Fédération des
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FEE Discussion Paper

Providing Assurance on

Sustainability Reports

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FEE

The Fédération des Experts Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe. It groups together 38 professional bodies from 26 countries, including all 15 Member States of the European Union and the 3 main member countries of EFTA. Between them, these bodies have a combined membership of 450.000 individuals, of whom approximately 95% are from EU countries. Roughly 45% of the accountants represented in FEE work in public practice, providing a wide range of services to clients. The other 55% work in various capacities in industry, commerce, government and education. FEE also co-operates with the professional organisations of Central and Eastern Europe, some of whom are already observer members of FEE.

FEE commenced operations on 1 January 1987. It took over responsibility for the activities previously carried out separately by the Union Européenne des Experts Comptables, Economiques et Financiers (UEC) and the Groupe d'Etudes des Experts Comptables de la CEE (Group d'Etudes). Both organisations had served the European accountancy profession since 1951 and 1961 respectively.

FOREWORD

In the run up to the forthcoming *Johannesburg 2002 - UN World Summit on Sustainable Development*, politicians, business leaders and community leaders are reviewing the progress made in realising the commitments made at the 'Earth Summit' in Rio de Janeiro, ten years ago. During those ten years, corporate sustainability reporting has evolved considerably, and today such reports typically include environmental, social and economic information.

I believe that FEE members' proven expertise in reporting and assurance provision is fundamental to the strengthening of these new forms of reporting. It is equally important that, as sustainability reporting continues to develop, preparers, assurers and stakeholders work together to agree upon the best sustainability reporting and assurance techniques.

This '**Discussion Paper Providing Assurance on Sustainability Reports**', focuses on a key element in the wide scale acceptance of sustainability reporting, namely independent, third party assurance provision. As an essential part of the reporting process, it is vital that preparers, stakeholders and other users are fully aware of the issues surrounding assurance provision. By issuing this paper, FEE's long-term goal is to raise the quality and the credibility of sustainability reporting.

The accountancy profession's relevant experience is an essential element in providing assurance on sustainability reports. Achieving generally accepted, high quality reporting requires an inclusive multidisciplinary approach, (indeed many accountancy firms already use multi-disciplinary teams when providing sustainability assurance). Therefore, FEE encourages multi-stakeholder dialogue on the issues raised in this paper.

Preparers, stakeholders and indeed society as a whole will benefit from enhanced sustainability reporting. I hope you find this paper informative and that you respond to the questions it poses.

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President
FEE

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1. INTRODUCTION

1. Although the Fédération des Experts Comptables Européens (FEE) is the representative organisation for the accountancy profession in Europe, this discussion paper is addressed to all those with an interest in sustainability reports. FEE recognises that individuals and organisations that are not accountants provide assurance on sustainability reports. Further, those firms of accountants providing such assurance necessarily include environmental and other experts in their multidisciplinary teams.

2. FEE would appreciate feedback from all parties with an interest in assurance including not only assurance providers, but also preparers and users of sustainability reports. The questions following each chapter set out the main issues on which feedback is sought, however FEE welcomes comments on any aspect of this discussion paper.

3. FEE has been active in drawing on the expertise of the European accountancy profession to improve the quality and credibility of new forms of reporting. In particular FEE has sought to improve the relevance and reliability of environmental reports by publishing proposals for a conceptual framework for environmental reporting[1]. That document helped guide the development of a significant initiative in sustainability reporting – the Global Reporting Initiative (GRI)[2].

4. In 1999, FEE issued a discussion paper on providing assurance on environmental reports and, in 2000, an analysis of responses to it. The present paper continues where the previous paper left off, and expands the discussion to include the recent trend towards sustainability reports: company reports that deal not only with environmental performance, but also the social and economic (not only financial) impacts of business[3]. It is hoped that the responses to this paper will allow FEE to establish a position on providing assurance on sustainability reports that will contribute to the work of those bodies active in this field.

5. The earlier paper dealt with all environmental disclosures whether in separate environmental reports or published in other ways (e.g. as part of the annual report and financial statements). In contrast, this paper only examines assurance on separate stand-alone sustainability reports.

6. Currently, sustainability reports appear in different formats with widely differing content, but there are moves towards harmonisation of sustainability reporting, for example the June 2000, Global Reporting Initiative, *Sustainability Reporting Guidelines on Economic, Environmental and Social Performance* (the GRI Guidelines). This paper does not include a detailed discussion of the form and content of sustainability reports or current reporting practice. However, Appendix 2 - *Literature* provides a list of the sources referred to in this paper and other materials, which may be used to gain a better understanding of sustainability and its reporting.

[1] These papers, and other publications referred to in this discussion paper, are listed in Appendix 1 – *Literature*.
[2] See http://www.globalreporting.org
[3] For simplicity, only the word 'company' is used throughout this discussion paper. The discussion paper is, however, also relevant to assurance on sustainability reports of other entities, such as governmental and not-for-profit entities.

7. The main factors influencing the discussion in this paper may be summarised as follows:

- as there are no statutory requirements for assurance on sustainability reports, a business case for assurance must be made

- sustainability reporting is still evolving and there are, as yet, no generally accepted format or contents of such reports

- there are no established ethical, procedural or reporting standards for providing assurance on sustainability reports[4]

- three different approaches: social, consultancy and accountancy, have been present in the historical development of assurance on sustainability reports

- the information in sustainability reports may not be of the right quality to allow meaningful assurance to be provided (immature corporate information systems, qualitative and subjective disclosures etc.).

8. Following this introductory Chapter are two background chapters summarising the relevant findings of the previous FEE discussion paper on environmental reports (Chapter 2) and discussing the nature of sustainability and sustainability reporting issues in general (Chapter 3).

9. Chapter 4 outlines the business case for assurance but also deals with its limitations. Chapter 5 provides a comprehensive overview of the assurance process, which leads to the detailed discussion (in Chapters 6 to 9) of several significant issues.

10. Chapter 10 examines the main themes arising in relation to sustainability performance measurement while subsequent chapters explore further issues relating to each of the three dimensions of sustainability: environment, social and economic (Chapters 11 to 13).

11. Chapter 14 – *Assurance reporting* concludes the discussion by examining the ways assurance may be communicated to users of the sustainability report.

12. FEE welcomes comments on any aspect of this discussion paper. Respondents' answers to the questions set out at the end of each chapter would be particularly helpful, but respondents are not expected to answer all questions. Where possible, views should be supported by reasoning and cross-referenced to the specific question or related paragraph(s) in the discussion paper. In addition, where not obvious from the identity of the respondent, a description of the viewpoint from which comments are made should be given.

13. Respondents may be preparers of sustainability reports or those considering preparing such a report, assurance providers or stakeholders, such as NGOs, employees or financial institutions. Viewpoints of respondents will vary and, as well as briefly describing their organisation (if any), it would be helpful if respondents could indicate the main themes underlying their comments. These are likely to be most easily stated by reference to the outcomes that the comments are seeking. The purpose of this discussion paper is to

[4] General standards may be found in International Standard on Auditing 100 *Assurance Engagements*, and some specific materials in *AccountAbility 1000 Framework* (AA1000) and *Social Accountability 8000* (SA8000). See Appendix 1 – *Literature* for further information.

encourage thinking about its subject matter and to facilitate sharing of views. The possible outcomes may impact sustainability assurance and allied fields such as reporting, social audit, auditing, financial reporting etc. There is an expectation that comments will be constructive and seek to improve the effectiveness and efficiency of assurance and allied fields. Time scales may well differ: some may highlight current difficulties that need resolution, others may want to chart an appropriate path forwards in the medium term, others will want to set out a vision to be realised in the future.

14. There are many questions that could have been included in this discussion paper but, for reasons of length, are not. Respondents should feel free to highlight other issues that they wish to comment on throughout the paper. These may be overarching matters that the paper has perhaps treated as an assumption (e.g. that assurance is beneficial), further consideration of the issues in Chapter 2 – *From environmental to sustainability issues*, matters that the paper has not covered at all (e.g. sustainability assurance and small companies), or simply matters of detail.

Comments to be received by FEE no later than 1 November 2002, should be addressed to:

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All comments will be treated as being on the public record and will be published on FEE's website: http://www.fee.be.

2. FROM ENVIRONMENTAL TO SUSTAINABILITY ISSUES

15. In October 1999, FEE published a discussion paper *Providing Assurance on Environmental Reports*. That paper identified important issues arising in the conduct of engagements to provide assurance on environmental reports. It sought general feedback and answers to specific questions. Comments on the discussion paper were received mainly from accountancy professional bodies. In October 2000, a summary of the responses was published. That document: *Analysis of Responses to FEE Discussion Paper 'Providing Assurance on Environmental Reports' published in October 1999* also presented FEE's conclusions. A selection of these conclusions is given below because they may also be relevant to providing assurance on sustainability reports.

16. The 1999 paper drew attention to the fact that, in practice, environmental reports were published in different ways, such as:

- stand-alone environmental reports, dealing with operations at site level or company level
- integrated with health and safety reports
- issued as part of a report on sustainability
- issued as part of the annual report containing the financial statements.

17. In contrast, this paper examines assurance on only separate stand-alone sustainability reports.

2.1 Issues highlighted by earlier discussion paper

18. On some issues raised in the 1999 paper a consensus arose or a conclusion was reached that can likely be extended to sustainability reporting. These findings are set out below and, in some cases, developed further in this paper.

Use of the term 'assurance engagement'

19. The term 'assurance' is preferable to terms such as 'verification' or 'review', which are also in use. This is because it avoids confusion with terms such as 'audit' and 'verification' that have more specialised meanings.

Providing high level assurance

20. The client and the assurance provider have to consider what level of assurance is to be provided, in particular whether this will be high or a lower level of assurance. The assurance provider has to assess what maximum level of assurance is possible in the light of the subject matter to the report, the criteria and the evidence reasonably likely to be available. Certain issues remain to be resolved:

- the lack of generally accepted criteria for environmental reporting
- the subjective and qualitative aspects of some reported matters
- the lack of reliability of quantitative environmental source data.

Competence

21. The assurance provider may achieve competence through the use of others with appropriate experience and expertise. Cooperation with experts in an assurance engagement may be organised in different ways. For example, the expert may be:

- employed by the assurance provider
- an independent individual (or firm)
- employed by the company. In this case the assurance provider recognises that such an individual is not independent of the company and introduces appropriate safeguards.

Responsibility for the assurance engagement

22. Where there are two or more assurance providers, e.g. an accountancy firm and an environmental consultancy, it was felt that separate reports should not be issued. Although there was no common view on which party should have ultimate responsibility, a single report could be signed by either or both parties. The report should specify the responsibilities of all parties.

Limiting the scope of the engagement

23. If the assurance provider is unable to obtain evidence which may reasonably be expected to be available in support of disclosures, that fact would be stated in the assurance report. Management may choose to disclose only selective information or to disclose some information without assurance. In providing assurance the professional accountant will consider whether there is adequate evidence to support an opinion, whether the overall presentation of the environmental report is not misleading and whether both positive and negative aspects are adequately reflected in the report.

Reference to 'suitable criteria'

24. In the absence of a generally accepted environmental reporting framework, the criteria used by management should be disclosed and may be referred to by the assurance provider. Guidelines such as those proposed by the GRI or published by UNEP, and the FEE Discussion Paper *Towards a Generally Accepted Framework for Environmental Reporting* could be used as a basis. Adaptation to the individual circumstances of the company may be assisted by stakeholder dialogue.

Risk assessment and internal control

25. The assurance provider plans and performs the engagement so as to reduce, to an acceptable level, the risk of expressing an inappropriate conclusion. In providing assurance on environmental reports the assurance provider evaluates only those procedures within the environmental management and information systems that are relevant to the objectives of the engagement.

Compliance with laws and regulations

26. Compliance with laws and regulations is the responsibility of management. The assurance provider should always obtain management's representations that all material non-compliance with environmental laws and regulations has been disclosed. If disclosure is not made, the assurance provider:

- assesses the impact on the environmental report, considering the materiality of this information for the users of the environmental report

- ascertains management's reasons for non-disclosure

- considers whether to continue the engagement, whether there is any need to disclose the matter to third parties, and the effect on the wording of the assurance report

- if necessary, takes legal advice.

Materiality

27. The reporting entity should decide which environmental disclosures are significant. What is 'material' may vary according to the scope of the information provided in the environmental report. Materiality thresholds may be agreed between the reporting entity and the assurance provider. Where the thresholds agreed are contrary the interests of stakeholders it might be necessary for the assurance provider to consider whether this acts as a form of scope limitation which should be reflected in the assurance report.

Assurance report

28. A better understanding of the benefits and limitations of assurance would be promoted by using a structured approach. A report should explain: the scope of the engagement, the responsibilities of the parties involved and the level of assurance provided.

Questions

Q.1 The issues above, from the 1999 paper, relate only to environmental matters. Which, if any, are not applicable to sustainability reports?

Q.2 Assurance is explained in Appendix 2 – *Glossary* as 'That which enhances the credibility of information.' In the absence of a specific definition in the professional literature of the accounting profession (where 'assurance engagement' is defined instead), is this a reasonable definition?

Is there scope for confusion with the well known terms such as 'quality assurance', or 'information assurance', the latter being defined by T1.523-2001 the American National Standard for Telecommunications - Telecom Glossary 2000 as '*Information operations that protect and defend information and information systems by ensuring their availability, integrity, authentication, confidentiality, and non-repudiation.'*?

Q.3 The term 'assurance engagement' is theoretically used by accountants to refer collectively to audits of financial statements and to other engagements providing a lower level of assurance. However, in practice, an accountant referring to an assurance engagement is likely to mean an engagement that is not an audit of financial statements[5]. While the theoretical discussion in this paper is aided by precise terminology, in society the word 'audit' is frequently used much more generally. Would stakeholders be better served by a 'sustainability audit' and should the accountancy profession change its over-precise terminology as a consequence?

[5] Even IFAC is not immune from this. The body which is to replace the International Auditing Practices Committee is to be named the International Auditing and Assurance Standards Board!

3. SUSTAINABILITY ISSUES

29. This chapter introduces the concept of sustainability (sustainable development) and some of the issues making sustainability reports challenging for assurance providers. Sustainability has only emerged recently (mainly within the last twenty years) and it is not precisely defined. The uncertain and evolving nature of the subject has a profound effect on the provision of assurance.

