Chapter 4
Are Sustainability Disclosures Fraudulent?

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4.1 Introduction

In 1987, the World Commission on Environment and Development produced a report that provided what has become an accepted definition of sustainability. This report became known as The Brundtland Report (World Commission on Environment and Development 1987) and defined sustainability as providing for the current generation without sacrificing the needs of future generations. This is a difficult definition to deal with for a number of reasons, not the least of which is that the needs of future generations are very hard to determine. Additionally, it is not clear how far in the future one should project a generation's needs. In emerging market countries, the government can still play a major role in economic performance, but as countries become more developed, firms will play an increasing if not a major role in sustainable development and therefore their social responsible activities are critical (Akisik and Gal 2011). As a result, corporate social responsibility (CSR) has become the focus of the debate on sustainability in most developed and developing economies. While corporations must play a major role in producing socially responsible outcomes, other stakeholders will also play important roles. For instance, government officials must verify that corporations adhere to established regulations, customers need to look for socially responsible products when making their purchasing decision, and creditors must take CSR initiatives into consideration when extending their financial support.

There is evidence that each of these stakeholder groups will use different types of information in making decisions concerning whether or not to view a firm as socially responsible. With the passage of the Dodd–Frank legislation (United States Congress 2010) the US regulators must consider the use of conflict minerals in

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firm's supply chains. The Securities and Exchange Commission (SEC) was charged with establishing rules to assist firms in making this determination (Securities and Exchange Commission 2012); however, even the Commerce Department agreed that this is a particularly daunting task for firms (Chasan and Maxwell 2014a, b). For customers, firms will provide information about their production processes as this stakeholder group has become more concerned that companies incorporate sustainable and socially responsible processes in the production of their products (Homburg et al. 2005; Mohr et al. 2001). Investors are increasingly interested in the possibility that a firm will have an environmental issue which could impact their ability to provide a suitable return or repay their debt (Godfrey et al. 2009; Heyes 1996; Hockerts and Moir 2004), so firms must be prepared to disclose any environmental issues that could arise. Thus, it is clear that stakeholder groups look for different CSR information in evaluating the social responsible performance of firms. This also implies that firms can use different approaches to reach these stakeholders, and each has different levels of veracity.

Firms have increasingly used diverse channels to disclose information about their socially responsible activities to different stakeholder groups. For disclosures to regulators, the format is usually quite restricted, and firms have received some specific guidance on the method, the format, and the content of these communications (Securities and Exchange Commission 2010, 2012). However, in making these disclosures to other groups there are a multitude of channels and formats available. One of the more formal avenues of disclosure is the reports that use the Global Reporting Initiative (GRI) format (Global Reporting Initiative 2006, 2011). There is evidence that these disclosures can have an impact on financial performance (Akisik and Gal 2014; Cochran and Wood 1984; Dhaliwal et al. 2012). Therefore, firms have an incentive to provide a favorable information in GRI reports. In fact, there is evidence that firms make certain disclosures to counteract and to preempt any possible adverse publicity (Perks et al. 2013; Vanhamme and Grobben 2009). There is also evidence that not all the information disclosed is accurate (Time 2010). This points out two problems with CSR disclosures; there is not any universally agreed upon report or disclosure channel, and there is not any agreed upon method to review the information contained in many CSR disclosures (Adams and Narayanan 2007; O'Dwyer 2011). However, if managers and owners are producing information with the intent of inducing stakeholders to provide support to their firm and the information may have material errors, then the first two criteria for considering these disclosures to be fraudulent seem to be met. It is the purpose of this paper to expand on issues that arise when considering whether or not CSR disclosures are fraudulent, what the implications for these types of disclosures are, and whether there are any unintended consequences of this concern over social responsibility.

4.2 What Does a Socially Responsible Firm Look like?

For a disclosure to be considered materially misstated, there must be a measure of what the true value would look like. Specifically, for a fraud to have taken place two initial conditions must exist. First, the entity making the disclosure must know a true value, and second, the information provided must be materially different from this value. Many pieces of information are used by stakeholders to determine that a firm is financially healthy. Similarly, many pieces of information are used to determine that firm is socially responsible. Different stakeholder groups put different weights on the available information in making a conclusion that for them this is a socially responsible firm. So a few questions remain, what does a socially responsible firm look like, how far away from a perfectly responsible firm is this firm, and perhaps more importantly, can we tell the difference.

