

SUSTAINABILITY AND INTEGRATED REPORTING FOR SCHOKOTASTIK COMPANY – A CASE EXPLORING ETHICAL ISSUES

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CASE DESCRIPTION

The primary subject matter of this case involves ethical issues in the context of sustainability and integrated reporting. The case explores sustainability-related reporting issues and presents an ethical dilemma faced by a junior accounting professional who is a member of the sustainability reporting team of a privately-held growing company. Secondly, the case provides an opportunity for students to gain knowledge and understanding of the global importance of sustainability and integrated reporting, the availability of reporting guidelines, and related issues that may arise.

The case has a difficulty level of four to five and can be taught in about 30 minutes. The case can be assigned as a group or as an individual project. Approximately two hours of outside preparation are necessary for students to fully address all questions in a group setting. The case can be used in an upper division or graduate accounting ethics course focusing primarily on ethical aspects, an international accounting course focusing on sustainability reporting issues, or another graduate business course focusing on corporate responsibility aspects. This case may enhance students' knowledge and understanding of sustainability-related reporting issues and potential ethical considerations that may arise; it also may enhance students' technical, communication, analytical, and research skills.

CASE SYNOPSIS

Sustainability and integrated reporting, which combines sustainability-related information with financial results, represent globally important trends. Diverse stakeholders expect that organizations of all types and sizes operate in a responsible manner and that they report reliable information about their effect on the environment, the availability of scarce resources, their employees, and the community in which they operate. Reporting of sustainability-related information continues to accelerate and is mandatory in an increasing number of nations. Reporting guidelines such as those developed by the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC), and the U.S.-based Sustainability Standards Board (SASB) provide the necessary foundation for high quality comparable reporting that is useful to decision makers.

This teaching case explores sustainability and integrated reporting in the context of a U.S. based privately-held fictitious company that manufactures European-style chocolate products. The case scenario includes information regarding the organization's sustainability-related priorities, its goals and achievements, and presents a sustainability reporting related ethical dilemma faced by a junior member of the sustainability reporting team. The objective of the case is to spark students' interest in sustainability-related reporting issues, to consider related standards and guidelines, and to explore ethical considerations. The assignments consist of case-specific as well

as research questions which are largely independent providing flexibility for instructors utilizing the case.

This case can be utilized in an accounting ethics or professional ethics course, an international accounting course, or in another upper division business course. The case is suitable for courses taught in traditional, blended, or online learning environments. Use of this case may enhance students' sustainability and corporate disclosure related knowledge; their awareness of related ethical considerations and professional ethics guidelines; and may enhance their analytical, research, and communication skills.

THE CASE*

Karina Schuester recently graduated with a masters' degree in accounting from a well-known state university in California. While a junior in college, she envisioned her future working as an auditor or consultant in a global accounting firm. After extensive networking with professionals, she realized that such a career would not provide her with the work-life-balance that she envisioned; yet, she was looking forward to a career that required continuous professional and intellectual growth opportunities and an innovative environment, while working with highly ethical associates.

During her first semester in graduate school, Karina enrolled in an International Accounting course, which in addition to extensive discussions of International Financial Reporting Standards (IFRS), also included discussions of corporate social responsibility (CSR) reporting, often referred to as sustainability reporting. Karina learned that a continually increasing number of companies of all types and sizes and across many industries, are formally reporting their sustainability-related activities to their stakeholders. She further learned that this reflects a global trend embraced by a growing number of countries and stock exchanges, some requiring mandatory reporting and in some instances integration of sustainability information with financial reports.

Karina's interest in this topic motivated her to write her course research project on sustainability and integrated reporting. During her research, Karina learned that in some countries, integrated reporting, which entails combining and integrating information related to sustainability with traditionally reported financial information, is required (Ernst & Young, 2015). The related research and her analysis further heightened her interest in this reporting area. She decided that she wants to work for an employer that provides her with opportunities to further enhance her understanding of sustainability and/or integrated reporting, as well as financial reporting, and ultimately enable her to participate in sustainability-related analysis and reporting.

