Institute of
CHARTERED ACCOUNTANTS
of New Zealand

EXPERTISE AND INTEGRITY

Report of the Taskforce on Sustainable Development Reporting

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Executive Summary

1.0 The terms of reference for the Taskforce on Sustainable Development Reporting were to define and scope what thought leadership in sustainable development reporting entails, and identify the outputs required by the Institute of Chartered Accountants of New Zealand (the Institute) (and/or other parties) having regard to the likely costs and benefits to the Institute, members and users of information.

1.1 In undertaking this task it is considered important to note that society is not static but dynamic, and that the information needs of users will continue to evolve over time. Further, the information and accountability expectations of users for external reporting by entities have broadened in recent years, resulting in the rapid growth of entities undertaking sustainable development reporting. Within this context it is paramount that users have information that is meaningful e.g. relevant, measurable and comparable, and that the benefits of disclosure outweigh the direct and indirect costs of collection and preparation.

1.2 Further, the verification of sustainable development reporting should have the rigour of the audit of a financial report e.g. an attitude of professional scepticism, independence, objectivity and integrity. Users should be given a high level of assurance on the audit subject manner, including the ability to benchmark the performance and impacts of entities over time. We note that there are currently no requirements for entities that produce separate sustainable development reports to have those reports audited.

1.3 There are important issues to test and subsequently analyse, including issues of causality and measurability. This would suggest a need for careful experimentation by entities over time.

1.4 Taskforce members are of the view that the external reporting information by entities should be driven by the information and accountability requirements of users.

1.5 We consider the nature of the information contained within sustainable development reporting fits within the current conceptual framework for external reporting and auditing by entities. The role of the Institute is to provide a context for good practice to develop and operate, within the framework provided by the Statement of Concepts, Financial Reporting Standard No. 2: *Presentation of Financial Reports* and Auditing Standard No.100: *Objective of and General Principles Governing an Audit.*

1.6 Currently we are unaware of any significant support for mandatory regulatory settings requiring all entities to undertake sustainable development reporting.

1.7 The Taskforce has suggested a number of recommendations to reinforce the Institute's role in connection with external reporting and auditing of sustainable development reporting, including the creation of a standing sub-committee to provide on-going leadership and guidance on the external reporting and auditing of sustainable development reports.

1.8 Taskforce members would like to formally place on record their appreciation of the support and valuable work of the Institute's Sustainability Special Interest Group.

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Introduction

2.0 The Taskforce on Sustainable Development Reporting (the Taskforce) was established to:

- *define and scope what thought leadership in sustainable development reporting entails; and*
- *identify the outputs required by the Institute of Chartered Accountants of New Zealand (the Institute) (and/or other parties) to achieve a position of thought leadership, having regard to the likely costs and benefits to the Institute, members and users of information.*

2.1 For the purposes of the Taskforce, the following working definition of sustainable development reporting was adopted:

- *External reporting of the economic, social and environmental performance and impacts of an entity.*

2.2 In using this definition, the Taskforce acknowledges the uncertainty surrounding the mix and weight of policy instruments required to achieve sustainable development, including external reporting.

2.3 Further, the following definition of thought leadership was adopted:

- *To enhance the position of the Institute so that it has the acknowledged ability to anticipate, shape, assess and apply innovation to the development of sustainable development reporting for the overall benefit of New Zealand.*

2.4 The Taskforce has undertaken an environmental scan, which provided an overview of the main bodies that may influence the development of sustainable development reporting within New Zealand, and also the current and intended activities of national and international accounting bodies.

2.5 In addition, a number of organisations were asked to present their perspectives on the external reporting of sustainable development: Treasury, Ministry for the Environment, New Zealand Business Roundtable, and New Zealand Business Council for Sustainable Development (NZBCSD).

2.6 There is evidence of demand for more information on the economic, social and environmental impacts of entities, strong interest in "socially responsible investing", and some indications of an expectation gap between what is sought by users in an annual report and what is currently provided. Some entities are responding to this demand, but the information provided varies greatly with regard to its usefulness and reliability.

2.7 Governments in a range of countries have sought to encourage sustainable development reporting, through both voluntary and regulatory approaches.

2.8 Some accountancy bodies have been pro-active in this area, particularly the Association of Chartered Certified Accountants in the United Kingdom and the Canadian Institute of Chartered Accountants, and (more recently) the Institute of Chartered Accountants of Australia and CPA Australia. The NZBCSD is requiring its members to issue sustainable development reports within three years of joining, and has expressed a desire for guidance from the Institute in this area. There are also a number of bodies developing sustainability reporting guidelines, the most comprehensive being the Global Reporting Initiative (GRI).

2.9 The following sections of the report discuss:

- Sustainable Development Reporting: Definition Issues
- The Purposes and Users of Information within Sustainable Development Reports
- Current Framework for the External Reporting and Auditing of Financial and Non-financial Information in Relation to Sustainable Development Reporting
- International Frameworks and Guidelines for Sustainable Development Reporting and Auditing
- The Way Forward, and
- Recommendations.

Sustainable Development Reporting: Definition Issues

3.0 The purpose of this section is to consider a definition of sustainable development reporting. In the first instance this requires consideration of what sustainable development entails, as this is the focus of the proposed reporting activity.

3.1 The term "sustainable development" was first defined in 1987 by the United Nations' Brundtland Commission as:

> *"…development which meets the needs of the present without compromising the ability of future generations to meet their own needs."*

3.2 A number of commentators have noted it is a very broad statement that few would disagree with, but provides no specific guidance for specific public policy approaches, including the nature of external reporting by entities.

