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OUTSIDE INSIGHTS

BEYOND ACCOUNTING

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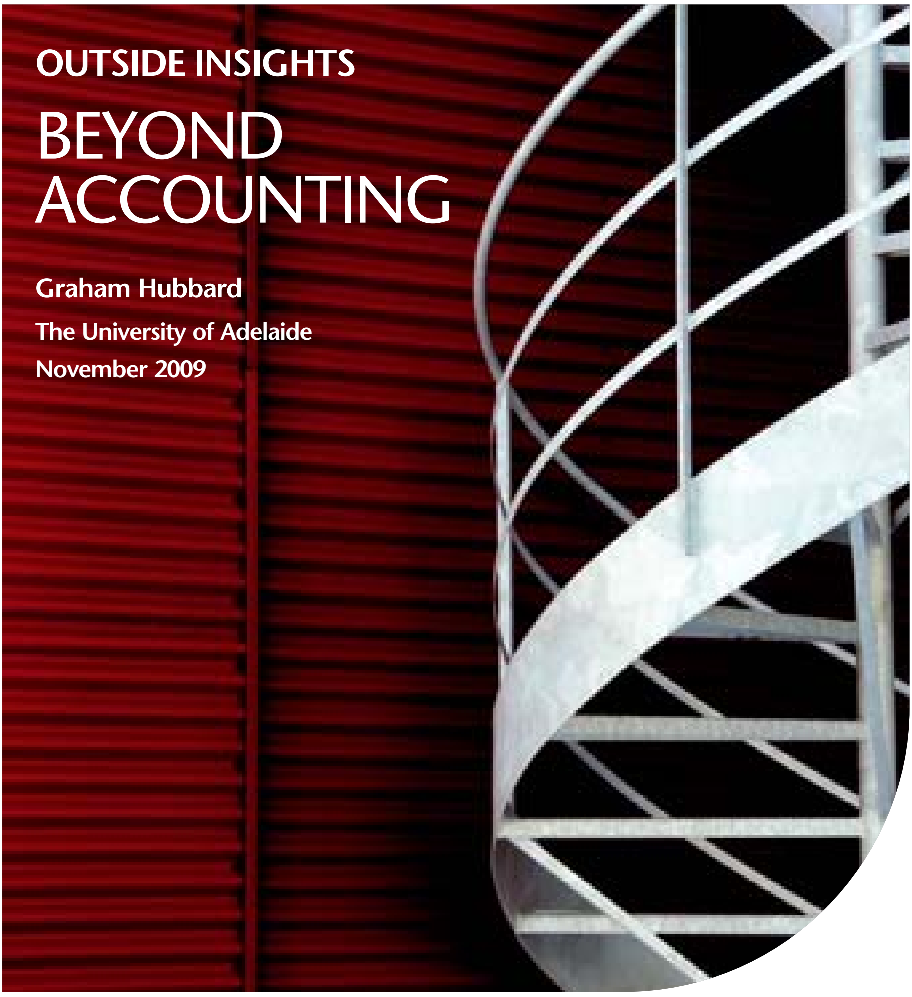

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Although sustainability is a growing issue, it is not well understood. As the subject is prioritised by business, governments and civil society, the need to clarify how to do it, how to measure and report on it, and how to assure sustainability information become key issues.

In the ICAEW landmark publication *Sustainability: the role of accountants* we argued that these areas of expertise – building and managing flows of valuable, reliable and trusted information – fall naturally under the remit of the accountant. They should therefore have a voice in the debate.

This Briefing forms part of our *Sustainable Business* thought leadership programme, within which the *Outside Insights* series offers a platform for stakeholders to put forward their views on issues relating to sustainability, the profession and the wider community.

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OUTSIDE INSIGHTS

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Introduction

This Briefing highlights significant questions that need answers before sustainability reporting gains broad-based acceptance. Who are the target audiences for sustainability reports? How do sustainability reports link to strategy? Can they be comparable across organisations and perhaps most importantly, what is the impact of sustainability reporting on business practice?