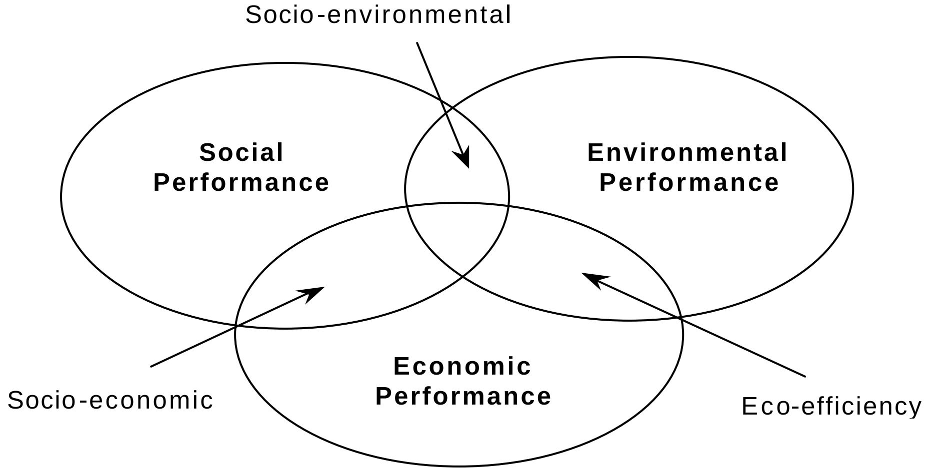
3.1 Sustainability

30. Societies aim to secure a higher standard of living through economic development. However, the world has become highly populated and the impact of agricultural and manufacturing on its natural resources has reached a significant level. In response to these pressures, this generation has begun to work towards protection of those resources for the benefit of future generations so that development may be sustained.

31. In 1987 the United Nations World Commission on Environment and Development, under the Chairmanship of Mrs. Gro Harlem Brundtland, issued *Our Common Future* (often referred to as the 'Brundtland Report'). The report included wording that has come to be widely accepted as a definition of sustainable development: '*meeting the needs of the present generation without compromising the ability of future generations to meet their own needs*'.

32. The Commission's work was directed towards formulating a global action plan proposing long-term environmental strategies and new ways to try to reconcile the objectives of development and the protection of natural resources. However, sustainable development involves more than just seeking a balance between economic development and conservation of the environment. Both factors exert considerable influence over the quality of life and it is this third factor that completes the model which is currently in general use to describe sustainable development (see Figure 1).

Figure 1



33. It is clear that no individual person or corporate entity can attain sustainability in isolation, and that sustainable development (if it is achievable) requires a concerted effort involving all sectors of global society. The Brundtland definition relates to the macro level and is not directed to individual entities. However, progress towards sustainability at an individual or organisational level is a necessary part of this[6]. A company may contribute, for example by adding economic value, restricting its emissions or use of scarce materials, and respecting social justice.

3.2 Sustainability for a reporting company

34. If a company is committed to sustainable development its decision-making will be influenced by relevant information. Some businesses are inherently unsustainable in the long-term (e.g. mining[7]) but may nevertheless wish to act to minimise the adverse contribution to global sustainability. Management will put in place systems to report and manage environmental and other relevant impacts caused by the company's processes and products or services. These will relate to the company but may also extend to consideration of its trading partners and other third parties. Companies may take a holistic approach to decision-making in which all dimensions of sustainability are given appropriate weight and consideration. A company may also report externally to derive benefit from its activities and satisfy the interests of its stakeholders (see also Chapter 4 – *Benefits and limitations of assurance* for a discussion of the benefits).

35. Sustainability reporting is currently also seen as a factor that can differentiate companies in capital markets. The Dow Jones Sustainability Index[8] gives the following definition of corporate sustainability:

'Corporate Sustainability is a business approach that creates long-term shareholder value by embracing opportunities and managing risks deriving from economic, environmental and social developments. Corporate sustainability leaders achieve long-term shareholder value creation by gearing their strategies and management to harness the market's potential for sustainability products and services while at the same time successfully reducing and avoiding sustainability costs and risks.'

3.3 Sustainability reports

36. There is widespread agreement on the basic components of sustainability and therefore the main dimensions that should be addressed in a sustainability report. However, there is no clearly defined framework for sustainability reporting, although the GRI Guidelines have achieved some recognition. The GRI Guidelines recommend that a stand-alone sustainability report contains the following information:

- a chief executive officer statement

- a profile of the reporting organisation

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[6] Appendix 1 - *Literature* provides information on materials, which may be used to begin to develop a fuller understanding of sustainability.
[7] The example is intended to illustrate the expected end of life of a one-mine company when the mine is depleted. Mining companies may be as active in sustainable development as any others.
[8] See http://www.sustainability-index.com

- an executive summary and key indicators
- vision and strategy
- policies, organisation, and management systems
- performance.

37. Under the GRI Guidelines, performance is reported by stating a set of performance indicators. These are grouped into environmental, economic, social, and integrated indicators. Within each category, indicators are grouped by broad area. Indicators are normally quantitative (such as water consumption per unit of product) but qualitative and supplementary information may also be given. Some indicators are applicable to many companies while others may be developed for industries or even an individual company. The extent of development of indicators varies by category, with environmental indicators being the most developed. Integrated indicators are at a very early stage of development (almost experimental) but reporting is expected to evolve to make more use of integrated measures. Performance indicators are dealt with in detail in Chapter 10 – *Sustainability performance* of this paper.

38. Other organisations have issued reporting guidelines or requirements (for membership organisations) but these are specialised and relate usually to only one aspect of sustainability. For example, companies adhering to the Code of Conduct of the Fair Labor Association[9] are entitled to communicate to the public (e.g. through product labelling and advertising) that complying brands have been produced in compliance with the Fair Labor Association Standards. Detailed public reporting is by the Association itself which issues standardised reports evaluating compliance. External monitors who are involved in this process are expected to evaluate compliance with the related workplace standards and work with company factories, contractors and suppliers to correct instances of non-compliance.

39. The lack of an agreed framework restricts the comparability of reports and makes it particularly difficult to assess the completeness of the information provided and the balance, i.e. freedom from bias. Not only is there a lack of agreement over content, it may be a long time before there is global consensus on the definition and measurement of performance indicators.

40. The issues relating to sustainability reports may be illuminated by considering financial reports. The objective of general purpose financial reporting is to allow users to take informed economic decisions. The accounting literature distinguishes between financial statements and other types of general-purpose financial reports prepared by a company (some of which may be issued with the financial statements), for example a narrative review of operations. For financial statements (which deal mainly with past events), investors are the defining class of user. It is from their perspective that preparers make judgements about what to report and how it should be presented. Their investment decisions are influenced by the resources controlled by the company, the quality of stewardship of those resources and the company's adaptability to change.

[9] Washington, USA. See http://www.fairlabor.org

41. Financial reporting may include disclosure of sustainability information, particularly environmental aspects. A sustainability report could be used as a type of financial report, as investors may make economic decisions based on its contents. Indeed, where the report is issued with the financial statements, this is intended. Conversely, a stand-alone sustainability report would normally include some disclosure of financial information in its economic performance indicators. However, such interlinking is potentially confusing and it is probably simpler to consider the user groups of financial and sustainability reports as distinct, although usually having some members in common.

42. The objective of general purpose sustainability reporting is to allow users to take decisions informed by such information. There is currently no defining user group for sustainability reports. It is usual to acknowledge the existence of distinct stakeholder groups whose members have different interests[10]. Some stakeholders will use the sustainability information primarily in aggregation with that from other companies, whereas others will be concerned more with the company itself. The existence of multiple perspectives complicates the preparation of sustainability reports as different users may have different views as to the relevance and materiality of performance indicators.

43. For financial reporting, accounting standards or law determine the boundary conditions, such as what legal entities are included in a company's consolidated financial statements and under what circumstances a matter may be recognised. However, there is an argument that the current financial reporting model needs to overcome its reluctance to recognise matters unless they can be measured reliably. For example, financial statements will not disclose the effects of pollution on the local community or the full social effects of redundancies in the workforce. Sustainability reports contain qualitative information and quantitative information that is less precise than would be acceptable for financial reporting and so are better able to meet the needs of non-investor stakeholders.

Questions

Q.4 Sustainability reports (irrespective of assurance) may provide benefits. What benefits and what potential drawbacks arise for (a) the reporting company and (b) stakeholders?

Q.5 What should sustainability reports themselves say about assurance and assurance providers?

[10] Stakeholders may include: women, youth, indigenous peoples, NGOs, business & industry, workers & trade unions, science & technology, farmers, and local authorities (this list is taken from 'Agenda 21', see Appendix 1 – *Literature*).

4. BENEFITS AND LIMITATIONS OF ASSURANCE

44. As there are no statutory requirements for assurance on sustainability reports, a business case for assurance must be made. This must necessarily include consideration of the environmental, social and economic benefits arising in the circumstances of each individual company. While this chapter briefly examines the immediate benefits of assurance and its limitations, a full discussion of the business case is outside the scope of this paper[11].

4.1 Potential benefits of assurance

45. Assurance plays an increasingly important part in many societies where companies are expected to be accountable, to perform responsibly and to report on their performance. Companies voluntarily commission assurance engagements on their reports because they perceive that benefits arise, both externally and internally. Users of the sustainability report are the obvious external beneficiaries of assurance but a company itself may benefit through improved public perception of its activities. Internal benefits arise where the assurance process promotes improvements, such as in control and reporting systems. The latter improvement may enhance sustainability reporting, through which further benefits arise.

46. The assurance provider issues a report that enables users to place more credibility on the information reported by the company. Each user of the sustainability report may benefit through being able to take decisions based on the information in the sustainability report with less uncertainty about that information. By dialogue with stakeholders, a company may be able to establish the value they place on reporting and assurance[12].

47. The involvement of external assurance providers may allow a company to benefit from their expertise and experience, through formal advice or joint working. The assurance provider may review systems, processes and internal controls, reporting any weaknesses to the company or offering insights having long-term business implications.

48. Improvements in data measurement, recording and internal reporting systems, learning and knowledge transfer within the company all enhance a company's internal decision-making and hence its ability to achieve its business objectives. Improvements may be specific, such as making use of a new development to enhance a process, or general such as stem from the increasing confidence of employees, management and those charged with governance in a company's sustainability performance. Regular and reliable information may be particularly important in reducing the risk of regulatory investigations and penalties relating to environmental matters.

49. An audit of financial statements provides a high level of assurance. In many cases, it may not be possible to provide such high level assurance on sustainability information. This is because:

[11] The World Business Council for Sustainable Development has published *The Business Case for Sustainable Development – Making a difference toward the Johannesburg Summit 2002 and beyond* (http://www.wbcsd.ch/projects/wssd/business-case.pdf) the thinking in that paper may be extended towards reporting and to assurance on reporting.
[12] See Chapter 9 – *Stakeholder dialogue*.

- there are no clear standards for sustainability reporting (these are particularly important in relation to balance and completeness)

- some subject matter may not be capable of sufficiently precise measurement (e.g. statements about environmental policy or social performance)

- available procedures may not provide sufficient evidence.

4.2 Limitations of assurance

50. The direct internal benefits from the assurance process may arise even if no external assurance report is issued. However, the external benefits vary depending on the nature and level of assurance provided, which can be significant affected by the issues discussed elsewhere in this paper.

51. There is a danger that users may not properly appreciate the nature and level of assurance provided. There may be an 'expectation gap' whereby a user mistakenly assumes that there is more assurance than actually is present. Alternatively, a user might devalue assurance if, for example, the assurance provider is not perceived as having appropriate expertise or standing.

52. Dialogue with stakeholders (which may also involve the assurance provider) may be used to explain assurance issues and reduce the risk of misinterpretation of assurance reports. Sustainability assurance reports themselves may be written to be easily understandable by all those who use them.

Questions

Q.6 Are there significant benefits or limitations of assurance in addition to those mentioned in Chapter 4 – *Benefits and limitations of assurance*? Overall, do the benefits outweigh the limitations?

Q.7 What actions should the assurance provider undertake to avoid (or limit) a so-called 'expectation gap' between a) the assurance provider and the reporting company, and b) the assurance provider and the reporting company's stakeholders?

5. GENERAL ASSURANCE APPROACH

53. This chapter describes the assurance provider's approach to providing assurance and identifies general issues, some of which are developed further in later chapters. Issues that arise in relation to particular aspects of environmental, economic, social or integrated performance are not dealt with here, but are explored in Chapters 10 to 13.

5.1 Different approaches to assurance

54. In general, three different approaches to providing assurance on sustainability information can be distinguished, although their elements may now all be found in the 'comprehensive approach':

- accountancy
- social audit
- consultancy.

55. These approaches are all important to sustainability reporting. They are not competing methodologies. The differences arise for historical reasons and are most apparent in the nature of the assurance provider and the areas of information within the scope of the report. The accountancy approach is essentially an independent assessment of the company's own reported information and has been applied by accountancy firms. The social audit is (historically) an independent third party report by a 'social auditor' without any report from the company. The consultancy approach arises from companies seeking assistance from external consultants and extending their involvement to reporting.

56. It is perhaps unfortunate that accountants (as financial statement auditors) are identified with the accountancy approach as other assurance providers (consultants and social auditors) and stakeholders may question the legitimacy of the approach for that reason. While accountants are viewed as experts in matters related to accountancy, they are not traditionally seen as being experts in the subject matter of sustainability reports. However, those firms of accountants providing assurance on sustainability reports necessarily make use of multidisciplinary teams for such work; professionals with expertise in various environmental, social and economic matters are employed to ensure that, overall, the firm has the capability to provide the required assurance. Today's firms of accountants are experts in business and well placed to apply an established assurance methodology to sustainability reports. Perhaps confusingly, such firms may also carry out assurance engagements employing the consultancy approach or perform a social audit.

Accountancy approach

57. The accountancy approach was developed by auditors issuing reports that give a high level of assurance on financial statements. Management prepares the sustainability report, which is then subject to the assurance process. The assurance provider uses a structured approach involving the analysis of risk and the use of appropriate procedures to gather evidence before issuing a report stating the assurance given. An overview of the accountancy approach is given in section 5.2 '*The assurance process*'.

58. The accountancy approach is well developed and well understood by auditors who can refer to standards and guidance issued by standard setting bodies[13] and a wealth of text books, firms' manuals and research studies. The preparation of financial statements is often subject to legal control and there are normally comprehensive professional standards specifying the form and content of financial statements. The accountancy approach usually operates, therefore, where there are comprehensive rules defining its subject matter.

59. In many jurisdictions statutory auditors are required to demonstrate competence in auditing as a prerequisite to being allowed to issue audit reports. Accountancy professional bodies provide training and monitor the compliance by members with auditing-related requirements. In some jurisdictions a 'peer review' system operates whereby firms review the quality of work of other firms.

Social audit approach

60. The term 'social' has been used to cover a multitude of aspects of company reporting, and could in its broadest sense also include environmental and economic aspects. The term 'social audit' may also be used in different ways. The term originated as a description of reporting on the performance of a company by external 'social auditors'. Social auditors may be organisations carrying out investigations on many companies in a particular area of interest or the term could be applied to a journalist investigating one company. The audit takes place with or without the cooperation of the company. There is no report by the company; the only public report is from the social auditor.

