Accounting, Auditing and Reporting:
Supporting or Obstructing the Sustainable Companies Objective?

Description of the research in the Sustainable Companies Project

It is clear that company law and accounting law have a potentially important role in directing companies towards more sustainable behaviour. Based on our research, company disclosure requirements are very relevant to this objective. We share the European Commission's opinion: 'Better disclosure of non-financial information may be a tool to further increase the number of European enterprises fully integrating sustainability and responsibility into their core strategies and operations in a more transparent way.'[1] With clearer reporting rules, companies and investors may be able to focus more effectively on sustainability issues and companies' environmental performance might more easily be evaluated.

The Sustainable Companies Project commenced in 2010. This project, led by Professor Beate Sjåfjell of the University of Oslo Faculty of Law, is financed by the Research Council of Norway. The project has involved a team of more than 40 legal scholars and has been mapping the law in 26 jurisdictions across the globe including 11 European Union Member States, the United States of America, China, Brazil and India. Professors Charlotte Villiers and Jukka Mähönen have undertaken a comparative analysis of the mapping in one of the three core areas of this research, namely that which explores the role of accounting, reporting and auditing in responding to the environmental sustainability crisis. The research focuses on the reporting and auditing requirements regarding the impact of corporate activity on the environment. Across the jurisdictions represented in the Sustainable Companies Project, there is a strong and well-established corporate financial accounting culture. Some jurisdictions appear to be more advanced than others, however, in environmental or sustainability accounting. Whilst recognition of the potential relevance of accounting to improvement of environmental performance might indicate that accounting and reporting could help to improve sustainable corporate behaviour, these mechanisms may also hinder such improvements. Our research explores the barriers and possibilities for improved sustainability through accounting and reporting as well as related audit and other assurance processes. Through the cross-jurisdictional analysis, our research seeks a more progressive role for sustainability related reporting and auditing.

Key results

According to our research, the development of sustainability reporting is crucial for supporting business actors to improve corporate social responsibility (CSR). This goal requires going beyond the conventional accounting and reporting methods of financial and cost accounting to find new informational tools and transparency procedures that address appropriately matters such as ecological health and their carrying capacities, thresholds and cumulative effects. Conceivably,

[1] European Commission, *Disclosure of Non-Financial Information by Companies* (Public Consultation Questionnaire, DG for Internal Market and Services, 2010), p. 3.

many corporations are ill-placed to provide or analyse such information, and perhaps such roles should be assumed by other stakeholders such as government environmental agencies and environmental, non-governmental organisations. But, at a minimum, the business sector should cooperate in the multi-party development of more nuanced and accurate sustainability reporting paradigms.

We have identified major obstacles to sustainable behavior in accounting rules and practices. Much CSR reporting remains left to voluntary and discretionary measures, leading to risks of corporate capture, lack of comparability, lack of consistency and uncertainty in benchmarking. Accounting techniques for non-financial issues are still at an early and rather primitive developmental stage and the role of accountants and auditors and their professional bodies nationally and internationally will be extremely important. Clear definitions of core concepts such as ‘sustainable development’, both generally and within the business context, and ‘materiality’ need further refinement. That task should underpin the clarification of key non-financial performance indicators. The recent proposal published by the European Commission for amending the Accounting Directives as regards non-financial disclosure may be a step in the right direction but it will require strong accompanying guidance and the flexibility it grants to companies with regard to the range of frameworks and standards they might use could undermine advances towards greater comparability.

The development of such non-financial information should also be tailored to the needs of as many stakeholders as possible rather than only investors. In order to avoid deceptive practice such as ‘greenwashing’, consideration must be given to the practical usefulness of disclosures and to move from the procedural tasks that emphasise report preparation, information verification and disclosure, towards behavioural change within corporations that leads to better sustainability performance. We advocate the availability of enforcement mechanisms to give strength to any new disclosure rules and to enhance their credibility further by giving to stakeholders the possibility of challenging information presented by companies. We also wish to see sustainability disclosures being applicable not only to the largest companies, but also to cover subsidiaries and to SMEs.

A major step forward can be identified in the efforts towards *integrated reporting* (IR) in which the company’s reporting discloses and explains the relationship between the financial, social, environmental and governance issues faced by a company. Rather than having a separate sustainability report, the company integrates sustainability issues into its main report, but also adopts an integrated strategic thinking and decision-making. Steps have been taken towards this ambitious form of reporting in South Africa but also more generally through the work of the International Integrated Reporting Committee (IIRC). New metrics are also relevant to these developments, along with new ways of disseminating company information with increasingly more sophisticated usage of the Internet to communicate with dispersed stakeholders and investors. One innovative theoretical example is the Sustainable Stakeholder Accounting Statement, which combines an environmental income profit-and-loss statement with an environmental equity balance sheet account.

More emphasis must also be given to the audit and verification of information published. As the European Commission states on CSR information: ‘In order to ensure the sufficient quality and credibility of the reported information, the question should be raised whether there might be a need for an independent check on the reported information and whether auditors should play a role in this regard.'[2] This requires more standardization and legislative actions, even mandatory rules on compulsory assurance. It may also entail special training and new specialist skills for auditors carrying out this function. As mentioned, further promising precedents identified in our research include South Africa's IR system and Australia's internalising of the objectives of more comprehensive reporting into company law itself rather than relying on external legislation.

It is still early days but the approach of integrated reporting offers a positive step. Without understanding and demonstrating the links between corporate strategies and financial performance with the social, environmental and economic context, there will remain a formidable barrier to sustainability. By recognising and working with the linkages between corporate activity and environmental, social and corporate governance context, these two dimensions may be better reconciled. The institutional and policy framework has not yet been completed. Reform is a matter of urgency since currently many of those companies deemed to provide the best reports are in fact among the worst offenders. To make genuine progress towards sustainable companies, correct and reliable environmental reporting is essential. Ultimately, it may become necessary to introduce enforceable mandatory disclosure and assurance of integrated or sustainability reports. Better reporting will clear a path towards better business behaviour and a healthier planet.

Charlotte Villiers	Jukka Mähönen
Professor	Dean and Professor of Civil Law
University of Bristol	University of Turku Finland

For further information on the Sustainable Companies Project see http://www.jus.uio.no/ifp/english/research/projects/sustainable-companies/

[2] European Commission, *Green Paper: Audit Policy: Lessons from the Crisis* (COM (2010) 561 final, Brussels, 13.10.2010) p. 8.