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CHARTERED ACCOUNTANTS
of New Zealand

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.

Taskforce Members

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

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Shaun Collins — Manager, Deloitte Touche Tohmatsu.

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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.