

Sustainability Reporting & Assurance **– trends, challenges and perspectives**



Reprint of:

Sustainability Reporting adds good value to business and society

Published in:

- 1) World Finance at the United Nations World Summit on Sustainable Development, September 2002
Published by HBL Media Ltd
- 2) OECD and the World Economy: Trends, prospects and statistics 2002–2003, October 2002
Published by OECD

Towards Assurance on Sustainability Reports

Published in:

AccountAbility Quarterly, July 2002

Published by AccountAbility/Institute of Social and Ethical Accountability, July 2002

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Companies need to help their customers, employees, investors and stakeholders understand how well significant risk and opportunities arising from the sustainability agenda are being addressed, argues Preben Soerensen.

As poverty continues to be a serious global issue and threats to societal environmental assets such as access to fresh water, clean air, and natural resources are becoming ever more severe, many are looking to business to be part of the solution. At the same time, business is undergoing a world-wide transformation, globalising its financing, workforces, supply chains, trading relationships, and information and communications technology.

As a consequence, the expectations of corporate responsibility in areas such as environmental protection, human rights, human capital, and product safety are rising rapidly. Key stakeholders such as shareholders, employees, and financial institutions want business to be responsible, accountable, and transparent.

Business leaders are increasingly acting upon this responsibility because it makes good business sense. It helps companies to mitigate risk, protect corporate brand, and gain competitive advantage while helping to reduce poverty and improve the quality of life for many. In extreme cases, companies may see their societal 'license to operate' threatened overnight if their key stakeholders perceive significant discrepancies between their own and the company's values. Shell, Nike and Monsanto have learned important lessons to that end.

Putting users in the picture

Reporting on these matters should give a clear picture of company values and principles, governance and management practice, performance, and help users to understand where the company is heading. Sustainability reporting, the annual evaluation of corporate performance in environmental, social and economic matters made available to the public, is largely still a voluntary exercise. In some European countries, disclosure requirements for annual reports introduce aspects of sustainable development issues. Over time, reporting on sustainable development issues related to the business will help users of annual reports to properly understand the business risks and future viability of the company. This will come about through generic disclosure requirements of annual reports.

Sustainability reports support a company's stakeholders when deciding whether or not they want to enter into a relationship with the organisation, be it as employees, customers, investors or in other capacities. While not all stakeholders actually read the reports, what counts for many is the fact that the company does report, that it addresses its responsibility in respect of sustainability issues and wants to show transparency.

Separate sustainability reports, also called environmental, social, corporate citizenship – triple bottom line – reports are usually produced on an annual basis. Such reporting is part of a company's overall communication programme and requires the joint efforts of many departments. This is often complicated and the undertaking will be unlikely to be successful without top management commitment, clear responsibility, and sufficient resources.

A useful sustainability report will help users to understand how well significant risk and opportunities arising from the sustainability agenda are being addressed and how well responses are integrated into business practice and procedures. This integration is a challenge to current traditional thinking and habits in many businesses concentrating mainly on short-term financial impacts.

Sustainability reporting is a part of, or a supplement to, any stakeholder dialogue a company may undertake as part of maintaining its societal licence to operate. It is not a replacement for this dialogue. Depending on the type of business and industry, there is often justification in reporting on governance and behaviour not only at a corporate level but also in reporting results and impact on society at local levels.

The Global Reporting Initiative (GRI), aiming to create a common framework for voluntary corporate sustainability reporting, has issued a set of sustainability reporting guidelines which give good guidance to organisations interested in producing a report. In addition, many inspirational state-of-the-art corporate sustainability reports are being produced which can also act as guidance. The continued advancement of such sustainability reporting guidelines, and more importantly, the continued experimentation of businesses to determine the most useful content, key indicators, and presentation of such reports, will raise the quality of sustainability reporting and make it much more useful for key stakeholders.

Common platform

While the GRI guidelines and current state-of-the-art practice is relatively well developed in respect of environmental issues, much needs to be done in reporting on social issues, the economic impacts on society, and the integration of the three areas into one report. In addition, the strength of many of today's reports is in describing performance within the boundaries of the companies' manufacturing sites.

It will be a real challenge for those who report to explore the scope of their impact on upstream (supplier related) supply chain issues related to human rights, environmental and societal impacts, and also in coping with the wider downstream (consumer related) impact of products and services. Thus, the wider societal footprint of the company and its activities and products is key in achieving useful and successful sustainability reporting.

