTRY S.A., CASA DE BUCOVINA-CLUB DE MUNTE, BIOFARM S.A., BERMAS S.A, FONDUL INCHIS DE INVESTITII BET FI INDEX INVEST, CARBOCHIM S.A., CONTED SA, TURISM, HOTELURI, RESTAURANTE MAREA NEAGRA S.A., ELECTROARGES SA, IAR SA Brasov, MECANICA CEAHLAU, OIL TERMINAL S.A., PREBET SA AIUD, PREFAB SA, ROMCARBON SA, SIF MUNTENIA S.A., SIF OLTENIA S.A., STIROM SA, BANCA TRANSILVANIA S.A., TERAPLAST SA, TURISM FELIX S.A. AEROTEH S.A., ALBALACT SA, FARMACEUTICA REMEDIA SA, OMV PETROM S.A., BOROMIR PROD SA, STK EMERGENT, TRANSILVANIA CONSTRUCTII SA, Fondul Proprietatea SA, SINTEZA S.A
36%	AEROSTAR S.A., ANTIBIOTICE S.A., BRD - GROUPE SOCIETE GENERALE S.A., BURSA DE VALORI BUCURESTI SA, CONPET SA, ZENTIVA S.A, SIF MOLDOVA S.A., SIF TRANSILVANIA S.A., S.N.G.N. ROMGAZ S.A., S.N. NUCLEARELECTRICA S.A., SOCEP S.A., C.N.T.E.E. TRANSELECTRICA, S.N.T.G.N. TRANSGAZ S.A., VRANCART SA, ELECTROMAGNETICA SA, ROMPETROL WELL SERVICES S.A., SIF BANAT CRISANA S.A., ALRO S.A.
4%	ARTEGO SA, COMELF S.A.

Source: elaborated by the author, based on http://www.bvb.ro

The share of entities with active strategies in the field of corporate social responsibility (36%) enables us to state that they are not indifferent to global environmental changes, considering the policies promoted by them. However, the percentage is quite low, which demonstrates that there are reserves in the strategic policies of Romanian companies. Besides financial statements and corporate governance, this segment includes also in treir reports information on the environment, sponsoring and other social events, carried out in order to interest and other stakeholders, including shareholders. The largest share (60%) is held by entities with active policies in the field of corporate responsibility, although the issue of transparency of information is no longer current. Entities listed in Romania understand the need to publish their reports. Currently, the biggest problem is attracting their entities' interests to other stakeholders, including employees and the products and / or services must be the result of the stakeholders' preferences.

Conclusion

In conclusion we can say that sustainability reports are designed to ensure business continuity entity by boosting transparency, quality of governance promoted by sustainable actions. These actions should aim at meeting the needs of the present without impacting the ability of satisfaction of the needs of future generations.

Talking about sustainability we think of financial, human and material resources of the entity required to obtain goods or services to be combined in such a way as to ensure survival in the toughest market conditions and are environment-friendly. Stakeholder theory argues that businesses should be concerned with the interests of all parties, when taking strategic decisions. Along with offering part of benefits to shareholders, the entity register various responsibilities and to other interested parties. Thus, shareholders are interested in the economic transactions of the company along with employees, customers, suppliers etc.

The holistic approach to the content and structure of sustainability reports allows us to affirm that performance evaluation, environmental, economic and social risks are not enough. Implementation of ideas, available resources, knowledge, skills, products and other innovative features are designed to complement the conditions mentioned above, and also to guarantee the survival of the entity under current conditions.

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