

Editorial

Corporate Responsibility Reports Assurance Trends and the Role of Management Accountants

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Abstract

Over the past decade, corporate responsibility (CR) has moved from the fringes of the business world to being a significant boardroom agenda. What began largely as an extension of public relations reporting where organisations disclosed basic health and safety monitoring, and environmental impact results has now grown to a wider set of governance practices premised on the philosophy of sustainability.

This paper discusses some of the developing trends in the area of assurance of CR reports, and the emerging challenges faced by the assurance providers and managers alike. The paper also explores the role of management accountants in enhancing CR reporting and its assurance practices.

Keywords

**Corporate Responsibility
Corporate Reporting
Corporate Governance
Assurance
Role of Management Accountants**

Introduction

Organisations are increasingly recognising the need for greater corporate disclosure on both the positive and negative impacts on the environment and society with the aim of demonstrating transparency, accountability and effective governance.

Accompanying such reports are various assurance statements which largely involve independent third party verification or audit of the contents of CR reports. According to KPMG's (2005) survey, 30% of the top 250 companies of the Global Fortune 500 had their environmental and/or social reports verified in 2002, while SustainAbility's (2002) analysis indicated 68% of the world's best sustainability reports were accompanied by some form of assurance statement. Given the growing trend in both CR reporting as well as assurance of CR reports, it appears that a critical analysis of the assurance process is both timely and warranted.

In the following three sections, we first make clear of the underlying premise for CR reporting, followed by an overview of developments in CR approaches and guidelines, and a discussion on recent standards and guidelines on CR assurance.

Concept of CR Reporting

CR reporting is premised on the notion of sustainable development. Sustainable development refers to both present and future generations having resources available for their use and enjoyment (Suggett and Goodsir, 2002; World Commission on Environment and Development, 1987).

This definition means taking account of the wider and *longer term* consequences of decisions. Organisations must take into account the consequences of economic decisions on the natural environment, on economic development, and on the social conditions in which people live and work. CR reports therefore need to cover not only the *future* impacts of economic activities such as products and services bought and investments made, but also the long term

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impact of waste created and pollution generated on the natural and human resources on which they depend. No longer can these be considered mere 'externalities'. Organisations much consider means of ensuring that the productive capacity of these resources is not irreparably damaged, i.e. that resources are not depleted faster than they can be replenished.

Organisations are therefore increasingly expected to be responsible not only for maximisation of shareholder wealth but also to behave in a socially responsible manner and to embrace the notion of managing resources for the well-being of current and future generations. This can cause conflict. Taking a long-view socially responsible route could result in higher short-term costs, which would adversely affect the economic bottom-line.

Despite such conflict, organisations are increasingly under pressure to demonstrate their commitment to the environment and social development in addition to informing on their economic performance. This often means that CR reports are exaggerated or under-reported and little more than public relations exercises, or 'greenwash', with readers having little or no assurance that the reports are reliable or in fact relevant. Further, very little link is made in the CR reports between CR strategy and its impact on financial performance.

The terms that have been commonly adopted in reporting this wider set of information i.e. that relating to financial, environmental and social performance of an entity, include: *sustainability* reporting, *triple-bottom-line (TBL)* reporting, and *corporate social responsibility (CSR)* reporting. For the purposes of this paper, we use the term Corporate Responsibility (CR) reporting to denote all such activities and related reports.

CR Reporting and Approach Guidelines

The development of CR reporting has evolved from simple narrative paragraphs (disclosures) within company annual

reports to elaborate stand alone reports issued by companies, containing information on their environmental and social performance. Much of these CR reports to date have been voluntary. In fact, in Australia, The Parliamentary Joint Committee on Corporations and Financial Services in June 2006 released a report titled, "*Corporate responsibility: Managing risk and creating value*" - based on 146 submissions from corporations, individuals and non government organisations. The report essentially recommends that CR reporting in Australia continue to follow existing trends, promote voluntary disclosures and *not* move towards mandatory reporting. The report argues that leading companies and government agencies are already voluntarily moving in the right direction by providing increased reports on their environmental and social impacts, and that current market and 'peer pressure' are sufficiently motivating proper CR agendas and practices.