3.3 The difficulty in defining sustainable development is a clear lack of agreement as to the extent of the degradation of the physical and social environment, the causes of any degradation, or the solutions necessary to correct any degradation. This disagreement is often fundamental and involves a number of competing paradigms about the nature of development, the relative importance of economic, social and environmental outcomes, and the structure of society to deliver these outcomes.

3.4 Sharp (2001) notes a number of concepts that are common to many definitions of sustainable development:

- it is multi-faceted, drawing on many academic disciplines;
- the emphasis on strong links between the welfare of generations with the capacity of the biosphere to sustain life over time; and
- a strong focus on the design of public policy instruments which ultimately drives the delivery of agreed outputs and defined outcomes.

3.5 Sharp also notes a number of significant differences, primarily that:

- the various definitions of sustainable development are based on sharply differing ethical positions;
- the development of substitutes for natural capital is an empirical and ethical issue that is unlikely to be resolved *ex ante*; and
- clear methodological differences are apparent across academic disciplines.

3.6 In a recent New Zealand report, *Sustainable Development in New Zealand: Here Today, Where Tomorrow?*, by Pacific Rim Institute of Sustainable Management, (2001), two interpretations of sustainable development were presented:

- weak sustainability where sustainable development can be accommodated within the current economic paradigm, largely by internalising externalities and innovation over time and suggests a balance between economic, social and environmental goals;
- strong sustainability which views the current economic paradigm as central to the problem of achieving sustainable economic, social and environmental goals, suggesting that radical changes to the structure of society are required, with ecological imperatives as the primary focus.

3.7 Some commentators, for example Toman (1998), doubt the capacity of any single approach, economic, scientific or otherwise, to provide a definite and reliable answer about what policy instruments will achieve sustainable development. As Sharp notes there is more optimism about being able to identify processes or procedures that could guide decision-making, hence the need for a high level of methodological pluralism and the rigorous evaluation of alternative policy tools, including external reporting.

3.8 Research undertaken during 2001 of the views of selected members of the Institute's Sustainability Special Interest Group (SSIG) noted that no consensus could be reached regarding a definition of sustainability, but found optimism among respondents that a general meaning of sustainability as a concept in the New Zealand business context could be reached in time. (Note Tregidga, Helen M (2002), *The Shared Meaning of Sustainability within the New Zealand Business Context and its Implications: A Delphi Study*, Master of Business Dissertation, University of Otago.)

Views of the Taskforce: Definition Issues

3.9 Despite the uncertainty about how to define and measure sustainable development, and which combination of policy instruments will best achieve sustainable development, there is growing interest, locally and internationally, in academia, government and business about the use of reporting mechanisms as a vehicle for supporting the transition to sustainable development.

3.10 The *quality* of sustainable development reporting provided by entities is an issue of public interest for users of information.

The Purposes and Users of Information within Sustainable Development Reports

4.0 Federation Des Experts Comptables Europeens (2001) notes that the broadening of internal and external reporting activity by entities has been driven by a number of factors, including:

- an increased awareness of the economic, social and environmental issues facing business and society;
- greater competition, fostering more comprehensive assessment of the internal and external drivers of profitability for private sector entities;
- the increasing vulnerability of corporate reputations in the face of better informed individuals and groups;
- improved information technologies which inform and enable users to act on the information more quickly than was previously the case;
- the introduction by regulators of a wider range of economic tools, e.g. tax, tradeable quotas, to address externalities to reduce market failure; and
- the focus of public sector entities on externally reporting non-financial information about the outputs they produce and the subsequent outcomes achieved[1].

4.1 Further, Federation Des Experts Comptables Europeens (2001) notes that financial reporting has been premised on the notion that, although a number of identifiable user-groups exist, the primary consumers of financial reports are shareholders, prospective investors and financial intermediaries.

4.2 The external reporting on the economic, social and environmental performance and impacts of an entity can have four potential purposes:

- to improve the efficient operation of entities in achieving their legal purpose, e.g. highlighting areas of an entity's negative economic, social and environmental impacts and also increasing transparency and strengthening accountability for users;
- to help meet the preferences of present and future investors, consumers, employees, creditors, suppliers and insurers;
- to inform stakeholders with no direct ownership, investment or consumption interests; and/or
- as a significant public policy tool to maximise human welfare over time.

Improving the Efficient Operation of Entities

4.3 Reporting on the economic, social and environmental performance and impacts of an entity may improve the efficient operation of entities in achieving their legal purpose. For example, see the Web sites for World Business Council for Sustainable Development, Case Studies; and Global Reporting Initiative, Reporting Guidelines, Company Reports. (See page 20 for Web site addresses).

[1] Public sector entities generally provide goods or services to address "market failures". The information and accountability require ments of the "users" and "owners" i.e. taxpayers and Parliament require, in the absence of price signals, non-financial information to assess the quality of provision and to assist in making better informed policy decisions.

4.4 Efficiencies through sustainable development reporting are noted in a wide number of areas, for example:

- reducing the use of non-renewable energy sources;
- greater efficiencies in energy use;
- greater transparency and accountability to a wider range of stakeholders, i.e. better external communication and public relations;
- payment systems for production not based on volume but performance; and
- awareness and reduction of waste.

4.5 Local and international experience to date suggests that the discipline of preparing a sustainable development report does provide a focus for improving performance for some entities. However, there is uncertainty about the causality between the processes used to collect sustainable development measures and the subsequent external reporting of those measures, and any greater internal efficiencies achieved.

4.6 It is also arguable whether these gains can be solely derived from the processes undertaken and information gained through the decision to report externally on sustainable development. It is probable that similar gains are also generated from different processes without external reporting.