In order to tell the difference between a socially responsible firm and one that is not, a stakeholder must have an idea of what exactly makes a firm perfectly or reasonably responsible. This could entail values for specific attributes: carbon emissions below a certain threshold. Or, it could include information about certain practices: this firm provides excellent workplace training. The problem then is assessing how a firm looks on relevant measures and then somehow measuring its distance from the ideal. In this case, and many others, the problem is one of placing the firm on a continuum and then measuring semantic distance.[1] This decision is similar to other measurement issues confronted by management and other stakeholders.

For instance, Fig. 4.1 looks at possible criteria a stakeholder might consider in evaluating a company. On each criteria, firm A and firm B have different subjective values, so the difference is really a semantic difference. Without objective criteria for "Good Hiring" practices, the placement of the value along the continuum is the result of a stakeholder or stakeholder group's perceptions. When a person (or assurance provider) evaluates hiring practices their placement of the firm along the continuum is based on their perception of the semantic distance from either the end point "Good" or "Poor." Further, the distance between companies A and B on each dimension may be considered as material by one evaluator and immaterial by another; i.e., some evaluator may consider point A on the hiring dimension as close enough to the "Good" end to evaluate the firm as having quality hiring practices. Additionally, one evaluator may consider firms A and B to essentially have the same hiring practices while a different evaluator may consider firm A's practices to be materially better than firm B. To form an overall evaluation, each dimension will contribute some weight in the determination of whether a firm is responsible. An evaluator that belongs to a particular stakeholder group may weight hiring as critically important and therefore rate firm B as being further away from "Perfect"

[1]An objective distance would be agreed upon measureable difference, while a semantic distance would be idiosyncratic, "I feel that this firm does a good (or bad) job of using locally sourced produce."

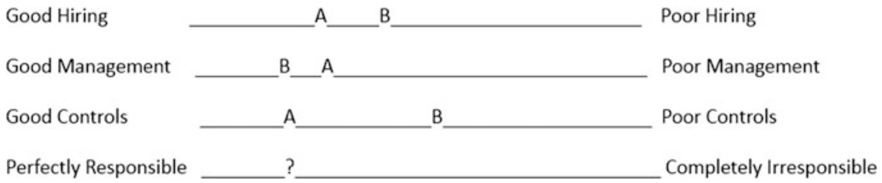

Fig. 4.1 Sustainability criteria

endpoint, while a supplier might consider the quality of management as more relevant and consider B to be much closer to "Perfect" than A. Even if there were only a few criteria to consider when making a determination about a firm's socially responsible or sustainable practices, then the consideration of an overall sustainability or social responsible rating would still be hard; however, there are many criteria that could be considered in making an overall evaluation of a firm.

In Fig. 4.2, the criteria from the (GRI 2011) are listed. Only a few of them might be considered as attributes that could be assigned values, while most are processes.

TABLE 1: CATEGORIES AND ASPECTS IN THE GUIDELINES

Category	Economic	Environmental
Aspects[III]	• Economic Performance • Market Presence • Indirect Economic Impacts • Procurement Practices	• Materials • Energy • Water • Biodiversity • Emissions • Effluents and Waste • Products and Services • Compliance • Transport • Overall • Supplier Environmental Assessment • Environmental Grievance Mechanisms

Category	Social			
Sub-Categories	Labor Practices and Decent Work	Human Rights	Society	Product Responsibility
Aspects[III]	• Employment • Labor/Management Relations • Occupational Health and Safety • Training and Education • Diversity and Equal Opportunity • Equal Remuneration for Women and Men • Supplier Assessment for Labor Practices • Labor Practices Grievance Mechanisms	• Investment • Non-discrimination • Freedom of Association and Collective Bargaining • Child Labor • Forced or Compulsory Labor • Security Practices • Indigenous Rights • Assessment • Supplier Human Rights Assessment • Human Rights Grievance Mechanisms	• Local Communities • Anti-corruption • Public Policy • Anti-competitive Behavior • Compliance • Supplier Assessment for Impacts on Society • Grievance Mechanisms for Impacts on Society	• Customer Health and Safety • Product and Service Labeling • Marketing Communications • Customer Privacy • Compliance

