ICAEW representation

THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND & WALES

ICAEW REP 29/06

GLOBAL REPORTING INITITATIVE: THIRD REVISION OF THE SUSTAINABILITY REPORTING GUIDELINES

Memorandum of comment submitted in March 2006 by the Institute of Chartered Accountants in England and Wales, in response to the Global Reporting Initiative consultation paper entitled 'Draft Sustainability Reporting Guidelines G3 version for public comment', published in January 2006

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INVESTOR IN PEOPLE

INTRODUCTION

1. The Institute of Chartered Accountants in England & Wales (the "Institute") welcomes the opportunity to respond to the consultation paper *Draft Sustainability Reporting Guidelines G3 version for public comment* (the "Guidelines") published for comment by the Global Reporting Initiative ("GRI") in January 2006.

2. GRI issued the Guidelines electronically on its website www.grig3.org and invited submissions electronically by 31 March 2006. The Institute reviewed the proposed guidance and our comments were delivered on-line. This Institute representation re-formats that submission for the purposes of publication. None of the commentary differs materially from that submitted to GRI.

WHO WE ARE

3. The Institute of Chartered Accountants in England and Wales is the largest professional accountancy body in Europe, with more than 127,000 members. Three thousand new members qualify each year. The prestigious qualifications offered by the Institute are recognised around the world and allow members to call themselves Chartered Accountants and to use the designatory letters ACA or FCA.

4. The Institute operates under a Royal Charter, working in the public interest. It is regulated by the Department of Trade and Industry (DTI) through the Financial Reporting Council. Its primary objectives are to educate and train Chartered Accountants, to maintain high standards for professional conduct among members, to provide services to its members and students, and to advance the theory and practice of accountancy.

MAJOR POINTS

General – our overall assessment of the Guidelines

5. We agree with GRI that there is a demand for improvements in the quality of sustainability reporting and support its goal of establishing a commonly accepted and trusted basis for this. We welcome GRI's structuring of its Guidelines as a principles-based system and are pleased to see the greater emphasis on principles in the revised version.

6. The current iteration of the GRI guidance is a significant improvement on previous versions and we congratulate GRI on the document. In particular, the restructuring of the Guidelines with the introduction of the narrative sections, the "Disclosure on Management Approach", and the focus on indicators on outputs and measurable data and information supported by individual 'protocols' has added significantly to their clarity and precision.

7. Nonetheless, we have some major concerns. The description of nearly fifty of a total of 79 indicators as "core" implies a prescriptive approach that

undermines the flexibility of a principles-based process of performance assessment by the management of an organisation. Indeed it suggests that the principles of materiality and relevance have already been applied and that these indicators meet both principles for all organisations, which we find it difficult to accept. Whilst we recognise the merits of comparability and consistency of reporting and support the inclusion of examples of indicators, we do not think that it is helpful to mandate their use in this way. We believe, therefore, that this is a distinction that should be dropped.

8. Furthermore, the guidelines are very producer-oriented and they seem to speak only to a 'gold standard' reporter. We are concerned that these two features – either separately or together - might well limit the accessibility of the reporting model for other business sectors or indeed other types of organisation (e.g. not-for-profits and the public sector). Furthermore, we wonder if the burden of such levels of reporting might well be too great for small and medium-sized businesses and our expectation is that the 'High 5' publication, aimed at this group, will be adapted in the light of G3.

9. We also feel that the current consultation process is unsatisfactory. This version of the Guidelines is a substantial step forward and has involved a significant change in its nature. This ought to have been accompanied by a period of field-testing and a longer and more flexible consultation period. This would have had the benefit of not only demonstrating that the Guidelines as fit for purpose but could have been used for an assessment of their value to reporters and their stakeholders. In particular, we believe that the lack of piloting means a further iteration of the Guidelines will be required sooner than GRI anticipates as the lessons from the implementation of the guidance emerge.

The most useful areas in terms of content/design

10. Generally the areas that we were most impressed by were:

    a. *Principles.* G3 is more firmly and explicitly positioned as a principles-based system. We regard this as vital to the success of any such system. See paragraphs 5 and 7 above.

    b. *Standard Disclosures*. We regard this as an important element of the report. It is pleasing to see the prominence they are given. It is a logical and comprehensive framework that draws on information that probably already exists in some form in most organisations. We firmly believe that a structured, consistent approach here will define the rest of the report. That said, however, a considerable volume of information is called for. Whilst this may well be very useful for internal management use, it may place considerable burdens on an organisation to report it. Furthermore, we wonder how far this quantity of material will be of value to readers. We believe that reporting organisations should make some periodic assessment of the value of this reporting process, both internally and to their stakeholders, and of where that value lies – as an internal management tool or a source of material for engagement, for example. Alternatively, this assessment might be undertaken by GRI.

c. *Disclosure on Management Approach, Performance Indicators and Protocols.* Previously much information, such as the description of processes, was incorporated in indicators that properly did not belong there. This iteration of the Guidelines sees a significant step forward in the proper separation of policies and similar information into the narrative text and measurable information into indicators supported by separate protocols. This constitutes a significant improvement to the Guidelines.