In terms of guidelines for CR reporting, various worldwide bodies such as AccountAbility (1999), Federation des Experts Comptables Europeens (FEE, 2002) and Global Reporting Initiative (GRI, 2002) continue to play an influential role in guiding best practice reporting procedures. While apparently pursuing somewhat different agendas, their common goal is to enhance the credibility of the reporting exercise through practices that are perceived as being fair, complete, unbiased and relevant (Owen and O'Dwyer, 2005). Further, a common recommendation by such organisations is for organisations to provide independent external assurance with their CR reports.

Developments in CR Assurance

An assurance engagement is defined as one

"in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria" (IAASB, 2004).

As with financial reporting, CR assurance is assumed to provide useful and reliable information (assured by an independent party), leading to better internal and external decision-making. Over the years, a variety of terminology has been adopted to describe the work undertaken by an independent third party in relation to social and environmental reports. For instance, “audit”, “verification”, “validation” or “assurance” have been generally used to denote similar activities. However, as noted within Standards Australia (2003), “verification” suggests a process whereby information provided by management has been compared against agreed criteria, while “validation” examines whether reported information meets a particular need. The term “audit”, on the other hand, more closely relates to its traditional usage

in external financial reporting and the provision of a high level of assurance whereby the procedures used are in line with a standardised set of guidelines. Verification and validation can be construed as denoting a more limited level of assurance. For the purposes of this paper, the term “assurance” will be adopted as defined above, and viewed as encompassing all the other “related terms or concepts” as previously mentioned. Assurance services are generally provided by two types of providers: accountants and industry specialists or consultants. However, according to KPMG’s (2005) study, major accountancy firms continue to dominate the CR assurance market with close to 60 per cent of the statements assured by such firms.

Table One: Comparison of ISAE3000 and AA1000AS Approaches

	ISAE3000	AA1000AS
Materiality	Based on defined users	Based on broadly defined stakeholders
Scope	Predetermined	Based on stakeholder engagement process.
Criteria	Relevant to the needs of defined users.	Based on stakeholder engagement process.
Level of Assurance	Two levels; "reasonable" (low level risk) and "limited" (moderate level risk).	Varied for different issues
Completeness and Responsiveness	Accuracy in relation to established criteria in given time period.	Evaluation of appropriateness and quality of performance, and future capabilities.
Public Statement	States a conclusion (positive for reasonable or negative form for limited) on whether subject matter is fairly stated.	Description of quality of report and underlying systems, processes and competencies.
Independence and Impartiality	Provider must comply with Parts A and B of IFAC Code of ethics, to ensure integrity, independence, objectivity and confidentiality.	Provider must make publicly available information about its independence and impartiality.
Competency of Provider	Provider must ensure that the engagement team has necessary professional competencies to assess subject matter.	Provider must make information about its competence, this forms part of public statement.

Assurance Standards

Two international standards are regarded as being particularly important in the area of CR assurance. First, the *AA1000 Assurance Standard (AA1000AS)* as released in March 2003 by AccountAbility, an international professional institute and standards developer. The other standard is the *ISAE3000 International Standard on Assurance Engagements, Assurance Engagements Other Than Audits or Reviews of Historical Financial Information* as promulgated by the International Auditing and Assurance Standards Board (IAASB) in January 2005. ISAE3000 is specifically applicable to professional accountants. Provided below, as shown in Table One, is a brief comparison of the two standards.

While both of these standards provide valuable innovations in assurance, it is also argued that differing language, method, development pathways, and institutional sources have led to confusion on the part of assurance practitioners, organizations seeking assurance, and stakeholders (Anonymous, 2005). Subsequently, a comparative study undertaken by AccountAbility, and KPMG Sustainability B.V. in The Netherlands, an assurance practitioner, indicates that the AA1000AS focuses on the quality of reporting process, while ISAE3000 emphasises the assurance procedure (AccountAbility and KPMG, 2005).