Fig. 4.2 GRI criteria

For instance, the attribute “human rights investment” might have a single dollar amount for its value, while for the “society anti-corruption” an evaluation might entail assurance that has a process in place to review areas of the company susceptible to offering bribes. The Dodd–Frank legislation (United States Congress, 2010) requires companies to ensure that they do not have conflict minerals in their product and to ensure they follow socially responsible practices with respect to their supply chain. Because the review of a firm’s entire supply chain can be quite difficult, SEC (2012) recommends that companies follow OECD guidelines with respect to conducting their reviews with due diligence (OECD 2013). If a single reporting framework is used, the problem of having multiple reports is alleviated (Adams and Narayanan 2007; Fornaro 2011; Securities and Exchange Commission 2010); however, the weighting of each attribute (Clarkson 1995) still depends on different stakeholders (or groups) perceptions of what exactly is important and coming to a sustainability measure.

4.3 What Measures of Social Responsibility Are Important?

Each group of stakeholders has a different set of information they use to conclude whether or not to support the firm. Some of this information does not come directly from formal reports, but from informal information channels. For instance, Madden et al. (2012) found that consumers making purchase decisions look at the characteristics of one of the firm’s products and project these characteristics to the firm’s other products. While Maignan and Ferrell (2001) and others (Öberseder et al. 2013) have found that being perceived as a good corporate citizen can be an important marketing tool. For creditors, there is a concern that the firm will be held responsible for an environmental problem which would impact the firm’s ability to repay their debts (Heyes 1996). Therefore, many banks use CSR reports with environmental data when considering loan rates (Thompson and Cowton 2004). For employees, there is evidence they use CSR information when considering prospective employers (Backhous et al. 2002) and that employer social responsibility practices increase the satisfaction of employees (Bauman and Skitka 2012; Riordan et al. 1997; Turban and Greening 1996). Finally, there is also evidence of a “halo” effect as quality financial statements have been shown to impact stakeholders’ perceptions of the quality of the overall CSR report (Akisik and Gal 2014). Given the importance that various stakeholders place on the firm’s social responsibility and sustainability information, there is a question of what values should be considered most important and whether firms should produce a single comprehensive report.

The disclosure of CSR and sustainability information does change the perception that stakeholders have of a corporation. However, they may not use the information contained in a CSR report directly in making a conclusion about the firm. There is evidence that stakeholders consider the CSR reports, particularly in GRI format, too complicated and therefore use reviews of these reports rather than the information

in the report (Akisik and Gal 2014). With evidence that different stakeholder groups use different information in making their evaluation, it raises the question of which information is most important. Is it the credibility attached to the company simply as a result of the release of CSR information (Herzig and Schaltegger 2006)? Is it the review of the reports that have accepted coverage of CSR attributes (Akisik and Gal 2014)? Or is it the release of information through other channels such as marketing communications (Madden et al. 2012) or government disclosures (Khanna and Quimio 1998)? If each of these methods of disclosure impact different stakeholders' perceptions of the firm, then it is important to consider how values for each of these types of disclosure are derived.

Firms have started to produce CSR information because it makes them appear to be a legitimate member of society (Hooghiemstra 2000).[2] So perhaps they make efforts to produce this non-financial information simply to appear as a good citizen. Information from GRI indicates that not all firms seek to have a review of their CSR reports prepared under their guidelines. This implies that firms do recognize the importance of simply producing a CSR report. There are also firms which do take the additional step to have their reports reviewed, but reviews of GRI reports are based on the degree of topics covered and not on the quality of the information. Thus, there are incentives to firms to simply make CSR information available to stakeholders. While there is also evidence that stakeholders use information which is not strictly released by a firm, it is clear that information released by a firm is used by stakeholders. This research seems to satisfy the first two conditions for a fraud to have occurred: Is there evidence that the firm considers CSR to have a material impact on stakeholders' decisions? Or in other words, firms do intend that stakeholders use this information for making a financially relevant decision (Silverstone and Sheetz 2007).[3] If firms do intend for stakeholders to use this information, then the next question is whether the irregularities in the information disclosed by corporations can be measured and attributed to intentional actions of the firm. The next section will look at this issue.