Financial reporting is a legal requirement for organisations across the world. Yet accounting for the effects of their strategies, practices and outcomes on external stakeholders requires non-financial measurement of social and environmental performance. Including this social and environmental performance in the reporting of organisations – which is becoming known as corporate responsibility reporting or sustainability reporting – has moved from being virtually non-existent in the 1980s to being unusual in the 1990s to being expected for all large organisations in the 2000s (White, 2005). Table 1 indicates how significantly this pressure has been responded to during the last few years by large organisations.

Table 1: Percentage of major organisations producing sustainability reports

Year	Global top 250	National top 100s	
1999	35%	24%	
2002	45	23 (28)*	
2005	52 (64)*	33 (41)*	
2008	79 (83)	45	
	Europe top100	**US top 100**	**Rest of world top 100**
2007	93%	73%	68%

* Including significant sections in financial reports.
Sources: Adapted from KPMG (2005 and 2008) and Scott, P. (2007).

Yet, in most cases, sustainability reporting is voluntary – there are no agreed local or global standards, no agreed metrics, no benchmarks, no objective external assessment and little audit/assurance. There is also a continuing perception that organisations are producing sustainability reports primarily as a public relations exercise – sometimes called 'greenwash' – to give the impression of concern over social and environmental issues, while only paying lip service to the underlying issues. Consequently, it is not surprising that sustainability reporting has yet to be understood, accepted or treated as of equal importance and value in assessing overall organisational performance by any of the wide range of stakeholders who are interested in reading these reports.

Case studies of high performing organisations are used to learn about what strategies and practices to adopt to improve the performance of organisations. Typically, assessment of 'performance' of organisations has been based on financial performance. If measures of 'performance' do not include an assessment of the social and environmental performance, we may well be promoting and encouraging organisations with bad sustainability strategies and practices. For instance, financial performance may well be improved by outsourcing to developing countries, but this may cause reputational damage in future years and result in more environmental damage in other countries than if the work had been performed in the home country.

While many frameworks have been developed for sustainability reporting, few have received much general traction. Limited light has actually been cast on organisational performance by sustainability reporting to date and so far it is unclear what impact it has actually had on organisation strategies, practices and outcomes. Many questions exist. What should a 'responsible' organisation be expected to do (and not do)? What is 'sustainable' organisation practice? Which measures should organisations really be worried about? Is the GRI framework a desirable global standard? Which organisations are performing well in non-financial areas? Can we trust what organisations say about their performance?

This Briefing provides background to the current state of sustainability reporting. It briefly covers the development of sustainability reporting. It considers approaches to sustainability reporting and the models of reporting that have emerged. It also considers general issues which arise from the measurement problems in the field. Finally, it proposes plans for research which is proposed to address these issues.

1 How has sustainability reporting developed and changed over time?

From limits to growth to sustainable development

The development of non-financial reporting began in the US in the 1980s. The key focus at that time – and typically for organisations beginning the sustainability reporting journey – was on environmental reporting, as external stakeholders became concerned with the impacts of organisations on a wide variety of community resources eg, air, land and water emissions, waste and whether the resources would be sufficient for future growth. In addressing these issues globally, the Brundtland Commission (WCED 1987) developed the term 'sustainable development', defining it as:

> 'development that meets the needs of the present without compromising the ability of future generations to meet their own needs'.

The findings of this Commission – that the world would have to modify its ways of operating to be 'sustainable' in the long term – set governments, communities and individuals thinking how to make these changes.

Organisations, however, were largely resistant. They did not wish to see their economic growth constrained by reporting their impact on community assets and resources outside their narrow organisation boundaries. The linking of 'sustainable' with 'development' also implied that these terms were mutually compatible – a perspective rejected by many academic researchers (eg, Gray 2006). Many organisations also used – and continue to use – 'sustainable' to mean 'sustainable profits' or 'sustainable growth' for themselves, a far cry from the originally defined meaning.