Assurance Challenges

A variety of reviews have been recently undertaken on the assurance practices of CR reporting worldwide (Nitkins and Brooks, 1998; KPMG, 2005; Owen and O'Dwyer, 2005; Deegan et al., 2006a; 2006b). For example, the study by Owen and O'Dwyer (2005) involved an analysis of 28 UK and 13 European assurance statements (which were short-listed for the 2002 ACCA UK and European sustainability reporting awards). Using an evaluative framework centrally informed by the AccountAbility, FEE and GRI guidelines, they reviewed the extent to which the contents of assurance statements satisfactorily address key elements of these guidelines such as independence, clear

identification of the scope of the engagement, materiality, completeness and responsiveness. Similarly, Deegan et al. (2006b) investigated the correspondence between 33 Australian assurance statements with GRI and FEE requirements. Further, in a related study, Deegan et al. (2006a) undertook an extended examination of assurance statements from four main geographical segments namely, UK (48 assurance statements), Europe (52 assurance statements), Japan (16 assurance statements) and Australia (33 assurance statements). It was argued that the sample utilised by Owen and O'Dwyer (2005) combined the regions and did not consider international differences.

In summary, the common conclusion of the previous studies is that there needs to be more rigorous and better quality assurance reporting practices. More specifically, the following criticisms have been raised as continuing challenges for assurance of CR reports:

Limited Stakeholder Input into the Assurance Process. The appointment of assurance providers is normally undertaken by managers. However, an inherent limitation is that they may place any restrictions on the assurance exercise, and thus it is unclear whether value is provided to management rather than the stakeholders (Adams and Evans, 2004).

Likewise, Moore (2006) argues that “the issue with which companies are grappling is not just more assurance, but the type of assurance necessary to engender trust among a range of stakeholders - from outspoken NGOs to financial analysts”. For example, organisations are viewed to continue to report voluntarily on selected issues and on selected measures. As argued by Blyth (2005), “there is a role for auditors beyond these purely quantitative and qualitative extremes. There is a clear demand for more rigorous assurance of these reports from a wide spectrum of stakeholders” p.28. Further, he cites Andrew Pendleton at Christian Aid who contends that: ‘even those that are externally verified often limit the scope of what their auditors look at, so you might be looking at

audits of a very limited number of social or environmental impacts chosen by the company.' In a similar vein, Rob Lake at Henderson Global Investors argues that: 'In most cases I assume the hard data is accurate. However, I'm not always convinced that the report covers all the right issues in the first place, or that the coverage is complete and meaningful on the really important issues.' Such comments clearly reflect the need for greater attention to a wider set of stakeholder needs.

Lack of Consideration of Materiality. In general, there is a wide range of issues that could be covered in CS reports, and thus a real challenge is in selecting what to report and whether to present assurance statements with such reports. What issues are material then becomes critical as many of the environmental and social impacts are akin to quantification e.g. improvement in emotional health, social inclusion, employee development, etc. Furthermore, an added issue is "to whom is it material". Blyth (2005) contends that materiality should be defined in stakeholder's terms. As noted by Zadek (2003),

If stakeholders don't think the information is relevant (or material), it just won't count... (and) public reporting (will) flunk as an accountability mechanism".

Difficulties in Defining Suitable Assurance Criteria for Non-Financial Aspects of CR Reports. These cover areas such as corporate strategy, performance outcomes and predicted or future outcomes, which remain challenging and contentious issues. Such *future oriented* issues are both at the heart of the CR definition and the perceived role of the management accountant as an information provider. Unlike the audit of financial reports where there are more standardised guidelines on report structure on *past* transactions, the more qualitative-oriented outcomes of *future* environmental and social impacts of the current actions of an organisation makes it difficult to provide clear guidelines to those providing assurance.

Furthermore, Adams and Evans (2004) argue that presently in some CR reports, data and information are either exaggerated or under-reported in a way that may distort a balanced view of the company's performance. Consequently, assurance providers will need to more clearly enunciate the methodologies adopted in their verification or audit process.