4.4 How Can We Measure Irregularities in These Communications?

For financial information, we have a standard to judge whether the information is not correct. The concept of materiality (Financial Accounting Standards Board 2008) applies to the overall accuracy of the statement. Any difference or omission

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[2]Initiating a process of communicating CSR information may backfire if the firm stops producing this information or if the release is temporally proximate to some irresponsible event (Morsing et al. 2008).

[3]Even if CSR information is not quantitatively material if it can be shown to be used it may be qualitatively material (Securities Exchange Commission 1999).

in a financial statement that would cause a user to change their decision or perception would be considered material. Given that CSR information does impact stakeholder decisions about whether to loan funds, to buy products, or to seek employment, it is clear that the information is relevant. In addition, there seems to be evidence that certain CSR information is not completely accurate (Time 2010). However, there is little evidence to establish the size of the difference that would cause stakeholders to change their decisions.

There is evidence that certain information classified as CSR or non-financial does have financial relevancy, and that stakeholders might find this information relevant in making decisions. For instance, BP settled the claims in the Deepwater Horizon oil spill for $18.7 billion. From the available information, it is clear that BP and Haliburton could have taken steps to either eliminate or alleviate some of the impact of this spill and mitigate both the financial and the environmental impacts. At the minimum, it seems that it would have been appropriate for these firms to disclose the cost savings that resulted from not using methods that might have mitigated the impact of the spill. Certainly this information would be hard to disclose in traditional financial statements. However, BP has produced sustainability reports using the GRI framework for a number of years and they were reviewed by external parties (2007 report had an A+ rating). Their A+ rating indicates a high level of coverage of the GRI categories. So the question can be raised by all stakeholders: Could not the fact that steps were not taken to protect the financial health of the firm and the environmental health of the Gulf of Mexico be considered a material? Would stakeholders have made different decisions or induced BP to take different decisions had they known this information? It probably can be argued that the answers to these questions are yes; shareholders and other stakeholders would have considered this information in their decisions and therefore it was material information and not disclosed. This satisfies conditions for a fraudulent disclosure; it is material, they intended people to rely on reports that had material information omitted; there were material omissions of fact, and there were damages. While this situation seems to be quite obvious, for other situations the determination of whether a CSR disclosure has irregularities is not as straightforward.

In addition to GRI reports, such as the one filed by BP, firms use other methods to communicate their social responsibility of sustainability intentions. Two important methods used to influence consumers' perceptions of a firm are through product labels and various types of commercials.

Figure 4.3 shows two products that use the term "Natural" on their label. The purpose of this labeling is to induce consumers to buy these products. Research has shown that information provided on one of a firm's products can induce consumers to attach this attribute to other products from the firm (Madden et al. 2012). This research indicates that not only might this labeling induce consumers to buy this product, but consumers might consider the firms other products as having the same quality. A problem with this labeling is that under US consumer protection statutes there is not an accepted definition of the word "natural," and therefore, a company cannot be held responsible for using this and other similar terms (Federal Trade

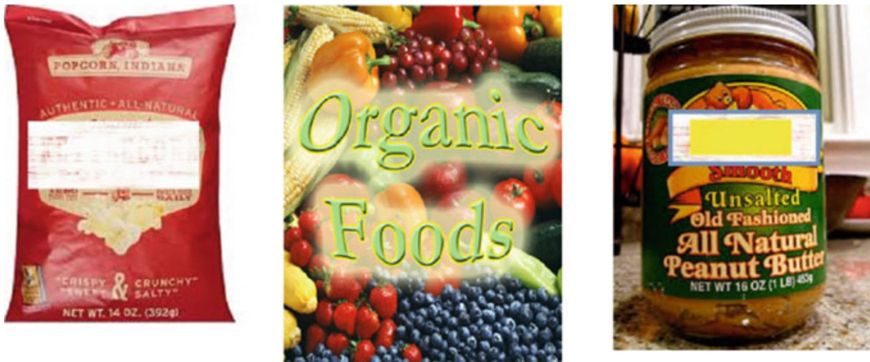

Fig. 4.3 Product information

Commission n.d.; Perks et al. 2013). Thus, while there is an intention to have consumers rely on this information in making their purchase decisions, there is no objective method to determine that the term was materially false, and certainly no way to determine damages. Other actions by firms that could probably be considered materially false with respect to the CSR practices are even harder to evaluate.