From environmental reporting to the triple bottom line

In 1998 Elkington developed the term 'triple bottom line' to argue the case for reporting environmental and social performance together with economic performance. The triple bottom line concept implied that economic, environmental and social 'performance' were to be balanced and were of equal importance. The introduction of 'social' aspects recognised that organisations had impacts on the communities in which they operated and also on the important role of the people who worked for the organisation. Over time, many voluntarily-produced 'environmental' reports morphed into 'environment and social' reports, to supplement the required financial ('economic') reports which organisations had to legally produce. The elements of a triple bottom line were produced, albeit in two different reports. However, there was no single 'bottom line' for either environment or social as there was with the financial bottom line.

Climate change brings organisational responsibility

During the 2000s, as it became clearer around the world that climate change was a reality, more large organisations began to take sustainability reporting seriously. The term 'sustainability report' began to be used to cover the wide variety of environmental and social impacts which the organisation was increasingly perceived to have on the community.

Authorities were also concerned that existing reporting, particularly by listed companies, did not reflect adequately the set of issues which should be used to assess the organisation's stewardship of its resources. For instance, the UK government in 2002 introduced a new Companies Act requiring an 'operating and financial review' (OFR), under which directors would be required to report on 'material factors', which would include its business relationships with employees, suppliers and customers, the impact of its operations on communities and the environment, and the fairness of outcomes (Goyder, 2002a).

The 2003 Accounts Modernisation Directive from the European Union came into force for annual reports published from 2006 and an increasing number of other countries (eg, Japan, Australia, Sweden, Norway, Denmark, Netherlands, France, Spain, South Africa) now require some sustainability elements to be reported. Even though the OFR was stopped by the UK government in November 2005 before it even began, the UK Accounting Standards Board in 2005 issued a 'best practice' guideline for narrative reporting which covered most of the areas which were included in the OFR, thus providing significant encouragement for companies to now report such information (Tomorrow's Company 2007).

As shown in Table 1 on page 3, by 2008 most large organisations in developed countries were producing some sort of report covering environment and social performance, as well as economic performance. Table 2 shows the names which are given to such reports. It shows that there is a wide variety of names being used. It also shows that there is a significant difference between Europe, the rest of the world and the USA, with Europe much more advanced on the use of all three elements of the triple bottom line concept.

Table 2: Names used for sustainability reports

Name	Europe top 100	USA top 100	Rest of world top 100
Sustainability	72%	27%	50%
Corporate responsibility	22	38	32
Environmental and social	2	3	9
Social and community	–	8	1
Environmental health and safety	–	11	3
Environmental	4	5	4
Philanthropic	–	8	–

Source: Author analysis from GRI data in Scott (2007).

However, 'sustainability reports' are typically focused mainly on the environmental and social elements of organisational performance, with the mandatory annual report containing the financial/economic performance. In this sense, the 'triple bottom line' has not come about, with financial performance assessment remaining separate and regarded as of superior importance.

Further, there is clear evidence of 'greenwash', whereby organisations report mainly positive aspects, or report their performance in positive terms, regardless of actual performance (Brown and Fraser 2006; Gouldson and Sullivan 2007; Tregridge and Milne 2006; Llena et al., 2007; Owen 2006). While large organisations are now reporting this information, SMEs are rarely engaged at this time (Perrini and Tencati 2006).

Investors are another stakeholder group which has sought sustainability reporting information from companies. Investors are increasingly seeking to invest in socially responsible investments (SRIs) ie, those companies deemed to be following good social and environmental practices. Ratings systems for non-financial performance of listed organisations, aiming to provide guidance for SRIs have been developed and have become quite significant (ACCA 2004). Specific investment indexes have been created, such as the US-based Kinder, Lydenberg, Domini (KLD) index (established 1988) and the Dow Jones Sustainability Indices (established 1999), as well as the UK-based FTSE4Good indices (established 2001) to assist those wishing to invest in socially responsible companies to make better decisions. This development suggests that the pressures for sustainability reporting and performance will continue to increase.

Who are the target audiences for sustainability reports?