61. This form of social audit relies on obtaining evidence from sources outside the company – typically from stakeholders and third parties. The auditor receives no payment from the company. Indeed, the social audit can be wholly antagonistic if a campaigning auditor organisation is involved. Because the social auditor normally has to demonstrate expertise in the subject matter of the audit to give credibility to any report, there may be a vary narrow focus on specific issues, making an extension of the social audit to a full sustainability report an unrealistic prospect. This form of social audit is not considered further in this paper because the focus is on assurance provided on sustainability reports prepared by companies[14].

62. The operating methods of social auditors are, however, relevant to the development of methodologies used by assurance providers, particularly in relation to the social performance indicators in a sustainability report. The need to provide assurance on social disclosures, such as indigenous representation in decision making in certain geographical regions, leads directly to assurance providers entering into dialogue with stakeholders.

63. A relevant development of the social audit is where the company collaborates with the social auditor and this may give rise to a joint report or one where the company reports information on which the social auditor comments. The social auditor offers advice on reporting but also reports independently both within and on the published report. The approach may focus more on the reporting process, with the inclusion of stakeholders' views through dialogue, than on the accuracy of the data. The scope of the report is

[13] Many countries have auditing standards based on those of the International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC). Further details are given in Appendix 1 – *Literature*.

[14] A review of the historical development and current influence of social auditing may be found in Humphrey C. and Owen D. (1999) Debating the 'Power' of Audit *International Journal of Auditing* 4(1), pp. 29-50.

limited to the area of expertise of the social auditor, which might be in social issues or environmental issues.

Consultancy approach

64. The consultancy approach evolved out of the use by companies of external consultants to improve their systems and performance, mainly in the environmental and social areas. Consultancy services – recommendations or more practical help – may be aimed at either improving the performance of the company in relation to sustainability or increasing the reliability and disclosure of sustainability information.

65. The consultancy approach allows a company to benefit from the involvement of experts as it moves towards greater disclosure of information and the provision of information of greater reliability. Consultancy recommendations often focus on the quality of the environmental (and social) management system. Consultancy engagements have not generally been performed by multidisciplinary teams but have relied on expertise in one particular discipline. It is difficult, therefore, for the consultancy approach to be extended to a whole sustainability report.

66. Users of a company's sustainability report derive assurance from the involvement of external experts in the activities and reporting of the company and from any published report of the consultants. The report may explain the consultant's involvement and what recommendations have been made to the company together with the company's response. In some cases a report may extend to an opinion on assertions made by the company, which is what is done under the accountancy approach. However, the close working relationship with the company may present obstacles to the consultancy assurance provider trying to demonstrate independence.

67. The actual methods used for the pure assurance aspects of the engagement may be the similar to those of the accountancy approach. Apart from detailed consideration of independence issues (if any), the methods may be affected by the reliance placed on work done in a consultancy capacity. For example, advice may be provided on improving the environmental management system (EMS), the reliability of which may be important in determining the work done to substantiate certain disclosures.

Other approaches

68. There are other 'judgment' approaches that are used individually or, because they focus on specific areas, in combination with the above approaches[15], including:

- assessment by a 'rating agency' type of organisation
- statement by one or more independent expert witnesses or 'famous faces'.

69. There is a further type of engagement in which an assurance provider carries out procedures that have been agreed with the company and reports only the factual findings. This form of report does not give assurance through any sort of opinion and so is not considered further in this discussion paper, however the factual results of the agreed-upon-procedures may be considered by users when forming a view on the reliability of related aspects of a sustainability report. Such engagements may be appropriate when a

[15] This analysis is from a conference paper by Robert Langford, *Providing Assurance on the Reliability of Sustainability Reports under the Global Reporting Initiative*, ICAEW, London, April 2000.

company is just beginning to report on sustainability and the scope of the report is severely limited or management and reporting systems are immature.

70. The sources referred to in Appendix 2 - *Literature*, may be used to develop a fuller understanding of the approaches referred to above.

5.2 The assurance process

71. This discussion paper focuses on assurance on sustainability information presented in a company's sustainability report. For such engagements an assurance provider may draw on elements of each approach, but the work will necessarily acknowledge the accountancy approach. This section introduces this 'comprehensive approach' to the assurance process, as used by accountancy firms and others, and some of the concepts behind it. Much of this material will already be familiar to assurance providers but the section may help preparers and users develop a better understanding.

72. In essence, the comprehensive approach is the accountancy approach, enhanced through accommodation of aspects of stakeholder dialogue taken from the social audit approach and the well-developed understanding of management systems and processes developed through consultancy methods.

73. The assurance provider plans and conducts the assurance engagement to obtain sufficient appropriate evidence to achieve the desired level of assurance and applies judgment in order to express a conclusion. Management and the assurance provider may enter into dialogue with stakeholders to establish the appropriate scope for the provision of assurance and the level of assurance to be provided. Although it is not really a linear process, the following simplified series of steps is suggested as an analysis of the assurance engagement from the viewpoint of the assurance provider. As indicated below, three of these steps are expanded upon in the subsections that follow:

- consider acceptability of the engagement (see section 5.2.1 below)
- agree subject matter, scope and terms of engagement formally with company
- plan: gather information, assess the risk of material misstatement, design appropriate assurance procedures (see section 5.2.2 below and also section 8.2 'The risk model' in Chapter 8 – *Risk perspectives*)
- where planning indicates that reliance may be placed on management systems, test the operation of systems (if tests are cost effective) (see section 5.2.3 below)
- perform substantive procedures: analytical procedures and tests of detail
- obtain management representations
- carry out an overall appraisal of the sustainability report
- consider other information issued by the company that may be inconsistent with the sustainability report or otherwise misleading in sustainability matters
- issue the assurance report and any associated reports to management

- if published on Internet, check agreement to original and review for appropriate presentation

- remain passively alert for information that may indicate that the assurance report should no longer be relied upon or that information published on the Internet has been altered.

5.2.1 Acceptability of the assurance engagement

74. When considering whether to accept an assurance engagement, the assurance provider will be concerned with such matters as whether:

    - the assurance provider has the necessary multidisciplinary skills to undertake the assignment (see under 'Characteristics of the assurance provider' below)

    - there are sufficient resources and personnel at appropriate locations to carry out the assurance work within a realistic timetable

    - there are any threats to independence that, after applying available safeguards, are so significant as to prevent acceptance of the engagement (see under 'Independence' below)

    - the subject matter is appropriate and suitable criteria exist for the intended level of assurance (see Chapter 6 – *Criteria for sustainability reporting and assurance* and Chapter 10 – *Sustainability performance*)

    - the scope of the assurance engagement is not subject to unacceptable restriction (see Chapter 7 – *Scope of assurance engagement*)

    - the company is of sufficient reputation and standing for the assurance provider to allow its name to be associated with it

    - other risks arising from the engagement are acceptable to the assurance provider

    - the fees for the engagement are sufficient.

75. Much of the information gathered for these purposes will also be used during the engagement itself to assist in assessing the risk of material error and to design appropriate procedures.

Characteristics of the assurance provider

76. Assurance providers range from individuals to global organisations. The provision of assurance relies on users having confidence that the assurance provider has the necessary standing and integrity as well as the specific expertise to carry out an engagement. Many persons and bodies need to demonstrate such characteristics in diverse fields (e.g. medicine, law) and a general discussion of this is outside the scope of this paper.

77. In connection with providing assurance on sustainability reports, expertise and independence are important. Accountancy firms may have to assume a higher need to communicate to users the ways in which they meet the need for specialist expertise, for

example in complex environmental matters. Consultancies and social auditors may face similar needs if involved in areas beyond those of their traditional expertise. They may also have to convince users that they are competent in assurance itself as well as being experts in the subject matter. Independence is discussed further below.

Independence

78. The assurance provider considers independence where the assurance is given in an independent capacity. Independence is very important to assurance provision. Independent assurance is generally considered to be more worthwhile because the judgements of the assurance provider are more impartial. Where an assurance provider is not visibly independent, users may have a suspicion that judgements may be influenced in favour of the company. Accountants providing assurance are normally required by their professional ethics to do so only where they are independent[16]. This means both independent in mind (which is not capable of proof) and, in order to demonstrate independence of mind, independent in appearance.

79. Independence cannot be absolute because every assurance provider, in common with all individuals and businesses, has relationships with others and, when sustainable development is the subject matter, is affected by the impacts reported. The significance of these interests, relationships and other factors determines whether independence of mind and independence in appearance are compromised.

80. The two threats to independence most relevant to assurance on sustainability reports are that the assurance provider may receive substantial other fees from the company (e.g. if also the auditor of the financial statements) or has carried out work as a consultant (e.g. putting in place an EMS) which has to be relied upon when obtaining evidence. These threats may be addressed by the assurance provider putting in place appropriate safeguards (such as, for the first threat, restricting fees from any one assurance client to a small proportion of total fees). However, in some instances, the assurance provider may decide not to accept an engagement because insufficient safeguards are available.

5.2.2 Planning

81. Planning involves gathering information and assessing the risk of material misstatement, in order to design appropriate assurance procedures. The concepts of risk and materiality are important. They interact because if relatively insignificant matters were to be considered material there would be an increased risk of material error. Risk is discussed further in Chapter 8 – *Risk perspectives*.

Materiality

82. It is clearly not worth reporting every item of information that might be relevant to sustainability. The ensuing sustainability report would be too costly and so long as to be unmanageable. It is necessary to have a significance threshold for disclosure such that matters that are below the threshold need not be reported.

83. A similar consideration applies to the degree of accuracy of disclosures. It is not reasonable to attempt to measure something with a high degree of precision if that

[16] For example, as set out in section 8 '*Independence for Assurance Engagements*' of the IFAC Code of Ethics. See http://www.ifac.org

precision only refines the disclosed value by an amount below the threshold for disclosure if it were a separate item.

84. This threshold quality is referred to as materiality. It is a matter of judgement, as to whether a matter (or an imprecision) is or is not significant to the decisions of stakeholders. Different stakeholders will have different views on the significance of the same sustainability disclosure. While that might also be true for financial reporting disclosures, the established principle is that investors are the pre-eminent stakeholders, and their perspective is the primary one that is acknowledged by financial statement preparers and auditors.

85. In relation to financial statements, where many disclosures are reducible to monetary amounts and where there is only one defining class of stakeholder (investors), it is possible to use, for some purposes, a monetary value below which items are considered to be immaterial. However, sustainability reports contain disclosures that are not capable of simple expression in terms of a common factor and so it is necessary to decide materiality for individual matters, and to do so taking into account relevant stakeholder views.

86. Materiality should also be considered on an overall basis when determining the acceptability of the overall presentation of the information in the sustainability report. If a company consistently discloses matters in ways that are favourable to it, the overall bias introduced into its sustainability report may become significant, even though the constituent disclosures are individually acceptable (i.e. not materially wrong).

87. Although the preceding discussion has examined disclosures that might be quantitative, many disclosures will only be capable of consideration in qualitative terms. For such items the determination of materiality is a purely judgmental matter. The judgement can be very difficult and because it has to be made at the planning stage (in order to know what work to do) it is critical to the whole assurance process.

5.2.3 Assurance work strategy (under the accountancy approach)

88. Throughout the engagement the assurance provider needs a general understanding of the legal and regulatory framework applicable to the company and the industry concerned and how the company complies with that framework.

89. The assurance provider updates or obtains an up-to-date knowledge of the company and its environment. This can involve interviews with employees responsible for sustainability matters, gathering technical information available in the industry, plant or site inspections and stakeholder dialogue.

90. In planning the assignment, the assurance provider obtains knowledge of the design of relevant aspects of systems, and evaluates their existence, appropriateness and effectiveness as a basis for deciding the nature and extent of the other work to be performed. This includes the techniques used in measurement, analysing, calculation or estimation of environmental and other impacts that are significant to the company's sustainability performance. The assurance provider considers whether the use of these techniques is acceptable and assesses the quality control over the use of these techniques.

91. The assurance provider has to obtain sufficient appropriate evidence to be able to draw reasonable conclusions on which to base the opinion. Such evidence is obtained from an

appropriate mix of tests of control to confirm assessments of systems and substantive procedures (which also provide indirect evidence of the effectiveness of control). If the preliminary assessment of system effectiveness is not confirmed by subsequent testing it is necessary for the assurance provider to revise planning decisions. In the following paragraphs, the characteristics of tests of control and substantive testing are described.

Management systems and tests of control

92. Tests of control are those tests performed in order to obtain evidence about the effectiveness of:

- the design of control systems: that is, whether they are suitably designed to prevent and correct material misstatements (these tests are normally confined to observation and enquiry)

- the operation of the controls throughout the period.

93. Because some disclosures rely on data accumulated during the whole period to which the sustainability report refers, the assurance provider considers whether controls were in operation throughout the period. If substantially different controls were used at different times, the assurance provider would consider each control separately. A breakdown in controls for a specific portion of the period requires separate consideration of the nature, timing and extent of the assurance procedures carried out in relation to the events of that period. The assurance provider may decide to perform some tests of control during an interim visit in advance of the end of the period. However, the assurance provider cannot normally rely on the results of such tests without considering the need to obtain further evidence relating to the remainder of the period.

94. If the assurance provider becomes aware of any material weaknesses in the design or operation of a formal management system, or the controls provided, these are normally drawn to the attention of management at an appropriate level of responsibility, as soon as practicable. Where consultancy services are provided this function may be significant.

Substantive assurance

95. Substantive testing comprises procedures performed to obtain evidence to detect material misstatements or omissions in the sustainability report. The nature and scope of substantive testing procedures depend on the circumstances of the engagement (for example nature and scope of the business activities, organisation, presentation of the sustainability impact of the company's business activities). Such tests mainly comprise two types:

- analytical procedures

- tests of detail.

96. Analytical procedures involve analysing disclosures and other data to see if it 'makes sense'. The assurance provider may use analytical procedures at the planning stages to identify any obvious potential misstatements so that these may be investigated further. Analytical procedures do not alone provide sufficient evidence as a basis for a final conclusion on critical areas.

97. To some extent the areas where the assurance provider would want to apply analytical procedures will be synonymous with the disclosed performance indicators. However, the

procedures may involve comparisons or ratio investigation beyond that which is disclosed.

98. Other substantive tests may be used to provide direct evidence on disclosures. Often carried out on a sample basis, they may involve substantiating individual items making up a disclosure and checking that calculations and summarisations have been done accurately. Assurance providers may make use of computer techniques where the nature of the test allows that.

Questions

Q.8 Assurance providers are referred to as 'independent', 'third-party' and 'external' as if these terms were interchangeable. Should special emphasis be given to the quality of independence, and if so how?

Q.9 If the assurance provider also provides consultancy services (the consultancy approach) is independence compromised overall (through a mainly financial self-interest threat)? Is it possible to properly distinguish aspects where assurance is provided from others where it is not and so isolate the 'self-review' threat to independence?