While she was happy with her decision, she decided to further enhance her future opportunities. During her last year in graduate school, she prepared for and successfully passed all parts of the Certified Public Accountant (CPA) examination. She also planned to sit for the Certified Management Accounting (CMA) examination soon after graduation. During her junior year in college, she had joined the American Institute of CPAs (AICPA) and the Institute of Management Accountants (IMA) as a student member.

Karina's Career Search

Karina started searching for a potential future employer that fits her career objectives. Her thorough research, which included review of companies' financial statements as well as any published reports relating to sustainability, resulted in her interviewing with six firms. During each

interview she expressed her interest in sustainability-related analysis and reporting. She received four attractive offers to join the financial reporting team at each company. She pondered the advantages of each offer.

One of the offers she strongly considered was from “Schokotastik,” a privately-held small/mid-size company that specializes in the production and distribution of high-quality chocolate products. During her meeting with Schokotastik’s Chief Financial Officer (CFO), Robert Conner, she expressed her desire to be involved with sustainability reporting; Robert appreciated Karina’s enthusiasm and indicated to her that if she joined Schokotastik’s financial accounting department, she would eventually have the opportunity to work closely with the company’s sustainability officer. Robert also showed Karina the company’s forthcoming sustainability report that set forth the company’s sustainability-related achievements as well as future sustainability targets. Karina was impressed by the apparently strong commitment of the company to sourcing, producing, and distributing its products in a continually enhanced sustainable manner. This positive impression was further strengthened after Karina met the founder of the Company, Emelia Meisner. Karina seriously considered Schokotastik’s offer. She received samples of the company’s products to take home to enjoy.

Karina grew up in Europe, enjoying European-style chocolate such as “Kinderschokolade” and “Nutella,” produced by the well-known Italian company Ferrero; and Lindor Truffles, produced by Lindt and Spruengli, a company known for its exceptionally creamy and delicious chocolate products. So far, she had been unable to find a U.S. based brand of chocolate that she enjoys quite as much as the chocolate she was accustomed to while living in Europe. After tasting Schokotastik’s chocolate, she decided that she had finally found chocolate as enjoyable as the brands she enjoyed while she was growing up in Europe. More importantly to her career aspirations, she believed that Schokotastik would become a very important and successful company in the specialty food industry in the U.S. that will continue to distinguish itself through its excellent products and responsible operations. Karina was excited about the opportunity to contribute to their goals and accepted the offer to join the company as a staff accountant.

Sustainability Goals and Achievements at Schokotastik

Schokotastik founder and Chief Executive Officer (CEO), Emelia Meisner has a strong commitment to sustainability. This extends into her private, as well as her corporate life. She began her career working for a large multi-national company operating primarily in the food and beverage industry. Seven years ago, she realized her life-long dream to start her own company and to sustainably produce highest quality specialty food products. As a connoisseur of fine chocolate, her aspiration was to start a company that would eventually be able to compete with industry leaders, such as Hershey and Mars. She believed that even though there are several major U.S. based companies and a number of well-known European companies in the industry, Schokotastik would be able to compete effectively by focusing on her company’s core mission, which is “to produce high-quality delicious chocolates in the U.S., using sustainable materials and processes and support the local community.”

After overcoming initial struggles and with the support of several private investors who believed in her company’s vision, Emilia was able to establish a niche with steadily increasing market share. The company’s effective marketing and distribution strategy, which includes a focus on the company’s commitment to sustainability, has resulted in steadily increasing sales and profitability. Two of its bestselling chocolates are “White Chocolate Infinity,” which is described

as white chocolate with a center covered with colorful sprinkles and surrounded by a milk chocolate shell; and “Black Forest Chocolate Rush” which is described as milk chocolate with cherry and kirsch in the center, surrounded by a white chocolate shell and covered by caramelized hazelnut pieces.