Views of the Taskforce: Efficient Operation of Entities

4.7 It is important to encourage a variety of approaches to improve the efficient operation of entities "one size will not fit all". This reflects a number of interrelated factors, including the size of entities, the range of activities undertaken by public and private sector entities, access to markets, a diversity of governance approaches and the different information needs of various users, both internal and external to the entity.

4.8 It is also important to undertake research into what approaches improve the efficient operation of entities, including the impact of sustainable development reporting.

The Preferences of Investors, Consumers, Employees, Creditors, Suppliers and Insurers

4.9 Present and future investors, consumers, employees, creditors, suppliers and insurers engage in investment in companies, buy goods and services from companies, choose to work for specific companies and supply capital and other goods and services. The outcome of this decision-making (directly or indirectly) is to influence the nature of the supply of goods, services and capital, the movement of resources between firms and the movement of employees between different employers.

4.10 Private contracting of this nature is influenced by the nature and quality of information that investors, consumers, employees, creditors and insurers possess to aid their decision-making. In the absence of market failures, optimal outputs are generally achieved for goods and services where productive and allocative decisions (what, how much, at what price, when, where, etc) are made by private firms and individuals in response to the preferences and contracting decisions of investors, consumers, employees, creditors and insurers.

4.11 Implicit within this framework is the assumption that those who bear the direct costs and benefits of decisions are best placed to assess both the risks and opportunities, including judgements about the quality and quantity to be produced, and the willingness of others to pay.

4.12 However, market failure in the form of information asymmetries may exist, for example, where one individual or firm is better informed about the qualities of a service or product than others are. This can lead to distortions in productive and allocative efficiencies through mismatches in production and/or the pricing of goods and services.

4.13 For example, the rapid development of ethical investment funds and indexes is driven by meeting the preferences of some investors who do not wish to invest in firms producing certain products or services, e.g. military hardware.

4.14 The cost of poorly informed decision-making can be high, as goods and services are in many cases non-returnable, i.e. once they are consumed or actioned they cannot be returned if they do not match the preferences of investors, consumers, employees, creditors, suppliers and insurers. It is also important to note that investing or consuming goods and services or contracting with employers, increases the incentives to make informed decisions through gathering and/or demanding better information about the quality of the goods, services or entity under consideration.

4.15 There may also be high transaction costs in identifying and collecting the information on which to base decision-making, which can upset the balance of market mechanisms in some cases. For example, the cost to consumers of individually testing the safety of car restraints for children may result in less information than is optimal.

4.16 In addition, producers may also lack relevant information to exclude people who do not contribute to the costs of goods and services because consumers may have incentives to understate their individual preferences, e.g. overstating the public safety benefit of street lighting to reduce one's share of the total costs.

4.17 There may be significant information problems and transaction costs that limit greater efficiencies in the decision-making of investors, consumers, employees, creditors and insurers. We note that there have been a number of private initiatives to help consumers better meet their preferences, e.g. free-range eggs stickers, low-fat indicators and the development of accreditation programmes for producers to label their products as organic. In addition, the demand by some investors for ethical investment options has led to the rapid development of a greater range of services and information to meet their preferences.

Views of the Taskforce: Preferences

4.18 The Institute, in assessing public policy issues, should consider the information available to users, in particular, whether any information problems and/or transaction costs may limit greater efficiencies.

The Information Needs of Stakeholders with No Direct Ownership, Investment or Consumption Interests

4.19 External stakeholders with no direct ownership, investment or consumption interests are represented by government and also non-government organisations and other communities of interest.

4.20 Government has a range of uses for information on the economic, social and environmental performance and impacts of entities, including:

- for developing public policy;
- assessment of compliance with a range of regulatory settings; and
- accountability purposes for public sector entities.

4.21 The legitimacy of these requirements is sanctioned through democratic processes, with accountability through electoral processes and the actions of the Executive being subject to the Public Finance Act, the scrutiny of Parliament, the Audit Office, and the Official Information Act, and the Ombudsman, to name some specific public interest protections.

4.22 Non-government organisations also have an interest in the economic, social and environmental performance and impacts of entities, principally promoting the respective interests of their constituents through public awareness and policy development processes.

4.23 For example, the views of non-government organisations e.g. trade unions to the introduction of more efficient technology that minimises waste products for a firm, but which reduces the number of employees required by half. However, the responsibility for this decision lies with management, who are accountable to the owners of the entity. This is not to say that non-government organisations cannot assess the information available about the technology and its impacts with the intent to influence the outcome, but solely that they are not ultimately responsible or accountable for the decision-making.

4.24 In assessing the costs and benefits of collecting and preparing information on the economic, social and environmental performance and impacts of entities it is important that the benefits derived from the information exceed the costs of providing it. This assessment is likely to vary widely between different entities and users, including the on-going assessment of legitimate accountability boundaries.

Views of the Taskforce: Information Needs

4.25 The principal focus of external reporting needs to be maintained on the key information and accountability requirements of users to make informed decisions about performance. However, this should not limit entities producing a range of alternative information tools, e.g. supplementary information, Web sites, and consultation activities to inform wider stakeholders about any performance issues or changes that are likely to have material impacts on a community.

4.26 The Taskforce recommends that the Institute review the information and accountability needs of users in relation to external reporting. The Institute should consider a range of research approaches, including the use of surveys, in undertaking this work. Clearly the information needs of users are not static but dynamic over time, so the continuing relevance of external reporting requires on-going attention.

Significant Public Policy Tool

4.27 Maximising human welfare views the natural environment as a resource which humans need to better manage to solve economic, social and environmental problems.