In some industries, it is the collective actions of all firms that produce non-sustainable practices. One example is the fishing industry. Each firm can use sustainable practices, but the combination of activities for all the firms in the industry can produce a non-sustainable result worldwide (Sala 2014). This result can even occur if countries take certain actions to require firms under their control to take steps they consider sustainable in conflict with perceptions of what other countries consider appropriate. In the fishing industry, this is particularly apparent as Japan has a different view of appropriate fishing practices than that of the USA. While overfishing certainly can be considered as a non-sustainable business practice, there are other actions taken by firms which would also probably not be socially responsible.

Using the categories from the GRI framework, there are other examples of firms' actions or in-actions that would make stakeholders question a firm's CSR. For instance, would stakeholders consider a firm that takes kickbacks from firms that rely on their testing procedures or falsifies background checks to be appropriate (Carreyrou and McGinty 2014; Fitzgerald 2105)? If it were not possible to rely on the results of medical tests, this certainly has implications that are not strictly financial, but would significantly impact other stakeholders. Another issue that has become increasingly important for all stakeholders is the security of firm's information system (Banjo and Yadron 2014). If a firm has not taken all appropriate steps to secure their corporate data, this can lead to loss of trade secrets and consumer information. One of the attributes for CSR communications under the GRI framework is security. While security of consumer information might be included in this category, firms are quite reluctant to disclose information about

their information security practices or any information about the information security initiatives at their firm. This means that stakeholders are only informed of the inadequate measures as indicated by a security breach at the firm.

This section has looked at various CSR issues that stakeholders probably would consider to be material; i.e., if they had the information, they would have changed their decisions regarding the firm. There are many situations in which omission of information leads to a material misstatement of information about the firm. So in many cases, there is substantial evidence that there is a basis for a decision that these actions were intentionally misleading: a condition for the action to be considered fraudulent. In the next section, the final part of determining a fraud, damages, will be examined.

4.5 Can We Measure Damages?

The final component of determining whether a fraud has occurred is to determine damages. Without damages there cannot be any compensation to the party that presumably relied on a material misstatement or omission. However, in CSR or sustainability misstatements that are material this is the most problematic factor. For instance, for the Deepwater Horizon oil spill there is an $18.7 billion dollar fine levied against BP. These funds are going to the people whose property was damaged or whose income was disrupted due to the spill. However, it is not clear that all other stakeholders have been compensated (Kent 2015). Shareholders obtained returns that might be higher than the returns had BP taken all steps necessary, and incurred the costs, to avoid the spill. So their reduced returns in the future, due to the fine, may actually not completely offset the higher returns of the past (Clarkson 1995). For debtors, the ability of BP to repay them may not be impaired, but there is evidence that environmental risks usually result in higher loan rates (Heyes 1996), and it is not clear that creditors had the information to adjust the rates. For other omissions or misstatements, the damages are even harder to determine.

For the non-sustainable actions taken by a collection of firms in an industry, the damages might be hard to apportion. In the USA, the impact of pollution from coal-fired power plants has been addressed at the national level, but the damages to individuals is hard to measure and may not be centered on the states where the plants are actually located (Harder and Kendall 2015). Attempts to mitigate the damages from this industry are met with challenges due to the impact regulations will have on certain states and industries that may have to absorb damages not equal to the actions of firms in their jurisdiction (Miller and Smith 2015). Measuring and collecting damages are difficult within single country, but when the actions are felt across international borders the process of enforcement is made almost impossible (Spegele 2015). In these first two cases, there are some actual damages which while difficult conceptually can be measured. However, in other cases damages may not even be agreed upon, let alone calculable.

There is evidence that consumers do make decisions about products based on the types, CSR and sustainability communications. Further, they tend to follow opinion leaders in making certain purchase decisions (Brown and Dacin 1997; Chan and Misra 1990; Homburg et al. 2005). Therefore, the inappropriate use of terms like "Natural" can lead to purchasing behaviors that may not be made if accurate information was delivered. Even if it can be concluded that firms use inaccurate terms meant to induce purchase of a product, determining damages is difficult. An examination of the Federal Trade Commission's cases does not reveal any actions in these situations (Federal Trade Commission).