When reporting, corporations should remember that it is always useful for users to track the actions, transactions and performance of the past 12 months in order to check whether management are actually doing what they have said they would do--"walk the talk". However, stakeholder focus, not least the focus of investors, will be on where the business is going in the future. For investors, this is because, in essence, it is the business circumstances and environment in the future and management's ability to respond effectively to future scenarios which determine today's monetary value of the business.

The new thing is that sustainable development issues will increasingly impact on the future business agenda. The Danish pharmaceutical group Novo Nordisk, in its 2001 triple bottom line report, provides an excellent example reporting on how the business views itself and its dilemmas in the context of the global health agenda.

Reporting on the wider economic societal impacts, including environmental impacts, is even more relevant when considering scenarios for medium and long term changes on rules and regulations, trade rules and international treaties – such as the Kyoto Protocol - which put a price on the cur-

Pricing the earth's assets

rently free environmental assets of the earth, and which may set quality criteria for environmental and social protection. The potential impact on business is huge as environmental and societal cost becomes internalised in products.

An interesting trend is emerging amongst companies prominent in the field of business and sustainable development who have now begun to integrate sustainability reporting into their annual report. Such a trend testifies to the importance that management attaches to sustainability issues. Good examples of integrated reports are the 2001 annual reports of Norwegian based conglomerate Norsk Hydro, Novartis, the Swiss pharmaceutical group, and France's Suez group. Such integrated reporting approaches are often supported by more detailed reporting targeting various audiences through printed and web-based media.

Sustainability reporting is fundamentally a sound business activity. Today, it is mainly driven by societal demands for corporate accountability and transparency but it may well soon become supported by an increasing amount of governmental regulation throughout the world as public and business readiness to acknowledge the value of formalised annual reporting on corporate performance matures. Responsible corporate conduct, accountability and transparency help companies to be better managed, attract talent, and maintain their societal license to operate.

Towards Assurance on Sustainability Reports

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In recent years, Deloitte has been involved, alongside other big auditing firms, in what is often referred to as ‘verification’ of sustainability reports. This business undertaking has been growing in Europe, but is still only carried out by a minority of corporations and the scope of such an assignment is usually significantly less than the scope and depth of a statutory audit of a company’s financial statements.

The term ‘verification’ is being widely used to cover a broad range of third party statements delivered by a variety of types of firms and individuals. The term is not defined in professional literature and thus it is being used with the content that one chooses to apply. Users should be advised that current best practice is that:

- a company should always agree with the verifier what service and type of opinion it wants;
- the reader should read the ‘verification’ statements closely to ascertain the scope of the ‘verification’ and the procedures performed;
- the reader should also assess whether the verifier has shown the necessary independence, objectivity and competence.

This is not an ideal situation. Assuming that the concept of providing assurance to sustainability reports is useful for society, businesses and their stakeholders, the current lack of clarity and harmonisation is a major obstacle to broader application. There is clearly a risk of confusion and misinterpretation. I believe the way forward is not to try to standardise ‘verification’, but rather to build on the concept of assurance, well known from the auditing profession, and also applied by AccountAbility in its AA1000 series.

Users ideally want a high level of assurance that a sustainability report as a whole, gives a true and fair view (considering the objectives of the report) and adheres to suitable reporting criteria, and is free of material misstatements. Professional services firms like Deloitte & Touche have, in most cases, been precluded from providing such an engagement.

The reason is that generally accepted standards for auditing require that suitable reporting criteria are applied and no such suitable reporting criteria exist yet. Time will tell if the Sustainability Reporting Guidelines from GRI will become a basic framework for such suitable reporting criteria as is clearly the intention.

According to the International Federation of Auditors’ International Standard on Auditing 100 on Assurance Engagement: “Criteria are standards or benchmarks used to evaluate or measure the subject matter of an assurance engagement. Criteria are important in the reporting of a conclusion by [an assurance provider] as they establish and inform the intended user of the basis against which the subject matter has been evaluated or measured in forming the conclusion. Without this frame of reference any conclusion is open to individual interpretation and misunderstanding. Criteria in an assurance engagement need to be suitable to enable reasonably consistent evaluation or measurement of the subject matter within the context of professional judgement.”