Q.10 This paper deals primarily with assurance from third parities. Users may also see 'assurance' in sustainability reports where management says the information is correct, or that systems are reliable or that an internal audit department has carried out work. Where external assurance is also given, it may extend to the accuracy of such representations. What problems do respondents see in this area, for example in user understanding, and how could they be addressed?

6. CRITERIA FOR SUSTAINABILITY REPORTING AND ASSURANCE

99. Since full sustainability reporting is not currently mandatory in any country, each individual reporting company may chose the scope and contents of its sustainability report and on what aspects assurance is sought. Assurance itself is similarly free of standards, as there are no established ethical, procedural or reporting standards for providing assurance on sustainability reports.

100. Specific reporting and assurance standards are developing, however, and there are standards in related matters that can be applied with adaptation. This chapter examines these circumstances with particular reference to the difficulties that they present.

6.1 Suitable criteria for reporting

101. The accountancy approach to assurance makes reference to the need for the subject matter of an assurance engagement to be evaluated or measured against appropriate standards or benchmarks. These are referred to as criteria. However, not all criteria will be suitable for that purpose.

102. The decision as to whether the criteria are suitable involves considering whether the subject matter is capable of reasonably consistent evaluation against, or measurement using, such criteria. The characteristics for determining whether criteria are suitable are as follows:

- relevance – relevant criteria contribute to conclusions that meet the objectives of the engagement, and have value in terms of improving the quality of the subject matter, or its content, so as to assist decision making by intended users

- reliability – reliable criteria result in reasonably consistent evaluation or measurement and, where relevant, presentation of the subject matter and conclusions when used in similar circumstances by similarly qualified assurance provider

- neutrality – neutral criteria are free from bias. Criteria are not neutral if they cause the assurance provider's conclusion to mislead report users

- understandability – understandable criteria are clear and comprehensive and are not subject to significantly different interpretation completeness – complete criteria exist when all the criteria that could affect the conclusions are identified or developed and used

- completeness – complete criteria exist when all the criteria that could affect the conclusions are identified or developed and used.

103. The assessment of whether criteria are suitable involves weighing the relative importance of each characteristic and is a matter of judgement in the light of the specific objective of the engagement. Suitable criteria are context-sensitive, that is, relevant to the engagement circumstances. If any of the characteristics are not adequately met, the criteria are unsuitable.

104. Criteria can either be established or specifically developed. Established criteria are those embodied in laws or regulations, or issued by recognised bodies of experts that follow

due process involving, for example public consultation over proposals. While the GRI Guidelines have received support amongst reporting companies, they do not yet contain criteria specific enough to serve as a complete framework for an assurance engagement on comprehensive sustainability information.

105. Specifically developed criteria are those identified for the purposes of the engagement and which are consistent with the engagement objectives. Given the lack of generally accepted criteria to assess sustainability reports, the criteria used should be clearly described by management in the sustainability report. The following paragraphs consider three specific areas of difficulty.

Completeness and balance

106. The assurance provider may be concerned with the completeness and balance of information disclosed in a sustainability report as well as its accuracy. Auditors of financial statements are familiar with the need of financial statements to provide a complete and balanced view of the financial position and results of a company. The auditors' report refers to the relevant legal and accounting standards forming the criteria and gives an opinion that implicitly encompasses completeness and balance of the information. In contrast, without suitable established criteria an assurance provider cannot make a positive statement about such matters.

107. There is a danger that users will assume in the absence of any statement to the contrary that a sustainability report is balanced and complete. However, assurance providers will not wish to be associated with a report that is misleading or unduly selective in its disclosure.

108. Specifically developed criteria are, therefore, important in sustainability reporting and stakeholder views are particularly relevant to their development. Involvement of the assurance provider in stakeholder dialogue may promote the adoption of criteria that are suitable. The criteria will normally have to be disclosed in the sustainability report.

Indirect impacts

109. The subject boundary of a sustainability report is not fixed as sustainability reporting can extend beyond the direct impacts of a company. Indirect impacts may arise in many ways. For example in the supply chain or as a result of the actions of users of a product (e.g dumping of non-reclaimable elements). Considerable debate can ensue about whether an indirect impact can be attributed to a company in any meaningful way. As a result their identification, in terms of suitable criteria, is very difficult. Because such matters are external they are also difficult to measure and management systems cannot directly control external impacts. Assurance may also be hampered by the lack of evidence. In practice, because of these factors, disclosures of indirect impacts are currently rare.

Comparatives

110. The suitability of criteria may be a particular issue in relation to earlier years. Comparatives are disclosures of earlier years that are presented to illuminate the current year. For example, a company may show its total energy use is declining by disclosing the figure for each of the past five years. Users of sustainability reports may assume that assurance extends equally to comparatives unless informed to the contrary.

111. Because sustainability reporting is evolving, new disclosures may arise for which management wishes to present comparative information for one or more years.

Comparative information will not necessarily have been subject to assurance procedures in those years and there may have been changes in the company's activities or methods of collecting and analysing data. Such factors could threaten the validity of the comparison, giving assurance providers problems in providing assurance.

6.2 Assurance criteria

112. In the same way that criteria are used to assess disclosures, criteria may be used to assess the assurance itself. In this case the 'assessment' is carried out by the users of the assurance report and helps their understanding of the assurance. For example, if reference is made to the assurance provider carrying out the work in accordance with a particular named set of standards, the user may examine those standards to gain an understanding of what had been done. Reports would normally refer to any deviations from standards, for example if there had been an unjustified restriction in the scope of the work.

113. There are no established ethical, procedural or reporting standards specifically for providing assurance on sustainability reports. However, the accountancy approach to assurance derives from standards and guidance issued by auditing standard setting bodies and there is ethical guidance dealing in great detail with independence for assurance providers[17].

114. The preparation of financial statements is often subject to legal control and there are normally comprehensive professional standards specifying the form and content of financial statements. The accountancy approach usually operates, therefore, where there are comprehensive rules defining its subject matter. There is an underlying question as to importance of the absence of suitable criteria in determining the extent to which the accountancy approach is suited to adoption for assurance on sustainability reports.

Questions

Q.11 Financial reporting may develop to include sustainability. Is this an inevitable conclusion and if so, when will this happen? Would it be better to retain financial statements as one aspect of a sustainability report?

Q.12 Should a conceptual framework for sustainability reporting be created in addition to guidelines for reporting (such as the GRI Guidelines) to address concepts such as materiality/significance and principal user? If, so what should it include?

Q.13 Is it inevitable that some subject matter is not appropriate for any level of assurance to be given? Should these be excluded from sustainability reports, or segregated from disclosures on which assurance can be provided?

[17] Many countries have auditing standards based on those of the International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC). IFAC has also issued a Code of Ethics that deals with independence for assurance engagements. Further details are given in Appendix 1 – *Literature*.

Q.14 Standard setting bodies will be examining sustainability assurance. Is the time right for a standard to be issued? What should any standard include? In view of the many different types of assurance providers, how could any standard be enforced?

Q.15 ISA 100 underpins the 'accountancy approach'. For engagements intended to provide a high level of assurance in relation to sustainability reports, is ISA 100 sufficient or should IAPC develop more-specific materials? On the assumption that ISA 100 will be amended to incorporate moderate level assurance, will more-specific materials still be required for assurance on sustainability reports? Is the approach in ISA 100, which deals with only two levels of assurance, appropriate for assurance on sustainability reports or is a more flexible approach needed? Dialogue with stakeholders is not within the scope of ISA 100. How should standards in this area be taken forwards?

Q.16 AccountAbility – the Institute of Social and Ethical Accountability is updating AA1000. Will that meet the need for an assurance standard? What role do you see for the AA1000 series in relation to assurance provision?[18]

[18] The provisions of AA1000 have not been discussed in this paper. However, FEE expects that a significant number of respondents will be familiar with that document and its revision process and will be able to provide views on its current and future relevance (see the section relating to Chapter 1 – *Introduction* in Appendix 1 – *Literature*).

7. SCOPE OF ASSURANCE ENGAGEMENT

115. This chapter describes the problems associated with limitations in the scope of an assurance engagement. The scope of an assurance engagement can be described in terms of the subject matter (in the sustainability report) on which assurance is to be provided and the specific objectives of the assurance engagement.

116. A key consideration is whether scope is limited at the outset of an engagement (by agreement or circumstance) or whether it occurs during an engagement (by chance or management action).

7.1 Anticipated scope limitation

117. For a given sustainability report, the scope of the assurance engagement may be limited in extent to less than the whole report. This may be because the company does not want assurance on all of the report (perhaps because of cost or other assurance providers being involved), or because there are limitations through lack of suitable criteria or evidence that preclude some matters being included.

118. For a given set of subject matter, the objectives of the assurance engagement may be restricted. For example: assurance may be given on the implementation of a policy, but not its enforcement; or on the operation of a system but not on the accuracy of performance indicators that depend on data from it.

119. For a given objective, a company may request in advance that the assurance provider does not employ the full range of possible evidence gathering procedures. For example, visits to sites may be restricted or stakeholder dialogue prevented.

120. If the assurance is limited, users may nevertheless associate the name of the assurance provider with the whole sustainability report. This may happen even if the assurance report clearly states the extent of, and any limitations on, assurance work. It is a matter of judgement as to whether a particular engagement is acceptable, as the fees for work done may not compensate for risks arising in areas excluded from assurance.

121. Similar considerations apply where other assurance providers are also involved. In those circumstances the assurance provider will also consider the risks attaching to being associated with the outcomes of their work.

122. Where the scope of the assurance work is expected to be very limited the assurance provider may consider instead an engagement in which certain procedures are performed and the outcomes reported factually (i.e. no assurance is expressed) so that users may form their own view on the information. Such an agreed upon procedures approach is not considered further in this paper.

7.2 *Scope limitations arising during the engagement*

123. There can be restrictions in scope due to lack of available evidence in circumstances where that was not foreseen, for example records at a location may have been inadvertently destroyed. The assurance provider would consider the impact on the engagement and whether such a matter should be included in the assurance report. However, in the absence of agreed standards on what constitutes 'reasonable evidence' in relation to sustainability matters it may be difficult to decide whether a reportable scope limitation has occurred.

124. There is a further and serious form of scope restriction where management does not provide evidence that the assurance provider considers necessary. When management obstructs the assurance process in this way the assurance provider will not only consider the impact on the engagement and whether such a matter should be included in the assurance report but might even resort to refusing to issue a report at all (i.e. ceasing to act for the company).

125. A more subtle form of this limitation arises where management changes its mind about the scope of an engagement and seeks to change the subject matter (perhaps excluding the performance indicator where a problem has arisen) or downgrade the level of assurance sought. The assurance provider will again consider such matters carefully before deciding on an appropriate response.

126. As sustainability reporting is evolving, there may be difficulties in deciding in advance whether suitable criteria and evidence will be available and, therefore, what is the precise scope of the engagement. This may be further complicated by consultancy advice making decisions on what is, or is not, a scope restriction more complicated.

7.3 *Areas of potential stakeholder doubt*

127. Stakeholders may form perceptions of the scope of the engagement that are not those intended to be transmitted by the assurance report. The following paragraphs deal with two of the more important ones.

7.3.1 Compliance with laws and regulations

128. The assurance provider will not act to enforce laws and regulations and will only report explicitly on compliance where that is agreed to be within the scope of the engagement. In most instances, it will be impossible for an assurance provider to give a report stating that a law has been complied with as, even if feasible procedures were possible, they might be prohibitively expensive. It will only be possible to report that the company has appropriate procedures in place to promote compliance with the law and deal with breaches.

129. The assurance provider only performs procedures to help identify possible or actual instances of non-compliance with applicable laws and regulations, which could materially affect the sustainability report.

130. As well as maintaining a general understanding of the legal and regulatory framework applicable to the company and the industry concerned the assurance provider may carry out the following procedures:

- enquiries of management concerning the company's policies and procedures regarding compliance with relevant laws and regulations
- discussions with management concerning the policies and procedures adopted for identifying, evaluating and recording litigation, claims and assessments
- discussion with stakeholders to confirm that all relevant laws and regulations are considered and to identify non-compliance where known to such stakeholders
- examination of correspondence with regulatory and enforcement agencies
- communication with the company's lawyers
- examination of how the company controls compliance with law and regulation.

131. In some countries, it is considered good practice for assurance providers to contact regulators. Other local practices, according to the countries involved, should be taken into account. These may be revealed by local stakeholder dialogue.

132. It would be normal for an assurance provider to obtain written representations that management has disclosed to the assurance provider all known possible non-compliance with laws and regulations whose effects should be considered in preparing the sustainability report.

133. When the assurance provider becomes aware of information concerning a possible instance of non-compliance, the assurance provider will obtain an understanding of the nature of the act, the circumstances in which it has occurred and sufficient other information to evaluate the possible effect on the sustainability report. When adequate information about the suspected non-compliance cannot be obtained, the assurance provider considers the implications for the assurance report.

134. It is necessary for the assurance provider to form a view on the significance of any matter. In doing so it may be necessary to establish stakeholder views where that can be done without breaching client confidentiality. A matter that is clearly significant in a local context, for example a labour issue in a joint venture, may not be significant in the wider context.

7.3.2 Threats to continuing operations

135. The assurance provider is not required to look explicitly for impacts of the company that are so significant that the company might cease to operate. However, in some cases, the assurance provider may become aware of issues of such magnitude. Such issues could include:

- serious weaknesses in the management systems that could jeopardise the existence of the company, such as the risk of a plant shutdown because of non-compliance with regulations

- new legislation, with which the company may not be capable of complying, that could lead to its future closure

- other severe violations of regulations.

136. For the auditor of financial statements, threats to continuing operations require further consideration for their implications in relation to the applicability of the going concern basis for financial reporting. There is no direct equivalent to this basis in sustainability reports as there is no developed generally accepted framework for such reports, nevertheless the assurance provider considers the impact of such matters on the assurance report. There is also no obligation on the assurance provider to inform the statutory auditor where such matters are identified. The assurance provider would normally ensure that such findings are reported to those charged with governance and/or management, or if required, to a supervisory or regulatory body of the company. If there are doubts as to who is to be informed, or if the recipients take no action, it may be appropriate for the assurance provider to seek legal advice and to consider the impact of this advice on the assurance report.

Questions

Q.17 What specific objectives should a 'full scope' sustainability assurance report ideally address? Should they relate to, for example correctness, or also completeness and balance?

Q.18 Within what timescale is it likely that sustainability and assurance will have developed to allow high assurance on a 'full scope' sustainability report? If this is achievable, what steps are necessary to achieve it? If it is not achievable, what must be done to get the maximum value for society of sustainability reporting?