By any measure, the number of reported cyberattacks is increasing. When a data breach is reported, firms usually are required to provide some sort of support to individuals whose information is acquired. While this can mitigate the damage to consumers in terms of identity theft and provide support for possible attempts to use their personal information in the future, other stakeholders might have less obvious damages. Providing support for individuals that had their personal data taken deals solely with damages to consumers, but there is evidence that poor information security can result in damages to other stakeholders. If a data breach is related to intellectual property, then the impact is much greater as this information may reduce a firm's competitive advantage. This loss of competitive advantage could impact both shareholders and employees (Cilluffo and Cardash 2015), and in this situation damages is difficult to determine.

These various actions can impact CSR and sustainability performance of a firm. While there are different stakeholders that could claim to have been damaged in each of these situations, there is a difficulty in making precise calculations. This is certainly a requirement to make a determination that a fraud has occurred. There is a question though that if the calculations of damages are difficult should this alleviate firms from the requirement to disclose information relevant for stakeholders? Would these disclosures allow for stakeholders to make a determination that one company has a better CSR or sustainability record? Finally, if this information is relevant in decision making for stakeholder groups should this information be reviewed in much the same way that financial information is reviewed? A final issue that has become relevant in this discussion concerns unintended consequences of the importance of CSR and sustainability disclosures.

4.6 Are There Unintended Consequences of Stakeholders Interest in CSR Information?

There is certainly ample evidence that firms recognize the importance different stakeholders place on CSR and sustainability information (Lin and Chasan 2015). However, there is also evidence that these requirements are creating unintended consequences. One example is the impact of the requirement of the Dodd–Frank Act to produce information on conflict minerals (United States Congress 2010)

as firms have run up extensive costs to investigate their supply chains (Chasan and Maxwell 2014a, b). This cost may be one reason that firms have gone to court to eliminate the requirement to disclose the minerals used in their production processes (Chasan 2015). Other examples of some consequences include the manipulations and misreporting of the trading of carbon credits (Henning 2015), and labeling products such as salt as being "GMO" free (Brat 2015). Finally, there is some evidence that firms are buying finished goods from certain suppliers so they can claim that they have no knowledge of the production process. This gives them a measure of plausible deniability in their use of processes that are not sustainable or socially responsible; instead, there is a possibility that some unknown supplier used non-sustainable processes. Stakeholders' interest in the disclosure requirements may be inducing firms to move part of their operations to locations that do not have the same regulations and disclosure mandates.

4.7 Conclusions

Stakeholders are concerned with the social responsibility and sustainability practices of both firms and governments. As economies become more developed, the practices of firms become paramount as governments play a greater role in developing and enforcing regulations. If a firm recognizes that producing favorable CSR and sustainability information can enhance different stakeholders perceptions about the firm and its products, then they have an incentive to produce this information. If their actual practices match the information contained in these disclosures, then stakeholders can take appropriate decisions related to their support of the firm. However, there is evidence that in some cases the information disclosed (or omitted) is materially different from their actual activities. These two conditions providing information that is materially different from the firm's actual CSR and sustainability actions combined with an intent to have stakeholders use this information in making decisions that are favorable to the firm meet conditions for a conclusion that the firm's actions are fraudulent. However, there is also a requirement that damages be determined for an action to be considered fraudulent. This is perhaps the most problematic as in most situations the calculation and appropriation of damages to specific stakeholders is extremely difficult. Instead, regulators impose fines which, while meant to punish firms, clearly do not find their way to the parties that relied on the material misstatement or omission. While there is concern by various stakeholders that firms use responsible and sustainable practices, there are problems with agreeing what practices are most important. Additionally, stakeholders need to have knowledge of sustainable and responsible practices that are not necessarily restricted to those within certain borders. For stakeholders to provide support to those firms whose practices they consider appropriate, CSR information must be readily available and as accurate as possible. Until this happens, firms have an incentive to disclose information that is most advantageous to their success.

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