Encouraged by the success of its high quality chocolates, eight months ago, the company launched a new product line – a selection of high-quality cookies. One of the differentiating characteristics of these cookies is that they are simple and delicious with a small number of all-natural ingredients. All of the cookies include premium chocolate and more than half include hazelnuts or almonds. Promotion of the cookies emphasizes the small number of natural ingredients and the company’s adherence to a high level of sustainable practices and animal welfare.

The company recently began exploring potential opportunities to market its products at large membership-based chains. One promising avenue the company explored is selling selected products during high-demand seasons at weekly “roadshows” at Costco.

The company’s private investors were especially attracted by the CEO’s promises to implement and commit to high levels of sustainability. While since its inception, the company prominently focuses on sustainability in all its promotional campaigns, it also includes information about its sustainability-related programs in its formal financial reports. Initially, the company reported on major sustainability goals, but has recently started to include a six-page section on sustainability with its annual report.

Karina’s Experience Working for Schokotastik

Karina started working with great enthusiasm. She felt comfortable with her workspace and most importantly, the professionals she worked with. She immediately established positive rapport with her immediate supervisor, Jack Neumann, the company’s controller. She had the opportunity to gain knowledge about the entire internal and external reporting processes and after a few months at Schokotastik, she felt that she had contributed to the accounting and reporting function. She has become an engaged member of the financial reporting team.

In anticipation of future financing opportunities needed for continuing expansion, the company’s board of directors decided to have its financial statements audited by an external financial auditor. At the beginning of the current year, which is also the beginning of the company’s fiscal period, Karina started assisting with the financial statement audit, functioning as primary contact person for the auditors. As part of this role, she assisted with the retrieval of needed documentation and prepared requested schedules and reports. During this process, she retrieved documentation related to long-term purchase commitments for raw materials, such as cocoa, eggs, butter, and nuts, which are key ingredients for the company’s products.

In March, Karina learned that she will be working with the sustainability manager, Margaret Barton. She was delighted about this opportunity and sent an email to Ms. Barton, who was at a conference, requesting a meeting to discuss her new responsibilities. A few days later, she met with Margaret. Karina immediately liked Margaret, and she discovered that they share similar attitudes concerning the importance of sustainability with respect to responsible interactions with nature, the environment, and with people; as well as the humane treatment of animals.

Karina familiarized herself with Schokotastik’s updated sustainability priorities and learned the following:

Schokotastik reports on the following priority sustainability goals and achievements related to its manufacturing processes:

- 1) Fully traceable cocoa
- 2) Fully traceable nuts
- 3) All eggs derived from cage free chickens, with at least 60% organic sourcing by 2022
- 4) 100% natural refined sugars
- 5) Zero or near zero workplace injuries
- 6) 40% reduction in water use between 2015 and 2025
- 7) 90% of waste recycled by 2025
- 8) 30% decrease in CO₂ emissions between 2015 and 2025
- 9) 0% food safety related incidents
- 10) Donations of 2% of its products to support community events

Margaret informed Karina that her major responsibilities during the first few weeks would involve gathering of information on the company's achievements thus far and its progress toward the articulation of future goals. This included reviewing reports received from various departments, communicating with department representatives to gather additional information as needed, and summarizing the findings in both narrative and graphic format. Karina started working on compiling the information received from other Departments; and asked Department heads for additional information as needed for her report to Margaret.

One of the facts Karina noticed while reviewing Schokotastik's key sustainability goals was that a number of issues that she personally perceives of high priority were not included in the company's goals. For example, she noticed that investment in renewable energy and empowering women was not included in the company's primary sustainability-related goals. Karina asked Margaret, why these were not part of Schokotastik's sustainability goals. Margaret explained that the stated sustainability goals were initial (stage I) goals, which would later be expanded to include other important goals. Stage I goals focused on environmental and product safety issues. During stage II, additional broad goals would include a focus on community engagement; investment in renewable energy; and employee-focused perspectives, such as gender representation, and expanded employee wellness programs.