Q.19 Do you consider it acceptable for a client to limit the scope of an assurance engagement? Should an assurance provider decline to carry out the engagement if the client imposes restrictions on the assurance work? If so, at what point should the assurance provider terminate (or not accept) the engagement?

8. RISK PERSPECTIVES

137. This chapter examines the risks for the parties to sustainability reporting. Assurance providers aim to manage their risks by the way they carry out an engagement. This risk management is fundamental to the assurance engagement and the discussion below relies on an underlying model of assurance developed as part of the 'accountancy approach' to assurance.

8.1 Risks of the parties involved

138. Sustainability reporting is subject to uncertainty. This ranges from the imprecision in measuring some impacts, to the judgemental aspects of normal estimates. The assurance process is itself subject to uncertainty as the evidence obtained is seldom conclusive and some doubt always remains as to the degree of corroboration of reported information. This uncertainty means that all the parties involved are subject to risk:

- stakeholders and other users
- the reporting company
- the assurance provider.

139. Stakeholders and users of a sustainability report may be subject to risks arising from negative social impacts from the reporting company's business operations. To the extent that information contained in a sustainability report is inaccurate or incomplete, users may be subject to the risk that decisions are based on inappropriate information. Inappropriate reliance on assurance may contribute further risk.

140. Reporting companies are subject to general business risks (i.e. risks affecting the ability to achieve business objectives) arising from sustainability impacts. Situations may occur which make the public aware of non-compliance with environmental legislation or labour laws. Risks to a reporting company may also arise from the lack of appropriate reporting of sustainability impacts or the manner in which sustainability impacts are reported.

141. The process of stakeholder dialogue also introduces risk because stakeholders who are not consulted, or are consulted but denied what they consider to be an appropriate response, may react adversely. For example, there can be a risk of damage to a company's reputation if stakeholders perceive that the company has produced an incomplete or misleading report or has engaged a discredited assurance provider.

142. The next section of this chapter discusses the risks to the assurance provider. The focus is on the risk that the assurance provider expresses an inappropriate conclusion that the report meets the sustainability reporting criteria applied when there are material departures from those criteria.

143. The assurance provider plans and performs the engagement so as to reduce, to an acceptable level, the risk of issuing a report expressing an inappropriate conclusion. This method is supported by two concepts: the risk model and materiality. The concept of materiality is discussed in Chapter 5 – *General assurance approach*.

8.2 The risk model

144. An audit cannot guarantee the complete absence of material misstatements in audited accounts. Accordingly, the risk of 'audit failure' has to be managed. An auditing firm has to determine a level of risk applicable to the whole of its clients so as to balance overall the risk of issuing inappropriate audit opinions (with a possibility of suffering loss as a result, e.g. through litigation) against the costs of reducing that risk (through doing more work or carrying out more quality control or better training staff etc.).

145. The risk model in auditing literature is stated by reference to account balances, classes of transactions and the financial statements. For a particular client, a firm will aim to assess the likelihood of a material misstatement occurring and carry out audit procedures sufficient (but no more than is necessary) to detect such misstatements so far as is necessary to reduce the risk that material misstatement still remains to the acceptable level. The actual level of risk that is acceptable for each client depends on the auditing firm's decision on the overall level of risk. Some firms plan to achieve the overall risk by applying the same figure to all clients; some firms may adopt a more sophisticated approach and also consider the relative size of clients or other criteria.

146. The way that risk is assessed within audit engagements varies between firms. One common approach is to consider, for each major category of disclosure (cash, receivables, fixed assets etc.) what the inherent risk of material error would be in the absence of any systems designed to control that risk. A further assessment is then made of the risk that controls that are present will not detect material errors arising. The operation of the controls may be tested by the auditor to confirm this assessment (or the auditor simply assumes controls are ineffective and uses that assessment). The product of these two risk assessments is used to determine the extent of substantive testing which is necessary to limit the remaining risk to an acceptable level for the particular disclosure category. Firms adopt various ways of combining the risks in different categories to give an overall assessment.

147. Similar risk considerations may be applied to assurance engagements on sustainability reports but, as disclosures are not capable of aggregation by means of monetary amounts, that part of the operation of the model is not directly relevant. FEE is not aware of any developed literature or research on the aggregation of such non-financial risks at present.

148. In a financial statement audit, the auditor does not report on the operation of systems of control, only on the amounts and disclosures in the financial statements that arise from their operation. In contrast, assurance on a sustainability report may include the existence and operation of systems within its scope. The assurance provider may have to consider the risk of system failure not only in relation to the disclosure of data but also in relation to the evidence necessary to allow assurance to be given directly on the operation of the system (which may involve aspects that are not in the sustainability report).

8.3 Levels of assurance

149. Even with high level assurance, there is a residual risk that there may be material error in the reported information. Where assurance is provided at a lower level of assurance than high, the residual risk is increased.

150. It may not be possible to achieve high level assurance on certain potential disclosures because of their nature, the lack of suitable criteria and restrictions on the evidence reasonably likely to be available. For example if the information system used to collect and consolidate information is found to be inadequate it is difficult to provide high level assurance on the information itself. However, if assurance is sought on the simple existence of an information or management system it may be possible to give high assurance on that matter (even if the assurance provider reports – with considerable certainty – that the system is not in operation). Once the assurance provider is asked to report on the adequacy of a system or the accuracy of its output, the circumstances may mean that it is not possible to provide high assurance.

151. Some potential subject matter is not suitable for an assurance engagement at any level of assurance. For example, a company may claim that its human rights performance is 'amongst the best in the world'. In such instances the assurance provider may seek to exclude the disclosure from the scope of an assurance report. In such circumstances, it is still possible for the assurance provider to consider the matter and perhaps report to management in a constructive way.

152. Even where there are no constraints on assurance, lower assurance may be achieved simply by performing different or less extensive procedures than would be necessary to achieve high assurance. The assurance provider and the company would agree what assurance should be provided in such circumstances.

153. The assurance provider's report and other mechanisms, such as stakeholder dialogue may be used to explain the level or levels of assurance provided. As explained further in Chapter 14 – *Assurance reporting* the accurate communication of levels of assurance may be problematic. In particular, it is difficult to report on balance and completeness where assurance is at a level below high.

Questions

Q.20 Do stakeholders and other users accept that risk, as described in Chapter 8 – *Risk perspectives*, is part of their interaction with sustainability reports?

9. STAKEHOLDER DIALOGUE

154. This chapter collects together and provides greater discussion of the issues relating to stakeholders and stakeholder dialogue. Communication with stakeholder may take the form of publishing information (both directly and through the media) including the sustainability report itself. Communication through meetings or other means whereby stakeholder views are sought is known as stakeholder dialogue.

9.1 Stakeholders

155. A working definition of stakeholders may be: individuals or organisations[19] that have, or could have, a non-trivial interest in a sustainable development decision of a company. The interest could be in influencing the decision or simply through being affected by the outcomes of a decision. For a company, stakeholders include: investors, government agencies, workers, suppliers, customers, and those potentially affected by environmental and other impacts.

156. Stakeholders with interests in environmental performance include international pressure groups, which may be of considerable importance to multinational companies operating in sensitive industries such as oil and gas.

157. Stakeholders are not synonymous with the users of sustainability reports: some stakeholders may not use the report; some users may not be stakeholders. However, for practical purposes, discussion of users and stakeholders focuses on those who are both.

9.2 Stakeholder dialogue

158. Properly implemented stakeholder dialogue may create value throughout a company, even where no sustainability report is issued. When considering stakeholder dialogue, a company will make reasonable efforts to identify its stakeholders and decide which are key to its activities and hence with which it is most important to engage in dialogue and with what frequency. These management decisions are important because they determine the range and balance of influences on the company from stakeholders – some of whom could have widely differing views and priorities.

159. Stakeholder dialogue is not a significant issue for financial reporting since both reporting and audit practices are well specified and generally understood[20]. This is not currently the case for sustainability reporting. Dialogue may influence decisions on matters that are reported, or indeed the consultation, or system of consultation, may itself be reported upon. This is particularly likely to be the case for the social component of sustainability reporting which is concerned with the interaction of the company with its stakeholders.

160. A company may use stakeholder dialogue relating to a sustainability report to ascertain:

[19] Stakeholders that are organisations may be entities such as other companies (e.g. suppliers) or government agencies. Where a stakeholder organisation has members that individually might also be stakeholders, it is often – and potentially confusingly – referred to as a stakeholder group.
[20] For financial reporting, stakeholder dialogue could be thought of as being undertaken by legislators and accounting and auditing standard setters – as part of their consultation processes when developing pronouncements.

- what matters stakeholders want in a sustainability report (and whether past reports have met their needs)
- the levels at which matters become significant enough to be included
- what imprecision in measurement or degree of approximation is acceptable
- what assurance, if any, stakeholders value.

161. Sustainability reports often benefit from the inclusion of a discussion of stakeholder engagement and their outcomes. This may include an explanation of the approach adopted by the company to identify key stakeholders. Accessibility and relevance of reports to stakeholders may mean that a company provides disaggregated (site based or local) reports in (where applicable) local languages as part of the overall sustainability reporting process.

162. Stakeholder dialogue has its limitations. There may be difficulty in identifying stakeholders, particularly in relation to wide ranging economic and integrated performance indicators. Searching to identify stakeholders and engaging with them once identified may take considerable resources. Some of those resources may have to be devoted to stakeholder education in order to promote a high degree of active participation and constructive dialogue. Companies that are not used to such processes may face considerable difficulties unless there is sufficient budget and active support from top management. One particular difficulty that can arise is where stakeholders have conflicting demands. This exacerbates the common problem of balancing the significance and extent of response to different stakeholder demands.

9.3 Significance of stakeholder dialogue for the assurance process

163. The assurance provider will normally obtain an understanding of the company's stakeholder relationships and the outcomes of dialogue (including those relating to assurance). This may be because such matters are reported, or because it enables the assurance provider to gain further insight in order to assess risk. If the company reports less than stakeholders want, the assurance provider may consider this when determining the completeness and balance of the sustainability report.

164. The assurance provider may observe the process of dialogue between management and stakeholders as a participant. Alternatively, there may be direct communication, without involvement of the company, between the assurance provider and stakeholders. The assurance provider may communicate the scope of work undertaken and the relevance and meaning of the assurance statement. In the assurance statement, the assurance provider may refer to any stakeholder dialogue that has been undertaken.

165. The growth in reporting of sustainability is likely to increase the knowledge of the public about such matters and increase the number of potential stakeholders. Preparers and assurance providers need an up-to-date knowledge of all the societies in which the company operates in order to anticipate and respond to the emergence of stakeholder demands.

Questions

Q.21 A balanced sustainability report discloses the bad news as well as the good. It must also balance the needs of all stakeholders. Is this what is really meant by balance? In view of the involvement of stakeholders, is this achievable in an objective way that allows the assurance provider to form a view on balance?

Q.22 Is there a role for stakeholder involvement in the appointment of assurance provider, particularly where the company wishes also to remove an existing assurance provider?

Q.23 Should stakeholder dialogue itself be a process which is examined by the assurance provider to address concerns that the dialogue process may be unduly influenced by the reporting organisation?

10. SUSTAINABILITY PERFORMANCE

166. This chapter examines common themes arising from providing assurance on sustainability performance. Individual aspects relating to environmental, social and economic performance are considered in Chapters 11 to 13 respectively.

167. It is important to note at the outset that environmental reporting is currently much more developed than social and economic reporting. This has a considerable effect on both sustainability reporting and assurance.

10.1 Performance indicators

168. Under the GRI Guidelines, performance is reported through the disclosure of performance indicators. These may be quantitative or qualitative. To put the indicators in proper context, reporters are asked to disclose relevant objectives and programme information and to comment on unusual events and identified trends.

169. Indicators are simply disclosures chosen because they provide information relevant to sustainability performance. Indicators are either generally applicable to all companies or specific to the reporting company. The disclosure of generally applicable indicators allows users to make comparisons with all other companies. The GRI Guidelines suggest generally applicable indicators for environmental performance but do not make suggestions for social and economic performance. Specific indicators are those that are judged critical to an understanding of the performance of the company. Their selection is determined by such factors as:

- the existence of generally recognised practice
- stakeholder demand
- the characteristics of the company and industry
- the feasibility and cost of making the disclosure
- whether assurance can be provide on an indicator.

170. The following are examples of indicators in the three dimensions of sustainability:

- environmental – total materials use (general), use of packaging materials (specific)
- social – employee retention rates
- economic – net profit/earnings/income.

171. Some indicators are given special prominence and referred to in the GRI Guidelines as ‘key indicators’ to be disclosed in the executive summary part of the sustainability report. These are the generally applicable environmental indicators and selected other indicators. There is no distinction in current sustainability reports that mirrors the primary statement/ notes format of financial statements (primary statements include the balance sheet and the

profit and loss account). Indeed there is no equivalent to the distinction between 'financial statements' and 'other information' in an annual report.

172. There is no generally recognised practice because consensus has not been achieved on generally applicable indicators. The greatest degree of consensus has arisen with environmental indicators. The environmental performance indicators in the GRI Guidelines have been subject to a robust review, assessment, and pilot-testing process. Social indicators are less developed and economic indicators are at an early stage of development.

173. The GRI Guidelines contain a section that asks reporters to experiment with 'integrated indicators'. These are two distinct types of indicator: those that link a company's performance to the macro level (termed 'systemic indicators') and those that bring together two or more of the three dimensions of sustainability (termed 'cross-cutting indicators').

174. Expenditure on research, expressed in relation to sector or national totals, is an example of a systemic indicator. Eco-efficiency indicators, such as the consumption of resources per unit of product, are the most developed cross-cutting indicators[21].

175. In order to link to the macro level it is necessary to find specific indicators where there is some justification for such a link, for example where the reporting company is a very significant contributor to the regional or national figures.

176. Sustainability is a multidimensional concept and when one attempts to split it into distinct dimensions it tends to lose some of its meaning. However, there is no common 'currency' for sustainability. It is impossible to take a single indicator, equivalent to financial profit, and use that in any way. The development of cross-cutting indicators involves a risk of misleading users by showing as related two or more unconnected measures of performance.

10.2 Management systems

177. A company may respond to risk by in many ways. Some risks may be accepted, some may be managed through a strategic process, others may be managed by the creation and operation of systems of internal control. Such systems may be described by reference to the areas of operation to which they relate. A company's systems may include: management accounting, financial accounting, environmental management, health and safety, human resources etc. and may be integrated or separate (perhaps with geographical diversity).

178. The sophistication and reliability of a system depends on the magnitude of the risks it is intended to control and the extent to which management has acted to put it in place. Financial reporting systems are normally well developed, the EMS may be well developed in industries with significant environmental impacts, whereas there may be little in the way of formal systems relating to wider economic impacts. The absence of a formal system does not in itself mean that the assurance provider has to conclude that

[21] The World Business Council for Sustainable Development published *Measuring Eco-Efficiency - A Guide to Reporting Company Performance* in October 2000. This provides a framework for companies to measure and report on 'eco-efficiency'.

there is inadequate control over the related aspects of a company's operations. However, reliance on ad-hoc or local management of risks may make control less reliable.