A key issue is which stakeholder group or groups are the targets for such reports? Spence (2007) found the main target audiences were investors (83%), employees (78%), NGOs (65%), government (57%) and customers (43%) but peers, communities, regulators, suppliers, local authorities, universities, media and creditors were also mentioned. However, KPMG/SustainAbility's survey of users of reports found that investors were less than 6% of total readers and they did not identify employees or customers as categories (Bartels et al., 2008).

Users also suggested that reports are often not linked to the business strategy of the organisation, failures are not appropriately recognised in reporting, reports are not assured and therefore lack credibility, especially when no standards or benchmarks exist and non-readers (who are by far the majority in the potential user population) are unclear of the value of the reports.

In summary, the current state of reporting is confusing and confused. Different organisations are at different stages of development and acceptance. The target stakeholder group(s) are varied and not clearly articulated. It is not known whether these groups read the reports or what they do with the information. There are few agreed metrics or standards to report against. What is reported is not necessarily trusted or valued. Nevertheless, there is increasing acceptance of the need for sustainability reporting of some kind and of the desire to make it more valuable.

2 Models of reporting

Model proliferation

Although hundreds of frameworks have been proposed to address the complex issues in sustainability reporting, only a few models have been adopted by large numbers of organisations.

ISO 14001 monitors the internal environmental processes of the organisation and has been adopted by thousands of companies worldwide. However, at best, it addresses only environmental issues and it does not require a report to be produced. It is also process-focused, not outcome-focused ie, the environmental outcomes could still be unacceptable even if the process was itself certified.

The Eco-Management and Audit Scheme (EMAS) has also been widely adopted within Europe (Castro and Chousa 2006). However, like ISO 14001, it is limited to environmental and process issues and has not had any impact outside Europe.

The balanced scorecard has been widely used as part of the normal management system of many organisations for the last 10-15 years. Though it does not explicitly cover environmental or social issues, they could be included within the existing four balanced scorecard quadrants (financial, customer/market, short-term efficiency and learning and development) or new sections could be added to include them in the balance (see Figge et al., 2002; ICAEW 2004; Hubbard 2009 for some proposals).

The existing financial reporting system could also be extended to cover social and environmental reporting, as has been advocated by Tomorrow's Company, seeking 'inclusive' reporting (1998, 2007). However, it seems unlikely that adding social and environmental reporting into financial reporting systems will be successfully addressed in the foreseeable future from within the accounting profession as accountants do not have the technical skills required for environmental assurance. The two glimmers of light for accounting are first that, finally, international financial reporting standards are about to be applied across the world, which should provide consistent financial reporting globally, allowing global benchmarking and performance comparisons. Second, that accounting has a well developed audit/assurance function, which is one of the key problems for sustainability reporting to address.

An emerging global standard?

Surprisingly, one model is emerging as a voluntary de facto global standard. Begun in the late 1990s, the third edition of the Global Reporting Initiative's guidelines ('G3') was released in October 2006. Based on the United Nations Global Compact 10 principles, for which over 2,900 organisations from around 100 countries have signed up, the GRI has managed to secure adoption by many leading and large organisations in the world.

GRI acts as a multi-stakeholder network of experts with the stakeholders developing the guidelines themselves, rather than having them imposed by regulation or top-down. The number of companies reporting against GRI guidelines has increased from 20 (1999) to 1,500 (King, 2008).

GRI recognises the problem of needing a somewhat flexible framework rather than required standard reporting by all. It is in the process of developing industry and country standards as well as the core protocols. Further, the encouragement to stakeholders to publish their reports electronically for general use for free on a common database (corporateregister.com) allows all stakeholders to rapidly access a wide variety of reports and for reporters to learn from the best practice available. Thus GRI sees reporting as a cooperative global process, with the users developing best practice by continual development and innovation over time.

3 General issues in sustainability reporting

The purpose of sustainability reporting is to provide information to holistically assess organisational performance in a multi-stakeholder environment. A number of key issues currently exist that must be addressed for sustainability reporting to meet its desired purpose.