The undefined verification

Lack of standards and guidelines

Even if it had been possible to perform a high level of assurance engagement, I doubt that up until now clients would have been ready to pay the higher fees for such an engagement or, indeed, whether an assurance provider would take on the engagement risk. This is because, in many cases, the conditions for performing in-depth evidence collection and evaluation have often not been in place (for example, there are often not sufficient internal systems, procedures and data processing controls).

In addition, there is not yet any consensus as to what competencies the sustainability report assurance provider should possess, or how the engagement should be performed. I believe, however, that the current ISA100 provide a good general basis for professional accountants to consider such services.

The purpose of assurance is basically to lend credibility to something that is under the control of one party and of interest and/or significance to another. The professional assurance provider comes into the picture as an independent, objective, third party and confirms the condition of the subject matter(s). This increase in credibility has typically turned out to be indispensable in respect of financial statements.

Such credibility will have to build on, and will not replace, the credibility inherent within the management of an organisation by means of their integrity, honesty and performance. Organisations may also improve the credibility of their undertakings and their assertions in sustainability reports by additional means, such as, by co-operation and dialogue with stakeholders.

Less than assurance on sustainability reports

As a result of these conditions, a particular form of independent engagement practice has emerged, so far most notably in Europe. Individual engagements identify certain objectives and related subject matters that are only sub-components of the report and/or of the process of preparing the report. In addition, an engagement often consists of procedures, agreed between the client and the service provider, that are only sub-components of the set of procedures and evaluations that would constitute a high level of assurance engagement (for example, providing a limited statement on the use of detailed procedures for the purpose of collecting, compiling, and validating the figures in the report, and on the consistency of this information at various levels, as identified or referred to).

Flexibility and current usability

The approach to ‘verification’ referred to above has provided a high degree of flexibility as to what was suitable and reasonable given the circumstances of individual companies. It was also a practical approach that allowed for getting started in a simple and cost-effective way and then eventually expanding on the objectives and scope of the ‘verification’ engagement over a period of years. As such, the quality and value of a ‘verification’ engagement could be improved along with improvements made over time in the quality and relevance of the sustainability report.

The drawback of current practice of ‘verification’ is that users of sustainability report must be cautious, and preferably even guided, in how to interpret the independent ‘verification’ statements. There is a risk of an ‘expectations’ gap in respect of the credibility of sustainability reports and the credibility of the ‘verification’ statements.

Our assurance-related work with sustainability reports is based on agreements with the client, i.e. setting the terms, scope and procedures to be followed. Such a service does not deliver the same high level of assurance as a full financial statement audit. However, it may be of great value in the eyes of the external readers and for the company’s management.

In our experience, the audit philosophy, principles and tools derived from the world of financial audit work well in this area. This entails all phases, from accepting the engagement to closing and concluding. Assurance engagement focuses on the risks of material misstatement using a risk based approach. While the subject matter of an engagement may be systems producing hard numbers, the essential elements to be tested are management and organisational behaviour and supporting systems, processes and practices. It goes without saying that an appropriate multi-disciplinary team is a prerequisite.

Deloitte experience

AccountAbility has started on a very ambitious journey. The AA1000S module on assurance addresses many of the issues and aspects that society, the reporting companies, the users and the assurance providers need to understand much more clearly. At this stage, though, a number of elements in the module need further clarification.

AA 1000 Assurance Framework

The big challenge, however, is that it is not enough that terms and definitions are agreed on paper. Providing assurance is a professional service, an occupation or maybe even an art. Assurance is not defined by law. Professionals within specific professions, such as auditors, lawyers or doctors, argue from time to time about what constitutes good and appropriate practice. Achieving such consensus amongst not only a number of different professions with different technical disciplines and perspectives, but also with various NGO type constituencies will indeed be a huge challenge. In addition, one would have to consider the different legal frameworks that regulate each profession (including their liabilities), some of which are international but most of which are national. For example, professional accountants base their work on legislation and professional audit guidelines, including the International Federation of Auditors' framework of international standards on auditing.

There is a great need for collaboration between a broad range of constituencies to elevate the discipline of assurance on sustainability reports to higher levels. AccountAbility has taken steps to become a forum for such activities and, as such, deserves to be supported. I personally believe that developing the assurance of sustainability reports is timely, necessary and valuable to users. I also believe that this is a process of evolution, not revolution. Standards and/or guidelines should be derived from (best) practices, or at least not be too far away from such practices in order to be widely accepted by interested stakeholders.

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