4.28 This highlights the need to adopt policy settings that meet society's needs by fostering the provision of goods and services at least cost, directing resources to those areas that contribute the most to society, and creating innovative ways to meet individuals' needs over time. It is unclear if the regulation of sustainable development reporting will produce a better outcome than would result from the status quo or alternative approaches, or whether its benefits will exceed the costs in all cases.

4.29 In considering the regulation of sustainable development reporting it would be necessary to undertake detailed analysis and substantial research to demonstrate that, firstly, a "market failure" exists which requires government intervention, i.e. regulation, and secondly, that sustainable development reporting would significantly improve the operation of the market in question for the overall benefit of society.

4.30 In undertaking this analysis it would be necessary to assess the suitability of a range of policy instruments available e.g. external reporting, taxation, statutory resource consent processes, to address the problem(s) identified. This would entail the assessment of policy instruments, against a range of principles, including:

- effectiveness (i.e. minimising the problems identified);
- efficiency (i.e. whether the benefits outweigh the costs);
- equity (i.e. treating firms in similar situations similarly);
- transparency (i.e. whether the approach is transparent to those affected by any disclosure);
- clarity (i.e. whether the approach is understandable and accessible to firms and users);
- certainty (i.e. whether the approach is sufficiently robust for users to allow meaningful judgements); and
- institutional incentives (i.e. the approach does not create perverse behavioural incentives).

Views of the Taskforce: Significant Public Policy Tool

4.31 Currently we are unaware of any significant support for mandatory regulatory settings requiring all private and public entities to undertake sustainable development reporting. We consider that further experimentation is required by entities within a voluntary framework with a focus on the provision of information that is meaningful for users, i.e. relevant, measurable, and comparable. These activities will benefit from adopting the framework provided by the *Statement of Concepts*, Financial Reporting Standard No. 2: *Presentation of Financial Reports* and Auditing Standard No.100: *Objective of and General Principles Governing an Audit.*

4.32 The evaluation of the regulation of sustainable development reporting should not be undertaken in isolation, but should consider the full range of public policy instruments that are available to address economic, social and environmental problems, including the likely compliance costs of any regulatory approach.

4.33 An important area for consideration is whether current pricing (and the subsequent accounting treatment) takes adequate consideration of externalities. For example, a negative externality would be the emissions from a tanning factory polluting a river system, in which the clean-up costs have not been factored into the unit price of the leather produced. Such externalities can result in the poor production of goods and services because decisions on the level or nature of production will reflect an individual's rather than society's benefits/costs.

4.34 The Taskforce recommends that the Institute should monitor developments in this area, actively engaging in the policy development processes of government (and other bodies), in consultation with members.

Current Framework for the External Reporting and Auditing of Financial and Non-financial Information in Relation to Sustainable Development Reporting

5.0 The *Statement of Concepts for General Purpose Financial Reporting* (Statement of Concepts), Financial Reporting Standard 2 *Presentation of Financial Reports* (FRS-2) and Auditing Standards No.100: *Objective of and General Principles Governing an Audit* (AS-100) represent the current framework for the external reporting and audit of financial and non-financial information in New Zealand. The following discussion provides our initial assessment of sustainable development reporting within the current framework.

5.1 At a conceptual level, sustainable development reporting does fit within the framework noted above.

5.2 If an entity seeks to externally report on sustainable development, such information would greatly benefit from sharing the qualitative characteristics of general purpose financial reporting, i.e. relevance, understandability, reliability and comparability. This will limit the possibility of entities reporting information that is not comprehensive, nor meaningful for meeting the information needs of users[2].

5.3 FRS-2 provides an adequate framework for entities undertaking sustainable development reporting, in particular highlighting:

- the need for rigour by preparers in clarifying the causal relationships between the inputs utilised, the outputs produced and the outcomes achieved by entities;
- the benefits in describing outputs in terms of quantity, quality, time and location;
- measuring achievement against both projected service performance and actual performance; and
- reporting supplementary information, e.g. objectives and statutory compliance, that is material for users.

5.4 Appendix 2 presents a diagrammatic representation of the structure of financial reports.

5.5 Given the uncertainty about exactly what sustainable development entails it is unlikely that reasonable audit evidence would be currently available to form a persuasive or conclusive opinion on the "sustainability" of an entity *per se*. However, reasonable audit evidence, e.g. testing the completeness and accuracy of data for specific economic, social and environmental measures, is unlikely to present any insurmountable audit problems within the framework provided by AS-100 and the applicable auditing standards[3].

5.6 The AS-100 framework was applied to a number of sustainable development reports with mixed results. The exercise highlighted a number of significant issues including the level of independence of the auditor, the degree of verification, limited benchmarking and imprecise terminology.

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[2] In this context it is important to note FRS-15: *Provisions, Contingent Liabilities and Contingent Assets*, which establishes standards covering the accounting and reporting of material environmental obligations and risks by entities.

[3] There are currently no requirements for entities who produce separate sustainable development reports to have those reports audited.

5.7 This exercise illustrated the need for the application of a robust audit framework to such information, and also a trend of practitioners providing audit services for sustainable development reports, without an apparent or transparent framework guiding the activity (for the benefit of users).

5.8 Members offering audit services for sustainable development reports should be aware that the activity is covered by AS-100. Therefore any audit opinion provided on sustainable development reports must be developed on the basis of the general principles relating to the performance of an audit, relevant auditing standards and the *Code of Ethics*. As such, the public and users have redress to the complaints and disciplinary processes of the Institute.