1. Who are reports for?

If, as is likely, the organisation seeks to provide valuable information to a wide range of stakeholder groups, clearer consideration of exactly who those groups are, what those groups seek and how to meet the conflicting needs of each group should perhaps be made explicit up front in reports.

2. How do sustainability reports link to business/corporate strategy?

Users (and non-users) have indicated that the most important aspect of a sustainability report is that it is linked to the organisation's overall business or corporate strategy (Bartels et al., 2008, Arnold 2008). Currently much of the information reported fits into the 'nice story' category without a clear context for its importance.

3. Materiality of issues reported

Related to the link to business/corporate strategy is the issue of the **materiality** of what is reported ie, that the variable measured is of significant importance to the overall performance of the organisation. As reporting matures, there needs to be a focus on the smaller number of items that are truly material in the sense that they are linked to the business/corporate strategy.

Materiality might be defined by the views of significant external stakeholder groups, who may have different views, as well as the views of those within the organisation, as they focus more on the externalities of the organisation's operation (eg, use of non-renewable energy sources, outsourcing of operations to developing countries, impact of emissions on local communities).

4. Validity of indicators

Clearly, there is an expectation that, by getting improved performance on the chosen performance indicators, overall organisation performance is improving (Gouldson and Sullivan 2007). However, research suggests that there is currently little relationship between measures in sustainability reporting and actual environmental, social or financial performance (Arnold 2008, Chatterji, Levine and Toffel, 2007).

5. Reliability of indicators

Clearly, what is measured needs to have **reliability** ie, when measured by different people, the same answer is received. Yet in the social area particularly, surveys of employees, customers or other key stakeholders often show widely varying responses by individuals or groups to the same question (see Gerhart et al., in press).

6. Objectivity of reporting

Many researchers have found sustainability reports to be biased towards reporting positive findings (eg, Owens 2006, Adams 2006, Tregridge and Milne 2006). This has led many researchers and analysts to be extremely sceptical of sustainability reports. There is a natural human tendency to find ways to 'manage' what is reported, resulting in considerable greenwash.

7. Transparency of information

If information is transparent, it can be tested and proved to be reliable. Making policies, processes and information transparent builds trust and credibility. Organisations which seek to hide information are naturally not trusted on the information they do provide. Scott et al. (2008) report that 70% of consumers do not trust information from organisations on climate change, particularly if it is not verified by independent parties. ACCA (2007) concluded that companies with large emissions were poor at reporting on emissions.

8. Comparability of information

Currently, **comparability** is a missing element of sustainability reporting. Having derived a measure and reported it, the question becomes, is this a 'good' or a 'bad' outcome? An issue arises around whether **absolute performance** or **relative performance** is the appropriate comparison. Relative performance is important in a competitive situation. Absolute performance is important overall though, for true sustainability.

9. Balance of information

The balanced scorecard has been well received within organisations because managers and others clearly recognise that organisational performance is about balance. Whatever is chosen as the overall set of measures of organisational performance must be seen to consider and have a balanced perspective (Hubbard et al., 2007), and it must also be simple enough to be understandable and comprehensible.

10. Understandability of the report

A major issue for current reports is their lack of comprehensibility – what does it all mean? This is because of the very wide range of variables being reported on, the lack of standards for reporting and for formatting reports, the wide range of stakeholders who have interests and the lack of assurance of the information contained within them.

While financial reporting is quite rigid in what must be reported (income statement, balance sheet and cash flow statement, all with defined items, and notes to the accounts which amplify and supplement the three statements) and how it must be reported, no such defined framework exists for sustainability reporting. As a first step, the GRI guidelines call for a profile disclosure of the organisation's strategy and a summary analysis of overall performance. A similar requirement for a CEO report on performance in the annual report is a critical element for understanding the strategic position and economic performance of the organisations.

11. Audit/assurance of the report and performance

A missing requirement of sustainability reports to date has been their **audit/assurance**. This is fundamental to the credibility of financial reports and has been recognised as necessary for sustainability reports in the future.