Differences in the Approaches between Accountant and Consultant Assurance Providers. Increasingly, the accountants are seen to adopt a more cautious approach that largely focuses on consistency of information appearing in the organisation's report with underlying data sets. They also appear to be much concerned with the absence of generally accepted social audit standards, which they believe are necessary for the provision of high level of assurance. Consultants, on the other hand, appear to focus more on completeness, fairness and overall balance in the opinion statements.

For example, Deegan et al. (2006a) find that assurance statements issued by accountants generally do not include recommendations, praise or commentary about the organisations processes and systems. In contrast, those assurance reports issued by other third parties often do. Such differences can be both confusing and misleading for report users.

Blurring of Consultancy and Assurance Services. Professional independence is a cornerstone of any assurance practice. In the case of CR assurance, the assurance provider's involvement in the design and in the verification of the CR systems remains unclear (Blyth, 2005).

Inadequacy in Integrating CR thinking in Strategic and Operational Decision Making. Decisions are often made on a short term basis and typically on the basis of incomplete or imperfect information which excludes external and intangible costs and benefits. The management accountant can encourage the integration of long-term CR thinking by overcoming the various cultural, organisational and economic impediments to sustainability.

He/She has the training to provide a more complete CR integrated information package to decision makers.

Lack of Expertise and Technical Competence of the Assurance Provider.

There are no current professional or educational requirements for independent 'assurance' providers. Many come from financial accounting backgrounds, but others come from Legal, IT, Scientific and Engineering disciplines. It can be argued, however, that as the management accounting professionals are trained in evaluating investment decisions regarding the future, they would be ideally suited with the essential technical competence to incorporate CR policies into such decisions. Thus, outside an organisation, a professional trained in management accounting could very well assist in the independent 'assurance' role.

The Role of the Management Accountant

The management accountant has a role to play not only in understanding, analysing and managing the efficiencies an organisation can gain from sustainable and responsible business practices, but also the long and short term impact of such CR practises. A small number of quantitative studies have shown that CR makes sound business sense (see Webley and More, 2003) and the management accountants is ideally placed to develop a business and financial case for their organisation engaging with CR issues. The pursuit of CR depends on the generation, analysis, reporting and assurance of robust and accurate information (both financial and non-financial).

At the *external* reporting level, because corporate responsibility, especially pertaining to some of the constituent aspects of sustainable development such as avoiding environmental damage and the ethical sourcing of products, are on the agendas of a wide range of consumer organizations and non-governmental organisations (NGOs), the management accountant can evaluate the cost of failure to engage with the challenges of CR. Such

costs include the strategic, business and reputational risk of not implementing CR strategies (see Ratnatunga, 2006). This may be particularly relevant in certain industry sectors which have been traditionally more exposed and less responsive than others, such as the petroleum, airlines and pharmaceuticals industries. Although some companies in these sectors have solid reputations for providing a high level of CR reports (e.g. Shell, SAS and Baxter) many do not. For example, the range of information that management accountants could provide could range from ascertaining the impact of cost savings in maintenance on the subsequent risk probability of an air crash, to the level of pollutants released to the waterways from the soap used to wash aircraft (as is calculated by SAS).

Failure to address these risks could result in investors not buying (or existing shareholders selling) the organisation's shares. The management accountant could quantify the resulting impact of such shareholder actions, not only on the share price itself, but also the impact on the cost of capital as a result of banks increasing their lending rates following such share movements. Another quantification that can be done is the impact on sales and market share resulting from a loss of customers due to a diminished reputation. Extreme impacts of a failure to address these risks would be host nations withdrawing their licenses or impose fines, local communities withdrawing their support and possibly becoming hostile, and workers becoming de-motivated and unproductive. The quantification of all these costs falls within the expert area of the management accountant.

At the *organisational* level, CR is all about long term viability. Organisations will not have a long term future if they cannot make a profit in an efficient and ethical manner. Thus the CR impact of investment decisions should be evaluated in terms both 'value for money' and the growth of long term 'shareholder value'. Hence, it is important that the management accountant gain an understanding of the concepts of

sustainability and the challenges it poses in achieving such values.