5.9 For a detailed discussion of the qualitative characteristics of the information provided in financial reports, the assumptions underlying the preparation of general purpose financial reports and the general principles relating to the performance of an audit, see The Institute of Chartered Accountants of New Zealand, (2002), *New Zealand Accounting Standards* and *New Zealand Codified Auditing Standards and Audit Guidance Statements*.

Views of the Taskforce: Current Framework for External Reporting and Auditing

5.10 We consider the existing framework provides an adequate basis for sustainable development reporting. The nature of the trade-offs between the relevance of economic, environmental and social phenomena and the ability to reliably measure such phenomena will evolve over time. However, in the interim, preparers should be acutely aware of the need to carefully balance the materiality of a given disclosure with the exercise of prudence. Entities should report information that is consistent with the information and accountability requirements of their users.

5.11 Preparers should ensure that sustainable development reporting is consistent with the qualitative characteristics of financial reporting, and auditors should ensure that verification is to the standard set by the existing standards governing auditing.

5.12 There is a need to review the *Statement of Concepts*, FRS-2 and the AS-100 to consider the fit with the wider range of information being externally reported by entities, and also the impact of the tensions noted in paragraph 6.4 and others.

International Frameworks and Guidelines for Sustainable Development Reporting and Auditing

6.0 A number of guidelines and frameworks for sustainable development reporting have been developed. The guidelines are either *process* guidelines (providing advice on how to complete a sustainable development report, for example the AA1000 Framework[4]) or *content* guidelines (which specify what should be included in sustainable development reports, for example the Global Reporting Initiative (GRI)). In some cases elements of both are included such as in the guidelines produced by the International Network for Environmental Management, the World Business Council for Sustainable Development, and the forthcoming NZBCSD guidelines.

6.1 The GRI is arguably the most comprehensively developed and widely used of all of the reporting guidelines. For this reason, a preliminary assessment of the conceptual framework for the GRI has been undertaken. The GRI is a long-term, multi-stakeholder, international undertaking whose mission is to develop and disseminate globally applicable sustainability reporting guidelines for voluntary use by organisations reporting on the economic, environmental and social dimensions of their activities, products and services.

6.2 The GRI seeks to move sustainable development reporting in a similar direction as financial reporting by creating a *generally accepted framework* for economic, social and environmental performance and impact disclosure.

6.3 The GRI Guidelines specify a structure for sustainable development reports: “core” and “additional” indicators of sustainable performance, and reporting principles. The reporting principles, which are derived from established financial accounting principles and adapted to sustainability issues, include completeness (including boundary, scope and temporal dimensions), inclusivity, consistency, accuracy, clarity, neutrality, timeliness, auditability, transparency; and sustainability context. (See Appendix 1.)

6.4 It is important to note, however, a number of tensions that will require further detailed consideration by the Institute and other stakeholders. These include:

- the balance between the costs and benefits of collecting and reporting information;
- the emerging importance being placed on the social and environmental impacts across the supply chain may require reconsideration of the entity concept;
- the operation of the *completeness* principle may limit the relevance, understandability, reliability and comparability of some of economic, social and environmental phenomena because of issues associated with the dimensions of time and space not encountered in financial reporting;
- the limitations of the *period reporting* concept; and
- there are still no universally accepted indicators of sustainable development.

[4] The UK-based *Institute of Social and Ethical Accountability* developed AA1000.

6.5 While the issues discussed above are important, the GRI does offer the potential for generating reports that are comparable across entities, providing a common framework to assess the performance of entities across a range of specific economic, social and environmental measures, but not the achievement of "sustainability" *per se*.

6.6 Further, while some aspects of the GRI reporting framework raise significant measurement issues, these are not unique to economic, social and environmental phenomena; similar issues are encountered in financial reporting. The GRI does encourage, in some areas, the use of narrative and qualitative reporting that seeks to provide an account of impacts, but not to imply causality or fully account for all externalities.

Views of the Taskforce: International Frameworks — including GRI

6.7 Whether the factors noted above are an impediment to the external reporting and auditing of economic, social and environmental phenomena will need to be assessed over time, in particular tensions between the qualitative characteristics of *relevance* and *reliability* of any reported information for users.

6.8 The Taskforce recommends that the Institute actively follows developments and supports further work in this area, especially through the International Federation of Accountants, International Accounting Standards Board and also local organisations — such as the Ministry for the Environment, the NZBCSD and university academics. The GRI represents a starting point for the development of external reporting and auditing of economic, social and environmental phenomena by entities.

The Way Forward

7.0 We consider that the issues surrounding sustainable development reporting will be best advanced by the creation of a standing committee within the Institute. We consider the standing committee should be a sub-committee of the Financial Reporting Standards Board (FRSB). This would ensure a degree of independence, but also cement the fit of sustainable development reporting within the current framework for external reporting.

7.1 The purpose of the standing sub-committee will be to provide on-going leadership and guidance on the external reporting and auditing of sustainable development reports.

7.2 The initial task of the sub-committee should be to review *the Statement of Concepts*, FRS-2 and AS-100 (and relevant auditing standards and guidance) to consider the fit with the wider range of information being externally reported and the evolving information and accountability needs of users, i.e. consumers, investors, employees, creditors, suppliers and insurers in relation to financial reports.

7.3 Further, the sub-committee should be asked to:

- co-ordinate the development of a research bulletin to consider the fit of the current conceptual framework for the external reporting and audit of information with the wider range of information being externally reported and the evolving information and accountability expectations of users in relation to financial reports;
- co-ordinate the development of a research bulletin to provide additional guidance on the audit/verification of sustainable development reports, bearing in mind available guidance and emerging international guidance;
- consider the need for a bulletin outlining the lessons to date for sustainable development reporting from financial reporting;
- actively follow and participate in national and international work on sustainable development reporting, particularly with Australian bodies;
- liaise with other internal and external bodies with an interest in sustainable development reporting, including the SSIG;
- consider the external reporting of sustainable development measures by the Institute; and
- assist Institute staff in engaging in government policy development processes which concern sustainable development reporting and related matters.