The main areas of content/design that need the most additional attention

11. Generally the areas that we felt would benefit from further development were:

    a. *Core indicators.* See paragraph 7.

    b. *Principles.* The principles could be better defined and where definitions already exist in financial and non-financial reporting they ought to be acknowledged and followed as far as possible. It would be helpful if it could be demonstrated (perhaps diagrammatically) how they should be applied to arrive at the indicators removing the false distinction between content and quality principles. See also paragraphs 14 to 18 below.

    c. *Assurability.* This is not well defined in the Guidelines and where it is included as a principle it would be better characterised as reliability of information and documentation. We believe that whilst the Guidelines are right to identify the importance of assurance and the necessity for organisations to have policies and procedures around assurance, the Guidelines should not venture into the territory of discussing assurance. This could be an area that could be developed separately. Furthermore, provided that this principle is characterised as reliability of information and documentation, then the tests for it should also contain some reference to the existence of internal controls and internal auditors, if applicable.

RESPONSES TO SPECIFIC QUESTIONS

Reporting Principles

What is your overall assessment of the Reporting Principles?

12. Generally we thought that the Reporting Principles were satisfactory.

What do you like about the Reporting Principles and their design?

13. We welcome the more explicit positioning of the Guidelines as principles-based. See paragraphs 5 and 7 above.

What about the set of Reporting Principles should be improved?

14. We found the distinction between principles governing reporting and quality to be an artificial and unhelpful one; the principles should apply generally. In addition, the relationship between principles should also be more clearly explained. In particular, although relevance and materiality are linked, they are not the same thing and should be treated separately. Accuracy, balance and completeness are qualities of a principle of reliability, which we prefer to the term 'assurability' as used in the Guidelines. Finally, 'inclusivity' is really part of the process of establishing relevance and completeness and we question whether it can be treated as a principle in its own right.

15. We consider that the principles could be better defined. Furthermore, where generally established terminology already exists in financial reporting it would be appropriate to adopt that here. In the case of financial definitions, a wealth of recognised text already exists such as the framework of the International Accounting Standards Board ("IASB")**.** For non-financial information the IASB has provided definitions for "understandability", "relevance" "reliability" and "comparability" in its recently issued discussion paper on Management Commentary. GRI might also refer to the ISO 14000 series on environmental management systems.

16. An approach of alignment with internationally accepted standards would add to the credibility of the Guidelines and reduce the potential for confusion. Precedent already exists for this. See, for example, the United Nations Conference on Trade and Development Manual for the Preparers and Users of Eco-Efficiency Indicators (the "UNCTAD Manual"). This explicitly cross-refers to the IASB framework.

17. The discussion of the principles is somewhat abstract and there is scope for a clearer link between the principles and indicators, providing more direction on how the principles are applied to derive the relevant indicators. A diagrammatic representation would be useful. Further guidance is also needed on applying the principles to narrative/qualitative information.

18. These observations relate directly to one of the key areas that GRI has identified as in need of review. This is to demonstrate how the reporting principles could be applied to help guide the reporting organization through decisions around the creation of their report and use of the GRI indicators.

Should "relevance and materiality" be defined in terms of the organisation's sustainability impact OR by information that would influence the decisions of an organisation's stakeholders?

19. This is a false distinction. An organisation's impact on sustainability is the context against which the particular issues of stakeholders at a given time are assessed and addressed. The important link between the two positions is implicit in the Guidelines themselves, which note that the report should focus on the issues of importance to its users as well as issues where the organisation

has the greatest sustainability impact. Reporting organisations should not lose sight of the larger picture and their own impact on the sustainability of the planet. To do so would be to undermine the whole purpose of the GRI exercise. However, organisations must also take a risk-based approach to their activities and respond to the specific requirements of their stakeholders.

20. The second position will generally act as the filter for an organisation to gauge which sustainability issues it should attend to. Indeed, an organisation may well have important stakeholders for whom the overall impact of the organisation is the major issue. However, on balance it is the "information that would influence the decisions of an organisation's stakeholders" that will provide the terms of reference for relevance and materiality.

Comments on Individual Principles

21. We had comments on three of the sections that related to principles:

    a. *Assurability*. See paragraph 11.c above.

    b. *Relevance and Materiality.*

        1) Relevance and Materiality are not the same principle and it is not helpful that they are treated as one. Relevance concerns the ability of something be it an event or an issue to impact upon the decisions of an organisation and its stakeholders.

        2) Materiality is normally used to define the quantitative and qualitative thresholds required to make a decision about including relevant issues or events in a report. In particular, the tests around relevance would benefit from the inclusion of a check as to whether a specific indicator is used internally by the management of the organisation.

