Chapter 8
Risk Management in Green Corporate Strategies

ABSTRACT

The risk is almost always a major variable in a corporate decision-making. However, few can predict with any precision the future. Nevertheless, managers that ignore it are in a real threat. Relevant social and environmental risks and potential impacts should be considered in the process of sustainability policies implementation. This chapter presents a literature review of existing risks outlined by the main reporting frameworks. It debates the influence of social and environmental approach in corporate reporting models. Further, the chapter develops an analysis of specific requirements regarding risks and uncertainties reported into the financial statements according to different financial reporting standards and their connection to social and environmental information that an entity should disclose. The focus of this chapter is on fundamental research that is related to inductive accounting theory and uses scientific methods for identification of corporate reporting theoretical difficulties that could impact the practice in economic entities.

INTRODUCTION

The interest in sustainable performance is driven by a number of factors, including responses to climate change and environmental degradation, depletion of natural resources (particularly oil) and increased recognition of the role of corporations as agents in economic and social transformations. However, these issues are perceived to affect the sustainability of the investment value of the company, its risk profile and future products and developments. Beyond the clear relevance to the physical environment, the concept of sustainability is extended to social and governmental issues. Thus, some organizations assume social responsibility (CSR) and Triple Bottom Line performances in a wider sustainable performance and reporting form known as environmental, social, and governance (ESG) (Hogarth, 2008). In Australia, Westpac Bank has initiated a new approach: broadening traditional accounting standards. They measure progress by three criteria: prosperity, social, and environmental justice. Their corporate

DOI: 10.4018/978-1-4666-8720-2.ch008

report comprises: ethical clauses in business, transparency, human rights, environmental issues, concern for employees and others.

Future tendencies must respond to the need of measuring the environmental liabilities generated by official or unofficial environmental protection demands that are not currently measured or reported through financial statements. Changing economic and regulatory environments, more complex business structures and risk management, increasing reliance on financial instruments and international transactions, and prominent corporate crises gave rise to risk reporting in non-financial sectors. In general terms, risk reporting shall allow outsiders to assess the risks of an entity's future economic performance (Schrand & Elliott, 1998; Linsley & Shrives, 2006).

Recently, risk reporting has gained interest in financial reporting practice, regulation, and international research. Worldwide, regulators ask for narrative disclosures as the key to achieving the desired step-change in the quality of corporate reporting. Lungu, Caraiani and Dascalu (2008) observed a lack of consistency in mandatory reporting related to this type of information. Nevertheless, the conflict between relevance and reliability in accounting can never be solved due to the uncertainty of the future (Altenburgeret & Schaffhauser-Linzatti, 2007). Expanding the traditional view, the social and environmental reporting is seen to benefit shareholders more by reducing risk than by increasing return. The researchers showed that the annual report is the most favored channel of disclosure. The general message is that, as far as annual reports go, quantified, verifiable disclosures have the most credibility and relevance. A study on The World Bank's performance in developing countries argues that the conventional accounting framework is not an appropriate tool to guide organized effort in balancing the competing-interdependent needs of multiple stakeholders (Rahaman, Lawrence, & Roper, 2004), in order to be aware of contingent social and environmental risks and uncertainties. According to Abraham and Cox (2007), a significant extent of UK research has explored corporate disclosure: Cooke and Wallace (1990), Meek, Gray and Roberts (1995), Ahmed and Courtis (1999), O'Sullivan (2000), Adams (2002), Camfferman and Cooke (2002), Stanton and Stanton (2002), Watson, Shrives and Marston (2002) etc. Beattie (2005) surveyed UK financial accounting research published over a 10-year period and found that 23% of the entire output comprised studies on corporate disclosure. One strand of this literature on corporate disclosure concerns information on risk. Existing explorations have tended to concentrate on specific aspects of risk disclosure, and in particular the disclosure of market based risk in relation to financial instruments (Beretta & Bozzolan, 2004; Linsley & Shrives, 2006; Dominguez & Gamez, 2014). According to a Price Waterhouse Cooper study (PwC, 2014) information concerning key risks to the business model, their management and their mitigation are extremely important for investment professionals.

According to Cabedo and Tirado (2004), companies are essentially exposed to two types of risks: nonfinancial risks, which are not directly related to monetary assets and liabilities, although they will have an effect on future cash flow losses (business risk and strategic risk) and financial risks, which do have a direct influence on the loss of value of monetary assets and liabilities (market risk, credit risk, liquidity risk and operational and legal risks). Each one of these risks must be quantified so that financial statements can present information on their equity, financial and economic situations together with the business risks to which they are exposed, thereby providing potential users with the most appropriate information necessary for the decision making process to go ahead.

Apart from the financial sectors, published research on risk reporting has been rather limited. Most efforts are empirical and the conclusions are various. Part of the literature consider risk reporting as largely beneficial for disclosing entities, assuming both lower cost of capital (ICAEW, 1999; J. F. Solomon, A. Solomon, Norton, & Joseph, 2000) and disciplining effects on risk management and governance

Related Content