7.4 Ideally the sub-committee would include representatives of the FRSB, the Professional Practices Board, the National Public Sector Committee, the SSIG, preparers and auditors in both the public and private sectors, users of sustainable development reports and also non-members with expertise in this area. The sub-committee would also be required to consult with all relevant standing Institute committees.

7.5 We consider that the FRSB should, in consultation with the Professional Practices Board and other relevant Institute committees, review the on-going need for the proposed sub-committee by 1 September 2005, and present a written report with recommendations to the Executive Board by that date.

7.6 The Taskforce considered a range of outputs that would allow the Institute to further develop a leadership and guidance position. (See Appendix 3.)

7.7 The Institute is well-placed, compared to other parties, to develop or endorse specific sustainable development services or products for financial reporting and audit, for members to use in public practice and other areas.

7.8 We consider the Institute is also well-placed to participate in government policy development processes, support national and international developments, consider the internal regulation of members and assess our own internal business systems for the purposes of further developing the reporting and auditing of sustainable development measures. In addition, the Institute has sound information and capacity to act as a conduit for information about sustainable development reporting.

Recommendations

General Statement

8.0 We consider the nature of the information contained within sustainable development reporting fits within the current conceptual framework for external reporting and auditing by entities. The role of the Institute is to provide a context for good practice to develop and operate, within the framework provided by the *Statement of Concepts*, FRS-2 and AS-100.

Recommendations

8.1 It is recommended that the Institute:

(a) establishes a standing sub-committee of the FRSB with the purpose of providing on-going leadership and guidance on the external reporting and auditing of sustainable development reports;

(b) ensures appropriate resources are made available to support the work of the sub-committee;

(c) reviews the *Statement of Concepts*, FRS-2 and AS-100 (and relevant audit standards and guidance) to consider the fit with the wider range of information being externally reported, and the evolving information and accountability needs of users in relation to financial reports (see (e)(i) below);

(d) agrees that the FRSB, should, in consultation with the Professional Practices Board and other relevant Institute committees, review the on-going need for the proposed sub-committee by 1 September 2005, and present a written report with recommendations to the Executive Board by that date;

(e) notes that the initial tasks of the sub-committee will be to:

(i) co-ordinate the development of two bulletins:

- a research bulletin to consider the fit of the current conceptual framework for the external reporting and audit of financial information with the wider range of information being externally reported and the evolving information and accountability expectations of users in relation to financial reports;
- a research bulletin to provide additional guidance on the audit/verification of sustainable development reports, bearing in mind available guidance and emerging international guidance;

(ii) consider the need for a bulletin outlining the lessons to date for sustainable development reporting from financial reporting;

(iii) actively follow and participate in national and international work on sustainable development reporting, particularly with Australian bodies;

(iv) liaise with other internal and external bodies with an interest in sustainable development reporting, including the SSIG;

(v) consider the external reporting of sustainable development measures by the Institute;

(vi) assist Institute staff in engaging in government policy development processes which concern sustainable development reporting and related matters; and

(f) within a voluntary framework, encourages the preparation of sustainable development reports where appropriate to broaden the scope of external reporting which is meaningful e.g. relevant, measurable, and comparable for users.

John Spencer

Chair, on behalf of the Institute Taskforce on Sustainable Development Reporting

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Glossary

Audit Guidance Statement No.1010: The Consideration of Environmental Matters in the Audit of a Financial Report (AGS-1010) — The purpose of AGS-1010 is to provide practical assistance to auditors by describing the main considerations in an audit of a financial report with respect to environmental matters; give examples of possible impacts of environmental matters on financial reports; and provide guidance to auditors when exercising professional judgements to determine the nature, timing and extent of audit procedures with respect to (1) knowledge of the audit environment (2) risk assessment and internal controls (3) consideration of laws and regulations and (4) other substantive procedures, e.g. using the work of an expert.

AS-100: Objective of and General Principles Governing an Audit (AS-100) — The purpose of AS-100 is to define the objective of and general principles governing an audit, and to provide guidance on the applicability of Auditing standards.

Federation Des Experts Comptables Europeens (FEE) — 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.

Financial Reporting Standards Board (FRSB) — The FRSB formulates Institute policies with regard to financial reporting and undertakes research in both the public and private sectors.

Financial Reporting Standard No. 2: Presentation of Financial Reports (FRS-2) — The purpose of FRS-2 is to establish a framework for the presentation of general purpose financial reports.

Global Reporting Initiative (GRI) — The GRI is a long-term, multi-stakeholder, international undertaking whose mission is to develop and disseminate globally applicable sustainability reporting guidelines for voluntary use by organisations reporting on the economic, environmental and social dimensions of their activities, products and services.

International Accounting Standards Board (IASB) — The IASB is an independent, privately funded accounting standard-setter based in London, UK. Board members come from nine countries and have a variety of functional backgrounds. The Board is committed to developing, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require transparent and comparable information in general purpose financial statements. In addition, the Board co-operates with national accounting standard-setters to achieve convergence in accounting standards around the world.

International Federation of Accountants (IFAC) — IFAC is the international body of national accountancy bodies recognised by law or general consensus within their countries. The mission of IFAC is the worldwide development and enhancement of an accountancy profession with harmonised standards, able to provide services of consistently high quality in the public interest.