The role of the management accountant in CR extends beyond that of collecting, analysing and reporting information. Many management accountants are in senior management roles exerting substantial influence on the organisation's strategy and competitive positioning, i.e. product differentiation, cost leadership and focus (see Porter 1980). The management accountant can influence these decisions to incorporate a CR perspective as such positioning has associated risks that can affect the reputation of the organisation.

The specific role the management accountant will play in CR thinking and reporting will vary by organisation and includes:

- Developing policies to address CR and sustainability issues;
- Implementing and the monitoring CR policies;
- Managing the associated operating and reputation risks of CR policy implementation;
- Monitoring CR policies relating to purchasing and supply chain management;
- Managing the information relating to the stakeholder contracts and analysis of stakeholder feedback;
- Identifying appropriate voluntary environmental, social and governance codes;
- Integrating operation of the CR codes with the existing MIS;
- Benchmarking the practices of 'world-class' companies in CR reporting;
- Providing and constantly updating information regarding appropriate CR regulations, taxes and subsidies.

The Way Forward

For independent assurance of CR reporting to add value, there needs to be greater clarity and coherence in both the process and the assurance reports. This would need to begin with a clear identification of the stakeholders and their needs. An example of stakeholder involvement can be referred

to Nike's recent formation of a Report Review Committee to reinforce their internal materiality processes. The committee consisted of key stakeholders influential in areas of labour, human rights, environmental, social, economic and diversity issues. Together NGOs, investor groups and corporate actors discussed issues of most importance to Nike, concentrating on social impacts in the supply chain and how to integrate CR into Nike's core business practices. Assurance processes, in turn, would need to consider whether the objectives and expectations of such stakeholders had been met.

Another key factor that is needed to enhance CR reporting assurance quality would be to have clear standards and guidelines on the audit methodologies and reporting processes. The study by AccountAbility and KPMG (2005), for example, concludes that an assurance process based on either AA1000AS or ISAE3000 alone is unlikely to deliver the same results. It is argued that while ISAE3000 provides rigorous procedural guidance for assessing the reliability, comparability, and consistency of information when undertaking an assurance engagement, AA1000AS emphasizes the relevance of the reported information for stakeholders. In other words, an assurance performed solely according to ISAE3000 may not assure users who need a "bigger picture" of past and expected future performance. Nevertheless, assurance based solely on the three AA1000AS principles might score well in responding to stakeholder concerns, but may not score as high on data accuracy. It is thus argued that the combined use of AA1000AS and ISAE3000 in sustainability assurance is likely to lead to enhanced results in the audit methodology and conclusion, resulting in greater stakeholder trust and confidence (Owen and Dwyer, 2005).

In all of the above areas there is a need for more involvement of the management accountant. The enterprise drivers of CR such as accountability and transparency, governance and reporting, risk management, finding sources of competitive advantage, all impact the work

of the management accountant. Many of these areas require quantified information and analyses, both financial and non-financial. Risk management in particular is now acknowledged as a major driver behind corporate engagement with CR issues. With management accountants being actively involved in the cost-benefit analysis of the various CR decisions, their potential role in enhancing and supporting the CR assurance process becomes invaluable.

Finally, there needs to be greater communication and clarity on the quality of the assurance providers, including the expertise and technical competence of the assurance provider. By the same token, there needs to be professional oversight on the training and certification of such assurance providers. This will also include clear guidelines on the maintenance of professional independence and objectivity.

Conclusion

CR reporting is only meaningful if sustainability reports are perceived as being relevant and reliable. Providing independent assurance reports is one way for organisations to meet this challenge, but much more needs to be done for progressing the quality of assurance processes in this area.

Organisations need to keep pushing for change and demand for greater clarity and quality of work from the assurance providers. The management accountant has a significant role to play in both the ex-ante area of integrating strategic CR thinking in organisations and the ex-post role of generating the CR reports.

Management accounting professionals are also trained in evaluating investment decisions regarding the future, and thus would be ideal professionals to support the independent 'assurance' process. Only by addressing these increasingly critical issues can new and better approaches to CR assurance be achieved, and such outcomes in turn will lead to greater value to shareholders and stakeholders alike.

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