179. The objectives of management systems may not be aligned with reporting matters in the sustainability report. For example, an EMS may be designed to provide information only on current environmental impacts and compliance with existing laws and regulations. However, where possible, the assurance provider will seek to rely on systems to reduce the need for substantive testing.

180. The assurance provider may be asked to provide assurance on the operation of a management system, including aspects related to objectives that do not otherwise relate specifically to sustainability reporting.

181. The general approach of the assurance provider is illustrated in this paper through a discussion in Chapter 11 - *Environmental performance* of the EMS.

10.3 Assurance issues

182. Assurance problems arise in relation to each dimension of sustainability reporting and also (perhaps even more) for integrated performance indicators. The characteristics of each dimension and the reporting company's degree of progress towards full sustainability reporting give problems a different importance in each dimension. Generally, the problems are more extensive where reporting is less developed as preparers, assurance providers and users are not familiar with the issues. The relevant factors include:

- lack of an agreed framework for reporting
- diversity and subjectivity of indicators (especially those newly introduced)
- extent to which relevant management systems are in place
- external impacts of the company
- difficulty in identifying stakeholders, effecting dialogue and responding to their demands.

183. For the assurance provider, the subjective nature of the information may severely limit the quantity and quality of evidence that can be obtained for assurance purposes. A commentary on performance, which deals with the way in which a company has operated or intends to operate, is likely to be highly subjective, involving the prediction of impacts beyond the boundaries of the organisation and the possibility of trade-offs between the needs of different parties. Reliable estimation of the economic impacts of a company is particularly problematic as it may be necessary to consider a long-termtimescale and a wide and varying market.

184. The format and 'strategic' nature of narrative reports may be such that the assurance provider is obliged to rely on a 'reasonableness review', checking consistency with publicised information, including other reports by the organisation. Such disclosures and assurance work are not consistent with the circumstances that would allow high assurance to be given.

185. The particular assurance problems of each dimension of sustainability are discussed further in Chapters 11 to 13.

Questions

Q.24 Financial reporting makes a distinction between the financial statements and the other information in the annual report (such as the report of the directors). The former is audited, the latter may be just checked for consistency with the financial statements and whether they are otherwise misleading. Should this distinction be made (perhaps separately presenting statements of performance indicators) for sustainability reports?

Q.25 Financial statements make a distinction between primary statements (such as the balance sheet) and the attached notes. Would a similar distinction between certain performance indicators aid assurance provision on sustainability reports?

11. ENVIRONMENTAL PERFORMANCE

186. This section deals with the particular considerations in relation to the assurance provider's approach to providing assurance on the environmental aspects of a sustainability report.

11.1 Environmental reports

187. 'Organisations create environmental impacts at various scales, including local, national, regional, and international. These occur in relation to air, water, land, and biodiversity resources. Some are well understood, while others present substantial measurement challenges owing to their complexity, uncertainty, and synergies.

188. Environmental reporting has evolved over the last 20 years and has reached a level of emerging common practices based on a shared understanding of environmental processes. At this time, the repeated appearance of certain environmental categories, impacts and indicators provides a foundation for a common information base. Nonetheless, organisational differences remain and are reflected in the variety of indicators used by reporting companies.'[22]

189. Research has revealed that environmental reporting is now undertaken by over 1000 companies in over 30 countries and all major business sectors. The majority of these reports originate from European companies. National policies have been instrumental in this growth. For example, US companies responded to legislation in the late 1980 that put comprehensive information on their toxic releases into the public domain by reporting information to give a more balanced view. In Japan a rapid growth in environmental reporting took place in the late 1990s as large companies were encouraged by government to report using a standard format. Within Europe, the key motivator has been the Eco-Management and Audit Scheme[23], and several countries have passed legislation aimed at increasing environmental reporting – including The Netherlands, Denmark, Norway and Sweden.

190. Environmental aspects of sustainability reports differ considerably in content but generally include some combination of the following information (normally relating only to direct impacts):

- the company's environmental policy
- the company's EMS and/or EIS
- a summary of the company's environmental impacts, with any necessary explanation of their nature

[22] Quotation from Part C 'Report Content' of the Global Reporting Initiative (GRI), *Global Reporting Initiative, Sustainability Reporting Guidelines on Economic, Environmental and Social Performance*, Boston, GRI, 2000.
[23] The Eco-Management and Audit Scheme (EMAS) was adopted by the European Council on 29th of June 1993, allowing voluntary participation in an environmental management scheme, based on harmonised lines and principles throughout the European Union. See Appendix 1 – *Literature*

- the environmental objectives and targets in relation to significant environmental impacts

- a summary of performance against environmental objectives and targets for all significant environmental impacts and, where available, comparison of performance against regulatory limits and industry-sector standards

- other factors regarding environmental performance, such as fines and penalties.

11.2 Management systems

191. Companies can be faced with significant environmental risks relating to pollution or other breach of legislation that can give rise to fines and directly impact the financial statements. This has perhaps motivated companies to formalise controls over such risks at an earlier stage than over other sustainability risks.

192. Companies that operate in industries with a high exposure to environmental impacts often operate an EMS. The design of such a system may meet existing standards (for example ISO 14001). Even where the company does not operate a formal EMS, but instead monitors and controls environmental impacts in other ways, for example through the accounting and internal control system, the use of some form of environmental information system (EIS) is normal.

193. An examination of the EMS and/or EIS will often be required, as the procedures operated within these systems are normally relevant to the objectives of the engagement. The lack of a formal EMS does not in itself mean that the assurance provider has to conclude that there is inadequate control over the environmental impact of a company's operations.

194. The assurance provider may need to refer to the requirements of competent environmental authorities and will refer to correspondence concerning administrative decisions or relating to environmental matters.

195. Using the information about the company's processes, the assurance provider determines the appropriate objectives for the company's EMS, taking account of the risks faced by the company resulting from its operations, relevant legal requirements and any constraints imposed by the competent environmental authorities.

196. Based on the documentation of the system and the results of any interviews and observations, the assurance provider obtains, in addition to the evidence obtained during the planning stage, a detailed understanding of the procedures operated by the company for the collection, processing and transfer of information relating to the environment.

197. The assurance provider compares the EMS in operation with the individual objectives previously determined. If the EMS meets these objectives, the effectiveness of the system could be confirmed by performing both tests of control and substantive tests. The results of these tests then determine the nature and extent of any further procedures. The identification of weaknesses leads to the plan being changed and other methods being used if necessary.

198. If, based on the assurance provider's assessment of the systems in place, the EMS and documentation of the environmental impacts generated by that system are found to be

appropriate, the assessment forms a basis for the information to be included in the environmental report. Hence, the assurance provider compares the data in the environmental report with that recorded in the documentation generated by the EMS and examines whether the environmental report accurately presents the aggregate information.

199. It should be borne in mind that the EMS may be designed to provide information only on current environmental impacts and compliance with existing laws and regulations. Where a company's own property has been the subject of previous environmental damage, including damage by a previous occupant, or there is no legal requirement to clean up the site, the EMS may not identify the problem. Furthermore, in the absence of an obligation for clean up, the company may not wish the matter to be mentioned in the environmental report. In such circumstances, the assurance provider may need to consider the effect of non-disclosure on the assurance report.

200. Where the assurance provider's engagement comprises providing assurance on the accuracy of the information in the environmental report, the work involves an assessment of the EMS in operation as a basis for the extent and nature of substantive testing. Examples of procedures for an assessment of the EMS are:

- testing the trail from measurement to entry in the records that form the basis of the environmental report
- testing the trail from the existence of waste to its disposal and the related record keeping
- checking the calculation of variances of actual emissions compared with targets.

11.3 Substantive assurance

201. In addition to testing of, and placing reliance on, the EMS, the assurance provider will perform procedures designed to directly substantiate matters disclosed in the report. In the following paragraphs, some examples are given of substantive tests relating specifically to environmental reports. In practice, considerable expertise may be necessary to confirm certain measurements and understand expert reports.

202. Examples of analytical procedures are:

- evaluation of input-output relationships
- evaluation of data on emissions or waste against corresponding data for previous periods, industry benchmarks or targets
- the quantity of waste in relation to the quantities of products or the quantities of raw materials used.

203. Examples of substantive tests of detail:

- examining the consumption of water, energy and materials: comparison with test certificates, delivery notes, invoices received and expense accounts

- examining the quantity of hazardous substances held: these procedures are based on public register information and inventory records

- examining waste and hazardous waste: comparison with records, invoices received and other documentation related to waste disposal, checks on the correct categorisation of waste, examining adjustments to waste records

- examining soil and groundwater contamination and sewage system: assessment of expert reports and investigations undertaken either by the company or third parties

- examining emission figures: comparison with test certificates and, if applicable, investigations undertaken either by the entity or third parties in order to determine air and water pollution, the release of heat, noise and other emissions and examining adjustments to emission records

- examining products/services sold: comparison with accounting data (financial accounting, cost accounting)

- examining investments and expenditures having a material effect on the environment

- examining the company's presentation of its compliance with the quantitative provisions as set out in environmental laws and regulations: comparison of the information presented with existing operating licences and any restrictions imposed by competent public authorities and environmental laws and regulations.

11.4 Assurance issues

204. The environmental dimension is the most developed dimension of sustainability reporting. Though less experimental, the environmental dimension may be the most important to a company and its stakeholders because of the magnitude of potential impacts of certain industries. The assurance provider will also face the most severe, purely technical problems in understanding the scientific complexity of certain environmental measurements and disclosures.

Questions

Q.26 Has Chapter 11 – *Environmental performance* provided an appropriate illustration of the current impacts of environmental performance indicators and management systems on assurance engagements? What other factors do you consider significant?

12. SOCIAL PERFORMANCE

205. This section deals with the particular considerations in relation to the assurance provider's approach to providing assurance on the social aspects of a sustainability report.

12.1 Social reports

206. *'The social dimension of sustainability captures the impact of an organisation's activity on society, including on employees, customers, community, supply chain, and business partners. Social performance is a key ingredient in assuring an organisation's licence to operate, and supports the organisation's ability to deliver high-quality environmental and economic performance. Many stakeholders believe that reporting and improving social performance enhances reputation, increases stakeholder trust, creates opportunities, and lowers costs.*

207. *At present, reporting on social performance occurs infrequently and inconsistently across organisations. While there is some agreement on measures for certain dimensions of social performance, they are not as well developed as measures of environmental performance.'*[24]

208. As a dimension of sustainability reporting, company social performance is usually limited to (non-financial) indicators on workplace quality (including health and safety, non-discrimination, training and education etc.) and human rights issues, but may also include social impacts of products and services.

209. The GRI Guidelines give examples of social performance indicators, and these are closely aligned with the nine principles of the UN Global Compact launched by Secretary-General Kofi Annan in January 1999. These principles include commitments to support and respect human rights and uphold labour standards in all parts of a company. There are several social/ethical charters and codes in circulation and any company publicly endorsing one will most likely be called upon to publicly demonstrate adherence to it. This may mean developing and disclosing appropriate social performance indicators, such as those recommended by the GRI.

12.2 Management systems

210. The existence of a wide range of social indicators means that companies do not often operate an overall social management system. Monitoring and control of social impacts maybe done through the accounting and financial internal control system, or on an informal basis. Where controls are in place they will often relate to employee safety or employment practices as breach of related legislation may give rise to fines that directly impact the financial statements.

[24] Quotation from Part C 'Report Content' of the Global Reporting Initiative (GRI), *Global Reporting Initiative, Sustainability Reporting Guidelines on Economic, Environmental and Social Performance*, Boston, GRI, 2000.

12.3 Substantive assurance

211. Examples are given below of areas where substantive tests may be carried out relating specifically to social reports. The assurance provider will verify underlying data to the extent considered necessary and consider the implications of information revealed by analytical procedures, including comparison to industry benchmarks:

- employee retention rates compared to previous periods, industry benchmarks or targets
- ratio of training spend/budget to annual operating costs
- ratio of jobs offered against jobs accepted
- employment numbers and survey data on job satisfaction level
- ratio of lowest wage to national legal minimum and local cost of living
- percentage of women in senior executive and senior and middle management ranks
- standard injury, lost day, and absentee rates making comparison with accounting data (financial accounting, cost accounting)
- investment per worker in prevention of illness/injury against industry benchmarks
- levels of health and post-retirement benefits provided to employees
- incidences of non-compliance with child labour legislation
- investment decisions influence by considerations of human rights performance of investee companies (operation of human rights screens on investments).

212. The assurance provider will examine the company's presentation of its compliance with the quantitative provisions as set out in social laws and regulations and compare the information presented with existing operating licences and any restrictions imposed by competent public authorities and social laws and regulations. It is only to this limited extent that an assurance engagement will address the company's compliance with social laws and regulations.

12.4 Assurance issues

213. The social dimension has less developed management systems than the environmental dimension, so the assurance provider will generally not be able to place as much reliance on management systems.

214. Similar actions of a company may produce dissimilar impacts in different local environments. This consideration limits the value of certain analytical procedures and introduces considerable doubt about the value of benchmarking against the policies and performances of other organisations.

215. Social performance will frequently be reported in the form of qualitative indicators that describe policies and programmes in place, for example to uphold labour standards and ensure that human rights are not violated. Indicators may be at several levels, ranging from a disclosure that a particular policy is to be adopted, though to a statement that there has been full global compliance. As the disclosure becomes more specific the assurance provider faces a progressively harder task to gain assurance. In extreme cases it will be impossible to give assurance on some statements and discussion with management may be necessary to revise the intended approach to disclosures.

216. Reporting quantitative social indicators will often mean collecting information from several different sources both inside and without the company, for example relating wage levels in different countries to the local cost of living or national averages. Relevant and timely statistics may be difficult to obtain.

217. Stakeholder dialogue is most relevant to the social dimension. Indeed, some disclosures depend entirely on such dialogue, for example, in relation to indigenous rights in certain geographic areas, disclosures concerning evidence of indigenous representation in decision making. Stakeholders with interests in social performance include international pressure groups which may be of considerable importance to multinational companies operating in sensitive industries.

Questions

Q.27 Has Chapter 12 – *Social performance* provided an appropriate illustration of the current impacts of social performance indicators and management systems on assurance engagements? What other factors do you consider significant?

13. ECONOMIC PERFORMANCE

218. This section deals with the particular considerations in relation to the assurance provider's approach to providing assurance on the economic aspects of a sustainability report.