International Network for Environmental Management (INEM) — INEM, a non-profit organisation, is the international federation for non-profit environmental management associations and cleaner production centres. The INEM network comprises more than 30 member and affiliated environmental management associations and 10 cleaner production centres in more than 25 countries on all five continents.

New Zealand Business Council for Sustainable Development (NZBCSD) — The NZBCSD, is a non-government organisation of private entities whose mission is to provide business leadership as a catalyst for change toward sustainable development, and to promote eco-efficiency, innovation and responsible entrepreneurship.

Statement of Concepts for General Purpose Financial Reporting (Statement of Concepts) — The *Statement of Concepts* sets out the concepts that underlie the preparation of general purpose financial reports for external users.

Sustainable Development Reporting (SDR) — Sustainable development reporting is the external reporting of the economic, social and environmental performance and impacts of an entity.

Sustainability Special Interest Group (SSIG) — SSIG, is a special interest group within the Institute of Chartered Accountants of New Zealand whose vision is to enhance the understanding of sustainability within New Zealand business.

World Business Council for Sustainable Development (WBCSD) — The WBCSD, a non-government organisation, comprises a coalition of approximately 160 international companies united by a commitment to sustainable development via economic growth, ecological balance and social progress. Members are drawn from more than 30 countries and 20 major industrial sectors.

Appendix 1: Global Reporting Initiative Reporting Principles

The GRI reporting framework includes the following principles.

Completeness — all information material to users for assessing the reporting organisations economic, environmental, and social performance should appear in the report in a manner consistent with the declared boundaries and scope. The completeness principle also includes *boundary* (reported information should be complete in relation to the boundaries defined by the reporting organisation), *scope* (reported information should be complete in terms of the scope of issues addressed and disclosed within the boundaries declared by the reporting organisation); and *temporal* dimensions (reported information should be complete with reference to the time period declared by the reporting organisation).

Inclusivity — the reporting organisation should systematically engage its stakeholders to help focus and continually enhance the quality of their reports.

Consistency — the reporting organisation should maintain consistency in the boundary, scope, and content of reporting and disclose any changes and restate previously reported information.

Accuracy — refers to achieving the degree of exactness and low margin of error in reported information necessary for users to make decisions with a high degree of confidence.

Clarity — the reporting organisation should remain cognisant of the diverse needs and backgrounds of their stakeholder groups and should make information available in a manner that is responsive to the maximum number of users while still maintaining a suitable level of detail.

Neutrality — reports should avoid bias in selection and presentation of information and strive to provide a balanced account of the reporting organisations performance.

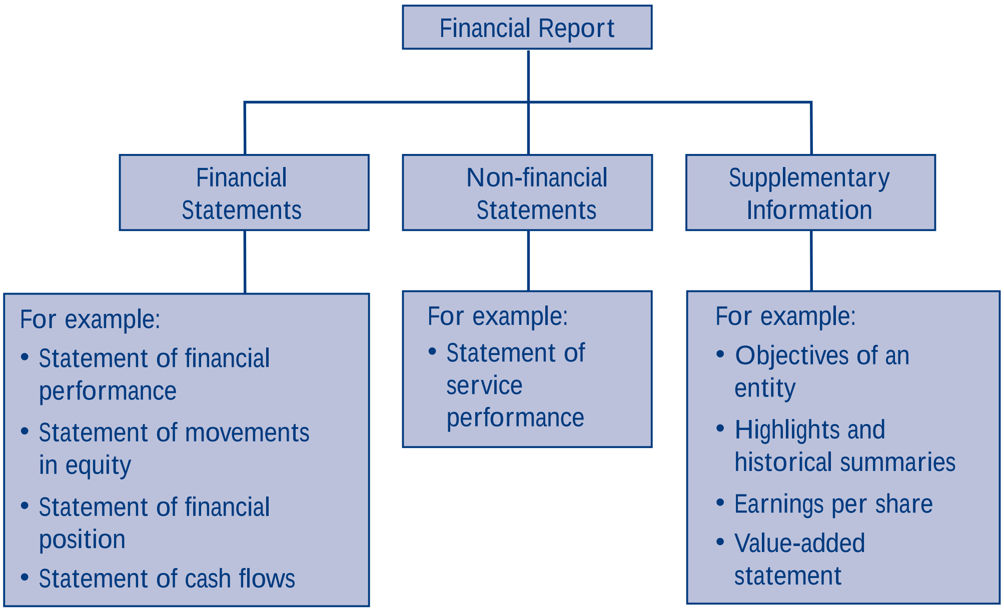
Timeliness — reports should provide information on a regular schedule that meets users' needs and comports with the nature of the information itself.

Auditability — reported data and information should be recorded, compiled, analysed, and disclosed in a way that would enable internal auditors or external assurance providers to attest to its reliability.

Transparency — full disclosure of the processes, procedures, and assumptions in report preparation are essential to its credibility.

Sustainability — the reporting organisation should seek to place its performance in the broader context of ecological, social, or other limits or constraints where such context adds significant meaning to the reported information.

Appendix 2: Diagrammatic Representation of the Structure of Financial Reports



Source: FRS-2: *Presentation of Financial Reports, Institute of Chartered Accountants of New Zealand, New Zealand Accounting Standards*, 2002, Wellington, page 6. Information on Sustainable Development Reporting may comprise financial information, non-financial information and/or supplementary information, the three broad categories of information that together constitute a financial report.

Appendix 3: Assessment of Possible Outputs for the Institute

Influencing Government Policy.

Capacity — The centralised location of the Institute, in combination with member input, should promote efficient and effective input on sustainable development reporting issues.