KPMG (2008) found that 'formal assurance' existed for 40% of the G250 and 39% of the N100 firms, with accounting firms dominating. However, this varied greatly from only 14% in the US to 73% in France. Further, an investigation by Hubbard (2009) found that even when 'assurance' was stated as having taken place, the assurance only covered a very limited amount of the material in the report.

GRI G3 guidelines provide the opportunity, but not the requirement for external assurance. AccountAbility, an independent professional consulting organisation, developed an assurance standard, AA1000 Assurance Standard, in 2003 which is well regarded in the industry and which has been updated in 2009. Professional accounting bodies released the International Standard for Assurance Engagements (ISAE 3000) in 2003 and KPMG (2008) found that this was the leading standard in use. The Netherlands has developed its own standard for assuring sustainability reports, and France, Italy, Sweden and Germany have developed guidance statements. But the type of social and environmental information which is included in such reports is outside the professional expertise of current auditors.

What is clear is that the lack of assurance is a fundamental handicap to the credibility of sustainability reports. Without independent professional assurance, the quality of the information cannot be regarded as credible.

12. External stakeholder engagement

Leading organisations are now using some form of external involvement in either the process or the assessment of the results, with reports from the external parties sometimes being included as part of the report. This opens up the organisation to a wider variety of views, gives external parties the opportunity to understand the issues facing the organisation and allows the process of report development to be used to develop appropriate compromises that meet parties' needs as much as possible. This approach is likely to strengthen the reputation of the organisation, improve its transparency and objectivity and develop a better set of indicators – and, more importantly, actions – that are more valued by relevant external stakeholders.

13. Integration with financial reporting

If sustainability reporting is to be equal to financial reporting in influence, how are the two types of information to be integrated together to get an overall perspective on organisational performance? True sustainability reporting requires economic results to be included, forcing those organisations which produce separate reports to duplicate the economic performance information to some extent.

14. Addressing true 'sustainability'

A final issue is fundamental to sustainability reporting. Despite the name, most current reporting does not report on **sustainability** explicitly or at all (Gray 2006). Most of the current measures are about current environment and social activities and trying to 'do good'. In the environmental area, the focus is on reducing resource use, especially non-renewable (eg, fossil fuels), slow-renewable (eg, old growth forests) or constrained (eg, water, energy) resources, reducing emissions and wastes and recycling outputs from one process to another ('from cradle to cradle'). In the social area, it is by the focus on contributing back to the society and community, providing growth and development opportunities for employees and improving relationships and practices for customers, suppliers, governments and communities.

But how does all this impact the needs of future generations? The fundamental changes to organisation practice required to more accurately consider true total costs and review practices holistically are slow in coming.

4 Sustainability reporting for tomorrow's company

While there are many issues which arise out of the current state of practice, future research might concentrate on the following issues through looking at large organisations across the globe and the decisions they have made about sustainability reporting and their experience resulting from that, both in terms of the reporting and also of the practice. These organisations are the leaders in reporting and have the largest impacts on external stakeholders. The issues we would propose to research are:

1. What impacts has sustainability reporting had on organisations? Has sustainability reporting been useful for them and their stakeholders and in what ways? Has sustainability reporting changed their organisational strategies and practices?

2. What reporting frameworks are organisations using? Why have they chosen these frameworks?

3. Why have some organisations still not adopted sustainability reporting? Have they changed their strategies and practices without matching reporting?

4. How does/how can sustainability reporting provide value to stakeholders of organisations? Which stakeholders receive most value and which receive least?

5. How do investors in organisations view the value of sustainability reporting and the various frameworks in particular? What do they want from sustainability reporting? What are the barriers to delivery?

6. What are the key issues which organisations see for the future of sustainability reporting and how do they believe they will be solved?

By focusing on the practices and changes of the largest organisations, insights can be derived into the wider future effects likely for all organisations, as well as the current issues which are perceived by those who are leading-edge practitioners.

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