13.1 Economic reports

219. *'Organisations affect the economies in which they operate in many ways, including through their use of resources and creation of wealth. These impacts, however, are not fully captured and disclosed by conventional financial accounting and reporting. Thus, additional measures are required to capture the full range of an organisation's economic impacts. Sustainability reporting has rarely embraced economic measures to date, although there is a lengthy history of measuring certain economic effects, for example, of company relocation, closure, and investment.'*[25]

220. Economic activity is linked to the environmental element of sustainable development but its measurement may assume that natural resources are freely available and have no value and that all economic activities, including clean-up costs, have a positive effect on results. The economic dimension of sustainable development is also closely related to the social element since it is concerned with how business and society allocate scarce resources to satisfy human needs.

221. At present, there are few examples of companies systematically reporting on their economic performance. A recent paper[26] found that *'even leading-edge companies which have publicly embraced the principle of 'triple bottom line' reporting have focused their economic reporting on an ad hoc bundle of performance measures covering profit and growth, dividends and shareholder return, tax, competition and investments.'* The paper also drew attention to the failure to address the key sustainability issues: *'with few exceptions, such issues were not addressed – for example, the world's dependence on fossil fuels or the destruction of ecosystems through raw material extraction by forestry and mining companies'.*

222. The GRI Guidelines include suggested economic performance indicators for the following groups of stakeholders:

- customers
- suppliers
- employees
- investors/lenders
- government and the community.

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[25] Quotation from Part C 'Report Content' of the Global Reporting Initiative (GRI), *Global Reporting Initiative, Sustainability Reporting Guidelines on Economic, Environmental and Social Performance*, Boston, GRI, 2000.

[26] *Adding values – The economics of sustainable business*, Simon Zadek and Chris Tuppen, British Telecommunications Plc, May 2000.

223. For a particular company, the potential for specific economic impacts may be large and may include:

- contribution of the industry sector to Gross Domestic Product, national competitiveness and productivity
- effect on national economies of any investment in national infrastructure
- economic effects of changes in location of operations
- impacts on economic development resulting from skills fostered by the company
- economic consequences of outsourcing policies.

224. Economic disclosures that derive from the financial accounting systems, such as environmental investments and annual operating costs are relatively common (and may be regarded as cross-cutting indicators). Such disclosures are not simple, as care has to be taken over the precise definition of environmental costs and its consistency over several reporting periods.[27] Where the indicators do not derive from the financial accounting systems or systems closely allied, they involve economic effects on the stakeholder groups, such as impacts on their economic capacity. Reliable assessment of such effects (when they are material) for reporting and assurance presents technical difficulties. Indeed, there may be difficulty in establishing the identity of stakeholders when the subject matter is potentially so wide.

13.2 Management systems

225. Companies affect the economies in which they operate in many ways, including their use of resources and creation of wealth. Specific management systems are not normally put in place to monitor and control 'economic' aspects of a company's business as economic performance indicators are diverse. However, in many cases financial reporting and allied systems are relevant. While certain economic effects, for example those of company location, closure and investment may be estimated and reported, wider impacts are not fully captured and disclosed by conventional financial accounting and reporting.

13.3 Substantive assurance

226. Examples have been given in Chapters 11 and 12 of substantive tests that may be appropriate to the environmental and social dimensions of sustainability reports. These provide sufficient illustration of the types of procedures carried out by assurance providers and accordingly no further specific examples are given in this chapter.

[27] Guidance on such matters is available in a UN publication Jasch Ch., *Environmental Management Accounting, Procedures and Principles*. See Appendix 1 – *Literature*

13.4 Assurance issues

227. Economic aspects of a sustainability report are the least developed dimension of sustainability reporting and assurance providers are faced by extremes of the problems that may arise elsewhere. In addition, for economic disclosures there is the particular problem of interaction between the report and disclosures in the financial statements.

228. Much of the information that is used in developing economic performance indicators is not likely to be subject to any form of internal control to prevent errors or omissions. Where economic data has been collected from sources outside the organisation, the assurance provider will need to assess the completeness and reliability of the information. This may involve inspection of source data and comparison with external macro-level economic reports. Upstream and downstream economic impacts of an organisation's activities are probably the most difficult aspect on which to provide assurance. Once a track record has been established, it may be possible to compare future economic impacts, as presently envisaged, with those that were forecast in previous years. Where expected external economic impacts are described in sustainability reports issued by similar organisations, the reason for any significant disparity may be considered.

229. Economic aspects include, but are not limited to, the impact of financial transactions that are reported as part of the financial statements. Where the assurance provider is not the financial statement auditor appropriate consideration will have to be given to how such figures are included in the sustainability report. It may be possible to incorporate figures and note that they have been extracted from the audited financial statements. However, there may be timing difficulties if the sustainability report and the financial statements are not issued at the same time.

230. If separate assurance is to be given on such disclosures at reasonable cost, the assurance provider will have to rely to some extent on the work of the auditors. Such considerations may also apply to assurance on the operation of the financial systems to the extent that they are relevant to other disclosures.

Questions

Q.28 Has Chapter 13 – *Economic performance* provided an appropriate illustration of the current impacts of economic performance indicators and management systems on assurance engagements? What other factors do you consider significant?

14. ASSURANCE REPORTING

231. An external assurance provider's report conveying assurance can take different physical forms and be made to one or more users, inside or outside the company. There may be other reports arising from the assurance process, such as suggestions to management for improvements in systems or, if required by legislation, reports to third parties, for example to report serious environmental damage. This chapter considers, however, only one form of assurance report: a report in writing to general users of the sustainability report. This is normally published in or with the sustainability report to which it relates.[28]

232. In general, a narrative assurance report will be used, in which the scope of the assurance engagement, the details of the procedures undertaken during the course of the assurance engagement and the conclusions are presented. The language used has to be understandable for the intended users.

233. Three different approaches to assurance were explained in Chapter 5 – *General assurance approach*. The report of a social auditor or a consultancy may be included in the sustainability report or referred to by it. Although the discussion below does not cover these reports in detail, the interaction between an overall assurance report and these reports is may be important.

14.1 Reporting standards

234. There are no specific standards dealing with the contents of assurance reports on sustainability reports. Where the assurance provider is a professional accountant and where the report is intended to convey a high level of assurance the IFAC 'International Standard on Assurance Engagements' (ISA 100) identifies a minimum set of information that should be disclosed:

'*(a)* ***title****: an appropriate title helps to identify the nature of the assurance engagement being provided, the nature of the report and to distinguish the practitioner's report from reports issued by others such as those who do not have to abide by the same ethical requirements as the practitioner;*

(b) ***an addressee:*** *an addressee identifies the party or parties to whom the report is directed;*

(c) ***a description of the engagement and identification of the subject matter:*** *the description includes the engagement objective, the subject matter, and (when appropriate) the time period covered;*

(d) ***a statement to identify the responsible party and describe the practitioner's responsibilities:*** *this informs the reader that the responsible party is responsible for the subject matter and that the practitioner's role is to express a conclusion about the subject matter;*

(e) ***when the report is for a restricted purpose, identification of the parties to whom the report is restricted and for what purpose it was prepared:*** *while the practitioner cannot control the distribution of the report, this will inform readers of the party or parties to whom the report is restricted and for what purpose, and provides a caution to readers other than those identified that the report is intended only for the purposes specified;*[29]

[28] Examples of current reporting practice may be obtained from the sources listed in Appendix 1 – *Literature*.
[29] This chapter does not address the 'restricted purpose' report.

(f) ***identification of the standards under which the engagement was conducted:*** *when a practitioner performs an engagement for which specific standards exist, the report identifies those specific standards. When specific standards do not exist, the report states that the engagement was performed in accordance with this Standard. The report includes a description of the engagement process and identifies the nature and extent of procedures applied;*

(g) ***identification of the criteria:*** *the report identifies the criteria against which the subject matter was evaluated or measured so that readers can understand the basis for the practitioner's conclusions. The criteria may either be described in the practitioner's report or simply be referred to if they are set out in an assertion prepared by the responsible party or exist in a readily accessible source. Disclosure of the source of the criteria and whether or not the criteria are generally accepted in the context of the purpose of the engagement and the nature of the subject matter is important in understanding the conclusions expressed;*

(h) ***the practitioner's conclusion, including any reservations or denial of a conclusion:*** *the report informs users of the practitioner's conclusion about the subject matter evaluated against the criteria and conveys a high level of assurance expressed in the form of an opinion. Where the engagement has more than one objective, a conclusion on each objective is expressed. Where the practitioner expresses a reservation or denial of conclusion, the report contains a clear description of all the reasons;*

(i) ***the report date:*** *the date informs users that the practitioner has considered the effect on the subject matter of material events of which the practitioner became aware up to that date; and*

(j) ***the name of the firm or the practitioner and the place of issue of the report:*** *the name informs the readers of the individual or firm assuming responsibility for the engagement.*[30]*'*

235. While it is most relevant to high level assurance, the above may also be influential when lesser assurance is reported. These minimum requirements may be tailored to the specific engagement circumstances. For certain assurance engagements, the assurance provider may choose to adopt a flexible approach using a narrative (or 'long form') style of reporting rather than a standardised (or 'short form') format. However, a consistent order of presentation is important for the comparability of assurance reports.

14.2 Reporting practicalities

236. The following practical difficulties may arise in relation to the assurance report:

- in the absence of generally accepted reporting standards for sustainability reports, it may require a considerable effort to set out the extent of the subject matter (where the scope of the engagement is limited) and to identify the criteria against which the subject matter was evaluated. This may be further complicated by reports presenting data for several years and reports where new types of disclosure are added each year. Although the GRI Guidelines have gained some acceptance, they are evolving and company-specific criteria may have to be employed and described

- as there are no specific standards for assurance engagements on sustainability reports, the assurance report may be required (where ISA 100 applies) to state that the engagement was performed in accordance with that standard. Where no standards are identified, it could take considerable effort to describe the engagement process and the nature and extent of procedures applied

[30] Quoted directly from paragraph 71 of ISA 100.

- users may not be familiar with the credentials of the assurance provider and these may need to be set out to add credibility to the assurance. For example, users might not know that a professional accountant will make use of experts in sustainability matters in a multidisciplinary team

- the report may need to set out and explain the degree to which the assurance provider is independent of the company and the subject matter of the assurance report (e.g. if consultancy advice has been given on systems from which disclosures arise)

- if there are reports from two or more assurance providers, their respective responsibilities will have to be communicated

- although a report ought to communicate the level of assurance, there is considerable doubt whether it is possible to communicate assurance levels between none and high (i.e. reasonably certain) assurance

- where the level of assurance is not uniform (e.g. high level on environmental performance, lower level on policies, organisation, and management systems) the report (or perhaps reports) will have to present that in an appropriate fashion. The readership of an assurance report on sustainability may not understand references such as 'less than a full audit'

- where assurance is being provided on matters other than simple disclosures (e.g. adherence to codes of conduct, effectiveness of systems) that will require explanation and it may be clearer to use a separate report

- where there is any assessment of sustainability performance or the rate of progress in reporting or performance, such assessments will need to be differentiated from the assurance on the sustainability report itself

- a necessarily long report introduces further challenges of achieving clarity and balance (including balance with the length of the sustainability report itself)

- in the absence of control over the format of summary sustainability reports and reporting on the Internet, the assurance provider will have to consider any effects on wording and whether to allow extracts, summaries or cross references to be used

- the views of stakeholders may be necessary to help determine the most appropriate wording for the report. Other dialogue with stakeholders may itself be referred to in the assurance report.

237. Problems associated with Internet reporting are not unique to assurance on sustainability reports, although, given the potentially greater interest from diverse users, the problems may be more than those in respect of financial statements. Some national auditing standard setters have issued guidance on such reporting but IFAC has yet to do so. As the issues relating to Internet reporting are not unique to reports providing assurance on sustainability reports they are not considered further in this paper.

Questions

Q.29 Do you agree with the minimum set of information that should be disclosed if ISA 100 is followed?

Q.30 Chapter 14 – *Assurance reporting* highlights several reporting practicalities. Proper disclosure of scope, criteria, the work done, level of assurance, standards applied and so on is seemingly only possible in a narrative report whose length may deter readers. Is there any solution to this overall reporting problem?

Q.31 Assurance may be obtained from one or more assurance providers. What is the best way to ensure that stakeholders appreciate the respective roles and responsibilities of the parties?

APPENDIX 1 – LITERATURE

This Appendix lists the papers and other publications referred to in the chapters of this discussion paper together with their source, which is normally the address of the Internet website from which they may be downloaded.

The Appendix also provides sources which may be used to develop an understanding of sustainability and to locate examples of sustainability reports and the associated reports of assurance providers. Several of the websites listed have extensive collections of relevant links through which further information may be obtained.

Chapter 1 Introduction

Fédération des Experts Comptables Européens (FEE), *Discussion Paper – Providing Assurance on Environmental Reports*, FEE, Brussels, 1999. See http://www.fee.be/publications/main.htm

Fédération des Experts Comptables Européens (FEE), *Analysis of Responses to FEE Discussion Paper 'Providing Assurance on Environmental Reports' published in October 1999*, FEE, Brussels, 2000. See http://www.fee.be/publications/main.htm

Global Reporting Initiative (GRI), *Global Reporting Initiative*, *Sustainability Reporting Guidelines on Economic, Environmental and Social Performance*, GRI, Boston, 2000. See http://www.globalreporting.org As explained on the GRI website, the GRI Guidelines are being updated during 2002.

General standards for providing assurance on sustainability reports may be found in International Standard on Auditing 100 *Assurance Engagements*, and some specific materials in *AccountAbility 1000 Framework* (AA1000) and *Social Accountability 8000* (SA8000):

- ISA 100 is available from IFAC. An exposure draft of a proposed revision to ISA 100 to incorporate 'moderate assurance' is expected after June 2002 and should be available for free download from a new website: http://www.iaasb.org

- *AccountAbility 1000 framework* (AA1000) is available from the Institute of Social and Ethical Accountability. It provides guidance to users on how to 'establish a systematic stakeholder engagement process that generates the indicators, targets, and reporting systems needed to ensure its effectiveness in impacting on decisions, activities, and overall organisational performance'. It is being revised during 2002 and will be renamed AA1000S. Module 1 of the new series will deal with 'quality assurance and external verification'. See http://www.accountability.org.uk

- *Social Accountability 8000* (SA8000) is issued by Social Accountability International (SAI), a charitable human rights organisation dedicated to improving workplaces and communities by developing and implementing socially responsible standards. SA8000 is a workplace standard that covers all key labour rights and certifies compliance through independent, accredited auditors. See http://www.cepaa.org

Chapter 2 From environmental to sustainability issues

Fédération des Experts Comptables Européens (FEE), *Discussion Paper – Towards a Generally Accepted Framework for Environmental Reporting*, FEE, Brussels, 2000. See http://www.fee.be/publications/main.htm

Chapter 3 Sustainability issues

United Nations World Commission on Environment and Development (UNWCED), *Our common future (Brundtland Report)*, UNWCED, Oxford University Press, Oxford, 1987. There is no Internet version of this text currently available.