Information — In comparison to other agents, the Institute has better information about the mechanics of government in some areas. A growing number of members have information about the measurement issues surrounding the external reporting of the environmental and/or social performance or impact of entities.

Incentives — Poor advice to government can have an adverse impact on the reputation of the Institute. This can reduce membership, thus revenue streams. Alternatively, providing sound advice will enhance our reputation (and membership).

Cost — Current activity.

Supporting National and International Developments.

Capacity — The Institute is well placed to support national and international developments with other national and international accounting bodies i.e. ICAA, CPA, IFAC, IASB and other stakeholders, using well-developed networks. However, the linkages to bodies directly involved in sustainable development reporting issues, e.g. GRI, are limited. There is also the expertise of members involved in sustainable development reporting activities, including environmental and/or social measurement.

Information — There is little in-house information on specific environmental and social measurements. Members who practice sustainable development reporting have growing knowledge, and some are at the forefront of sustainable development reporting.

Incentives — The involvement in international developments that are not robust will damage the reputation of the Institute. Alternatively, sound input will enhance the reputation of the Institute. Inertia could place the Institute's "legitimacy" in the eyes of members (and other stakeholders) at risk.

Cost — This is a new output for the Institute, as such there will be costs and benefits.

Regulation of Members

Capacity — The Institute is well placed to consider the impact of sustainable development reporting on entry requirements, quality assurance, standard developments and disciplinary processes. There is currently no specific mechanism, e.g. a committee or sub-committee, with a specific focus on sustainable development reporting.

Information — The Institute has access to information about the relative costs and benefits of sustainable development reporting in the regulation and practice of accountancy.

Incentives — If sustainable development reporting is not appropriately integrated into the entry requirements, quality assurance, standard developments and disciplinary processes, users i.e. potential members and members, and end-users e.g. firms, can seek alternatives.

Cost — No significant additional costs involved in incorporating sustainable development reporting in the current regime, as the business analysis of entry requirements, quality assurance, standard developments and disciplinary processes is on-going. There may be one-off costs, e.g. sustainable development reporting standards for tertiary providers.

Internal Business Systems of the Institute

Capacity — Supply of the skills required would require the up-skilling of in-house capacity or using contract capacity depending on the scope of any adopted sustainable development activity undertaken.

Information — The Institute has robust information about its operational business requirements, including reporting on service performance.

Incentives — Poor business analysis influences individual staff rewards/sanctions. Poor quality business systems may influence membership growth. It may present credibility issues for some members and other stakeholders if the Institute adopts a "thought leadership" position, but does not actually produce a sustainable development report.

Cost — Adopting sustainable reporting activities within the internal business systems of the Institute will increase costs (relative to any cost savings and other benefits e.g. credibility).

Conduit for Information

Capacity — The Institute is well positioned to disseminate information about sustainable development reporting via Web sites, journals, library services etc.

Information — The Institute offers a specialised collection and dissemination point for information. Other agents could potentially offer similar information in competition via similar modes i.e. Web sites, journals, and library services.

Incentives — The incentives on productive and allocative decisions will be mixed depending on alternative information sources available and the cost borne by users.

Cost — May increase costs.

Specific Training

Capacity — Little in-house capacity beyond the administrative and conceptual level for environmental and social measurement issues. Ability to contract provision from experts, which is currently undertaken by Professional Development in contracting specific sustainable development courses for members (and others).

Information — Contracting for professional development through the provision of training for members (and others) provides Institute staff with an understanding of what factors influence the supply and demand of training for sustainable development reporting. Other bodies also supply similar training provision i.e. members have alternative sources of training.

Incentives — Cost-recovery drivers for professional development place strong incentives to effectively match supply and demand.

Cost — A cost-recovery approach provides strong incentives to supply training that meets members needs.

Development or endorsement of specific sustainable development services and/or products for members (and/or others)

Capacity — Other agents may have greater specialised capacity to develop sustainable development products or services for "public practice" and other fields, especially for environmental and social measurement, for example, engineers and social scientists.

Information — Beyond financial reporting, consumers and other producers of specific sustainable development products or services may have better information about the costs and benefits involved, including the quality required, the quantity to produce and the willingness of others to pay.

Incentives — The incentives are poor, because if the Institute makes incorrect productive and allocative decisions it will continue to trade. There are currently no checks and balances, other than the market, on the development of sustainable development services or products. Further poor investment may reduce the ability to undertake other key functions of the Institute.

Cost — Costs will increase (depending on payment approach) if the Institute engages in the development of specific sustainable development products for members (and others) outside current expertise. The endorsement of products (depending on the quality) may raise issues of liability if they prove not to work, i.e. do not enhance sustainable development. Alternatively, the endorsement of quality products will enhance the reputation of the Institute.

Taskforce Members

The following individuals were members of the Institute Taskforce on Sustainable Development Reporting:

John Spencer, *(Chair)* — Chief Operating Officer, Wickliffe Limited.

Bruce Gilkison — Principal, Gilkison O'Dea Ltd.

Shaun Collins — Manager, Deloitte Touche Tohmatsu.

Colin Higgins — Lecturer, Massey University.

Wendy McGuinness — Consultant, McGuinness & Associates.

Kevin Simpkins — Deputy Controller and Auditor-General, Office of the Controller and Auditor-General.

Tony van Zijl — Professor, Victoria University of Wellington.

Peter Whitehouse — Adviser, Business New Zealand.

Greg Schollum — Chief Financial Officer, Wellington Regional Council.

Tony Gray — Chief Financial Officer, Mighty River Power Ltd.

NB: The individual Taskforce members did not represent the organisations from which they come, and accordingly the report does not reflect the views of those organisations.