Karina's Review of the Recent Report

During her review of the most recent report, Karina noticed that it indicates that by 2022, all eggs used in the company's manufacturing processes will be sourced from cage-free chickens. She suddenly realized that as part of her work with the external auditors a few months ago, she had reviewed a new four-year purchase contract with a vendor who offered quite favorable terms and who will supply about 18% of the company's projected needs for fresh eggs for the next four years. She recalled the name of the company and to her surprise, she discovered that the vendor currently houses its chickens exclusively in cages. Karina strongly opposes what she considers an inhumane practice.

That same afternoon, she brought this to Margaret's attention. Margaret promised to check into this apparent discrepancy. A few days later, Karina asked Margaret whether she was able to find out more about the situation and Margaret told her not to be concerned about this. The sourcing/purchasing department has promised to "look into this issue." Karina was not satisfied with the answer, but did not know how to resolve the issue. She continued her work, with a degree of distraction. She respects and likes Margaret and wished that she could leave this issue for

Margaret to address. However, she felt that she has an ethical responsibility to address this discrepancy herself.

Meeting of the Board of Directors

One week later, Schokotastik's members of the board of directors met for their regular quarterly meeting. One of the items on the agenda was for Margaret to provide an update on the company's progress toward meeting the sustainability-related goals. Margaret invited Karina to attend, both for the experience and to take notes relevant to sustainability. Karina naturally was excited about this opportunity and looked forward to her participation.

On Tuesday morning, the board meeting commenced punctually. The President, CEO, CFO, and Chief Operating Officer (COO) provided updates on operational and financial achievements and on future strategies and initiatives. The distribution manager, proudly reported that "Roadshows" have been scheduled at 14 different Costco locations starting late November through the beginning of December, a season which traditionally shows sharply increasing sales of chocolate products. During the "Roadshows," company representatives will promote and sell an assortment of the company's most popular products. The company hopes that Costco will eventually carry some of its products on a regular basis.

The CEO reported that he has received a very promising inquiry from a well-known venture capital investor with a reputation for investing only in socially responsible companies. The amount discussed would allow the company to expand its manufacturing facility and its product lines, as well as enhance its marketing and distribution budgets. The board members tentatively authorized the expansion, contingent on the company reaching a beneficial agreement with the potential new investor. The board members also voted to voluntarily adopt and comply with financial reporting rules consistent with public company Generally Acceptable Accounting Principles (GAAP) and to continue to include sustainability-related information in their annual report.

In her role as sustainability director, Margaret provided board members and company executives with an update on their progress towards achieving the company's sustainability goals. Margaret included some highlights of recent achievements and closed with the statement that she was confident that all sustainability-related goals will either be met or exceeded.

After the Board Meeting

After the board meeting, Karina silently walked back to Margaret's office. Margaret asked Karina to sit down and said: "I can see that you are troubled by my report to the board of directors." Karina responded: "I don't understand why you did not mention that we are not going to meet the target of sourcing 100% of eggs from cage-free chickens." Margaret responded that she discussed this with the COO prior to the meeting and that he strongly recommended that she not bring up this point. He also promised to review the long-term purchase agreements and, if necessary, will void the contracts. Karina responded: "but there are steep penalties, if we rescind the contract; shouldn't we disclose this in our annual report?" Margaret responded that the board tends to deal with broad issues and strategies and not day-to-day operations, nor small details. She asked Karina not to worry about this.

The Challenge

Pretend that you are in Karina's position.

1. Identify the accounting/reporting issues that Karina should consider.
2. Explore the ethical issues that Karina faces and briefly describe the potential solutions to the ethical dilemma.
3. As an accountant, what ethical guidelines or standards should Karina consider? Please cite the guidelines and relate specific guidance to the issue Karina faces.
4. If you were in Karina's position, what would you do?
5. Consider your answer to question 4 and describe the possible implications of your decision for (a) the company and (b) for Karina.

Author's Note:

*The case deals with a fictitious company; any similarities with real companies, individuals, and situations are purely coincidental.