The Dow Jones Sustainability Index is a listing of companies identified as being amongst the global leaders in corporate sustainability. It provides links to the related websites and so is useful to those wanting to see examples of current sustainability reporting. See http://www.sustainabilty-index.com

The Fair Labor Association accredits organisations applying its Code of Conduct. The website provides information on its sponsors and the companies that have adopted the Code. See http://www.fairlabor.org

Agenda 21, the Rio Declaration on Environment and Development, and the Statement of principles for the Sustainable Management of Forests were adopted by more than 178 Governments at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janerio, Brazil, 3 to 14 June 1992. See http://www.un.org/esa /sustdev/agenda21.htm

Chapter 4 Benefits and limitations of assurance

The Business Case for Sustainable Development – Making a difference toward the Johannesburg Summit 2002 and beyond published by the World Business Council for Sustainable Development (WBCSD). See http://www.wbcsd.ch/projects/wssd/business-case.pdf. The WBCSD is a coalition of 150 international companies that aims to provide business leadership as a catalyst for change toward sustainable development.

Chapter 5 General assurance approach

Debating the 'Power' of Audit, Humphrey C. and Owen D. (1999) International Journal of Auditing 4(1), pp. 29-50.

International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC), *International Standards on Auditing*, IFAC, New York. See http://www.ifac.org

The International Standards on Auditing (ISAs) issued by the International Auditing Practices Committee (IAPC)[31] of IFAC establish the basic principles and essential procedures for professional accountants in public practice for the performance of audit engagements. Many national standard setters have issued auditing standards based on ISAs (in the USA separate, but equally rigorous, standards apply). At the time of issue of this discussion paper, IAPC is revising several important ISAs to give effect to what has become known as the 'business risk' approach to auditing. Elements of this are described in Chapter 8 – *Risk perspectives* of this paper.

Independence is dealt with in the IFAC Code of Ethics. Downloadable from http://www.ifac.org

[31] During 2002 IAPC is to become the 'International Auditing and Assurance Standards Board'.

Robert Langford, *Providing Assurance on the Reliability of Sustainability Reports under the Global Reporting Initiative*, ICAEW, London, April 2000.

Chapter 6 Criteria for sustainability reporting and assurance

International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC), *International Standard on Auditing 100 Assurance Engagements*, IFAC: New York, June 2000. Note that the document may also be known as ISAE 100 as it refers to itself as an International Standard on Assurance Engagements (ISAE). See http://www.ifac.org

Chapter 9 Stakeholder dialogue

Agenda 21 is a programme of action for sustainable development worldwide. Its agreement was a key historical event in stakeholder recognition. It addresses the role of different stakeholders in the implementation of a global agreement including: women, youth, indigenous peoples, NGOs, business & industry, workers & trade unions, science & technology, farmers, and local authorities. It was agreed at the United Nations Conference on Environment and Development (UNCED) held in Rio de Janerio, Brazil, in 1992. See http://www.un.org/esa/sustdev/agenda21.htm

AccountAbility 1000 framework (AA1000) deals extensively with stakeholder engagement see http://www.accountability.org.uk

The Copenhagen Charter: a management guide to stakeholder reporting Ernst & Young, KPMG, PricewaterhouseCoopers, House of Mandag Morgen, 1999.

Chapter 10 Sustainability performance

The WBCSD published *Measuring Eco-Efficiency - A Guide to Reporting Company Performance* in October 2000. This provides a framework for companies to measure and report on 'eco-efficiency'. See http://www.wbcsd.ch

Chapter 11 Environmental performance

The Eco-Management and Audit Scheme (EMAS) was adopted by the European Council on 29th of June 1993, allowing voluntary participation in an environmental management scheme, based on harmonised lines and principles throughout the European Union. For participation by companies its aim is to promote continuous environmental performance improvements of activities by committing organisations to evaluate and improve their own environmental performance. The scheme does not replace existing Community or national environmental legislation or technical standards. See http://europa.eu.int/comm/environment/emas/

Jasch Ch., *Environmental Management Accounting, Procedures and Principles*, United Nations Division for Sustainable Development, Department of Economic and Social Affairs (United Nations publication, Sales No. 01.II.A.3). See http://www.un.org/esa/sustdev/estema1.htm

Chapter 13 Economic performance

Adding values – The economics of sustainable business, Simon Zadek and Chris Tuppen, British Telecommunications Plc, May 2000.

Sustainability generally

Sustainability is a major area of inter-governmental and public concern. In addition to the UN website mentioned above, which is a primary source of information, (http://www.un.org/esa/sustdev/index.html) the following two websites provide an overview of the global trajectory of sustainability at the beginning of this century.

The next World Summit on Sustainable Development is in Johannesburg 26 August to 4 September 2002. The related website contains relevant news and papers and a comprehensive set of links to websites of government and other Summit participants. See http://www.johannesburgsummit.org

UK Government, reports on progress by the United Kingdom as a whole towards sustainable development. Includes a section called 'What is Sustainable Development?' See http://www.sustainable-development.gov.uk/index.htm

As well as the FEE website (http://www.fee.be), extensive information may be found on the websites of three accountancy bodies:

- ACCA: reporting awards and other resources http://www.accaglobal.com/social_environmental/
- Canadian Institute of Chartered Accountants: annotated list of websites http://www.cica.ca/cica/cicawebsite.nsf/public/CICAProfessionalAffairs
- Institute of Chartered Accountants in England and Wales: annotated list of websites http://www.icaew.co.uk

The provision of references to the large body of relevant academic literature is outside the scope of this discussion paper. However, the book *Accounting for the Environment*, Rob Gray and Jan Bebbington, pub. Sage ISBN 0-7619-7137-8, gives a knowledgeable insight into the subject and its extensive bibliography and is a good starting point for research.

Sustainability reports

Examples of sustainability reports and reports of assurance providers may be found through Internet search engines. The following surveys or collections may also be useful:

The Corporate Register provides a searchable database of companies issuing environmental, social and sustainability reports. See http://www.corporateregister.com

The Dow Jones Sustainability Index listing of companies. See http://www.sustainabilty-index.com

'The Global Reporters', a benchmark survey of corporate sustainability reporting 2000, SustainAbility Limited with the support of the United National Environment Programme (UNEP). See http://www.sustainability.com/publications/engaging/global-reporters.asp

'Stepping Forward' a benchmark survey on Canadian corporate sustainability reporting identifies 57 companies that prepare sustainability reports of different kinds. See http://www.stratos-sts.com/pages/publica010.htm

APPENDIX 2 – GLOSSARY

This glossary provides short explanations of terms used in the discussion paper. These are not intended to be definitions. FEE provides an 'Environmental Lexicon' that gives definitions and much more information on relevant organisations and other matters. It may be downloaded from http://www.fee.be/publications/main.htm

Accountancy approach:
A method of gaining assurance on sustainability information. In contrast to the consultancy approach and social audit it is an independent assessment of the company's own reported information. It is so called because it was developed by accountants acting as auditors issuing reports that give a high level of assurance on financial statements. It is a structured approach involving an assessment of risk of material misstatement in order to design appropriate assurance procedures.

Accountancy professional bodies:
Individual accountants may qualify to become members of professional bodies by passing examinations. The professional bodies have codes of conduct for members with which they enforce compliance. The bodies may also act on behalf of their member by responding on their behalf to discussion papers. A list of such bodies is given on the IFAC website.

Agreed-upon-procedures (engagement):
Where a client wants to obtain assurance, but the circumstances are such that an accountant cannot do an audit or other assurance engagement, the accountant may perform certain procedures of an assurance nature and simply report the results without giving a conclusion. Accountants refer to such an engagement as 'agreed-upon-procedures'.

Analytical procedure:
A substantive procedure which involves the analysis of information for significant relationships, ratios or trends and the investigation of inconsistencies that are revealed.

Annual report:
In financial reporting, a document relating to a particular year (which need not be a calendar year) containing the financial statements and other financial information (of a more narrative nature).

Assurance engagement:
An engagement to provide assurance.

ISA 100 refers to assurance engagements as follows: *'Assurance engagements performed by professional accountants are intended to enhance the credibility of information about a subject matter by evaluating whether the subject matter conforms in all material respects with suitable criteria, thereby improving the likelihood that the information will meet the needs of an intended user.'*

Assurance provider:
A firm or individual performing an assurance engagement.

Assurance:
That which enhances the credibility of information.

Audit:
An assurance engagement in which the credibility of information is enhanced to a high level, for example a statutory audit of financial statements.

Auditing standards:
The term may mean a body of rules required to be followed by auditors (as in 'International Standards on Auditing') or refer to individual requirements within that body setting out the basic principles and essential procedures that auditors should carry out in particular circumstances.

Auditor:
A firm or individual performing an audit. In many jurisdictions, auditors of financial statements are required by law (or delegated requirements) to hold an appropriate professional qualification.

Consultancy (approach):
An approach to assurance provision in which the assurance provider reviews the management systems (and codes of conduct in practice). It leads to proposals for improvements by management.

Control system:
That part of a management system that seeks to ensure that the specific objectives of the management system are achieved.

Control:
A policy or procedure within a control system.

Criteria (for reporting):
Standards or benchmarks against which the subject matter of an assurance engagement may be evaluated or measured.

Cross-cutting indicators:
A type of integrated performance indicator that bring together two or more of the three dimensions of sustainability.

Eco-efficiency:
A form of cross-cutting performance indicator involving the economic and environmental (ecological) dimensions.

Economic:
A dimension of sustainability dealing with the economic impacts of a company, i.e. the effects on the economy or economies in which it operates.

EIS:
Environmental information system.

EMS:
Environmental management system.

Environmental information system:
A system that reports environmental information.

Environmental management system:
A management system designed to address and control the environmental impacts of a company.

Environmental report:
A reports of a company dealing with the environmental dimension of sustainability. The term may also be used to refer to a stand-alone report or disclosures concerning environmental matters issued with other reports (e.g. financial statements).

Financial statements:
A report (usually annual) of a company dealing with financial matters, such as profit and assets. In many jurisdictions the form and content are prescribed by law or regulation or applicable financial reporting standards.

GRI Guidelines:
Sustainability reporting guidelines issued by the GRI.

GRI:
The Global Reporting Initiative is an international multi-stakeholder body established to create a common framework for sustainability reporting. See http://www.globalreporting.org

Health and safety report:
A company report specifically dealing with workforce health and safety matters. It may be produced voluntarily or in relation to specific external requirements.

IAPC:
International Auditing Practices Committee is that part of IFAC that issues International Standards on Auditing and other assurance pronouncements. During 2002, IAPC becomes the International Auditing and Assurance Standards Board. See http://www.iaasb.org (becomes operational during 2002).

IFAC:
The International Federation of Accountants is a body whose members are themselves bodies having accountant members. IFAC issues standards for audit and assurance work and a code of ethics for accountants. See http://www.ifac.org

Independence:
A state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgement, allowing an individual to act with integrity, and exercise objectivity and professional scepticism. As this is difficult to demonstrate, it is commonly linked to the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude that independence had been compromised.

Indicator:
A readily understandable disclosure that shows the status of a part of a management system or related impacts thereby giving users a sense of the wider sustainability performance of the company.

Integrated indicators :
Performance indicators that either relate to two or more dimensions of sustainability ('cross-cutting') or link the company's performance to the macro level ('systemic').

Internal control:
Those policies and procedures a company employs to ensure the achievement of its objectives. It may be used as a collective term for management systems.

Investors :
People or entities that use money so as to increase its value and / or produce income. Investors in a company buy its shares or debt instruments.

ISA 100:
An International Standard on Auditing that deals with assurance engagements (also known as ISAE 100) issued by IAPC.

ISO:
The International Organization for Standardization: is a worldwide federation of national standards bodies. ISO standards are produced in many fields. The ISO 14000 series is primarily concerned with 'environmental management' and is important in the context of sustainability. See http://www.iso.ch/

Key indicators:
Important performance indicators that, under the GRI Guidelines, are reported with prominence.

Management systems :
A management system is the policies and procedures operated to achieve specific objectives relating to performance and / or reporting. It may be considered to be a combination of an information system and a control system, however the term is often used in a way synonymous with the related control system.

Management:
Those directing or running the company. (In this paper, no distinction has been drawn between management and those charged with governance.)

Materiality:
A threshold quality of the significance of a disclosure such that, above it, omission or misstatement of a disclosure would affect the users of a report.

NGO:
Non-Governmental Organisation: usually refers to those having a direct interest in sustainability issues, that may also be considered to be 'stakeholder groups', for example WWF. See http://www.wwf.org

Performance indicators:
Disclosures chosen because they provide information relevant to sustainability performance. Indicators are either generally applicable to all companies or specific to the reporting company. Some may also be common within an industry.

Review:
A word used in the context of assurance to indicate a range of engagements differing in their subject matter and the level of assurance (below high level). The term can also be applied to procedures forming part of an engagement as in 'review of correspondence between management and lawyers'.

Social audit:
An assurance approach in which an outside party comments on one or more aspects of a company's sustainability performance. In this context, 'social' can include other dimensions of sustainability.

Social management system:
The management system relating to the social dimension of sustainability. In practice, two or more systems may deal with individual aspects, e.g. health and safety and equal opportunities.

Social:
The dimension of sustainability that relates to the human impacts of a company, such as working conditions and community involvement.

Stakeholder dialogue:
Interaction between a company and its stakeholders to ascertain stakeholder views and communicate information relevant to stakeholders.

Stakeholder group:
A stakeholder that has as its members individuals (or other entities) that are, or could be, individual stakeholders.

Stakeholders:
Those having a non-trivial interest in the decisions of a company.

Substantive procedures:
Procedures performed to obtain direct audit evidence concerning disclosures. They are of two types: tests of details, and analytical procedures (compare 'tests of control').

Sustainability reports:
A document relating to a particular period (often a year) containing disclosures about the sustainability performance of a company.

Sustainability:
The concept of development towards meeting the needs of the present generation without compromising the ability of future generations to meet their own needs.

Systemic indicators:
A type of integrated performance indicator that links a company's performance to the macro level.

Tests of control:
Procedures carried out to obtain indirect evidence concerning disclosures by obtaining evidence that a management system, or part of a system, exists and is operating as it should. A procedure may involve observation and enquiry, as well as reperforming actions the system should have carried out. Test data may be used in computer systems or reports generated by controls may be examined.

Tests of detail:
A substantive test that is not an analytical procedure. Such test may include inspection and verification to supporting documents (on a test basis).

UNEP:
United Nations Environment Programme: established in 1972, works to encourage sustainable development through sound environmental practices. Extensive information resources are accessible at http://www.unep.org

Verification:
A test of detail in which a matter is confirmed by reference to very persuasive evidence, such as checking a disclosure to third party documentation.