        3) This version of the Guidelines also discusses materiality in terms of a prioritisation process. However, the generally accepted meaning of the term is as an absolute rather than a relative measure - information is or is not material - and does not define priorities. Given that this is a different use of the term to that employed in financial reporting it would be necessary, if it is to be maintained in this form, to have some explanation of how this would work.

        4) In addition the Guidelines state that "the report should focus on the issues most material to its users". Additional guidance on how to gauge what is "material to users" would be welcome.

    c. *Sustainability Context and Setting the Reporting Boundaries*

        1) These are different in nature from the other principles, which concern the qualities and characteristics of reported

information. These two principles properly belong at a higher, strategic level of discussion. They could be more effectively treated separately to the guidance on principles.

2) The terms “control” and “significant influence” used in the section “Setting the Report Boundary” are well understood terms of art in financial reporting. However, their use here is more generalised and could lead to confusion. As a minimum the Guidelines should indicate the differences between their use of terms and those in financial reporting and make explicit that this is about how organisations influence or are influenced by their supply chains.

Standard Disclosures

Please comment on the different sections of the Disclosure Items

22. *Strategy and Analysis*

a. We rated this section “Good”. We were pleased to see sustainability firmly linked to organisational strategy, clearly positioning it as a major driver of business rather than as something that occurs in addition to an organisation’s activities. However, this section tends towards being overly prescriptive, leaving little scope for individual judgement.

23. *Organisational Profile*

b. We rated this section “Satisfactory”. Whilst we think this is a useful tool, it is highly prescriptive. We would also expect to see some guidance around discussing the organisation’s supply chain included here.

24. *Report Parameters*

c. We rated this section “Unsatisfactory”. With regard to terms employed in Reporting Boundary, there is a need for greater precision when using definitions already established in accounting literature – see paragraphs 11.b, 15 and 16 above.

25. *Governance*

d. We rated this section “Satisfactory”. We have noted in paragraph 9.b. that a considerable volume of information is called for in Standard Disclosures and particularly in this section. We have questioned in paragraph 9.b whether this process is more valuable as a management guide than as a source of useful information for stakeholders for whom the volume of material may be overwhelming.

e. The information under the section on governance may well be detailed separately for some organisations under legislation, listing rules or codes. Organisations ought to be able simply to indicate where it is available.

f. There is no discussion of the declaration of senior executive/directors' outside interests. It may be that this is intended to be implicit in paragraphs 4.7 and 4.8 of the Guidelines. However, it would be worthwhile setting this out explicitly.

g. In the first part of the guidance there is, quite properly, emphasis on transparency of process and reporting. Transparency is tacitly brought in under governance through "Commitments to External Initiatives" and in the social indicators under corruption. However, it is not actually specifically referred to and one metric might be an organisation's commitment to Principle 10 of the Global Compact and its adherence to the Compact's terms. Given the importance of transparency, GRI might wish to make a clear reference to it.

Commenting on individual Disclosure Items

26. *Statement from CEO and Chair.* It is unclear why the forward-looking timeframe was specifically restricted to short and medium term and to a specific period of 3 to 5 years. Whilst we accept that for some organisations there is limited value in discussion of the long-term, for others such as pharmaceutical companies, oil and gas producers or the metals and mining sector, this may be highly relevant. It would be unfortunate to exclude this; indeed we believe organisations should be encouraged to comment on as long a term as possible. Furthermore, what organisations see as medium or short-term will differ and may not be the 3 to 5 year parameters that GRI suggests.

27. *Reporting Boundary*. We found these definitions to be vague. Whilst the sections on boundaries and the boundaries protocol do discuss the value chain, this is done simply in terms of the exercise of influence or control. The definition of operational boundary should be expanded to include critical business relationships and the supply chain.

28. *Assurance*. If GRI is not going to address fully the issue of sustainability assurance - and we believe that this is the correct approach - then this section should finish at the end of the first sentence. This leaves the section simply requiring that the organisation should state its policy and practice with regard to assurance. The rest of the paragraph may be considered to endorse implicitly the practice of not including the scope of the assurance of the sustainability report and this is not something we would support. See also paragraph 11.c.

29. *Stakeholder Engagement.* This is clearly an important and instructive exercise for an organisation and its stakeholders. However given that this reporting model envisages a spectrum of audiences, we believe it is important for an organisation to identify those stakeholder groups in whose interests it is

legally required to act - as opposed to those for whom it has a commercial or other compelling reason to engage. This section does not take account of this, which is a significant omission and ultimately does not benefit any of the stakeholders.

Disclosures on Management Approach

Do you consider the Disclosures on Management Approach a useful innovation?

30. We think that this is a significant addition to the Guidelines and one that has brought considerable clarity, drawing together information that was previously absent or scattered through the document. As we noted in paragraph 10.c, the absence of this section resulted in information being packed into the indicators that was not really appropriate to them. The introduction of the DMA covering policies, responsibilities, context and so on has largely resolved this by removing such information to a narrative format without the loss of any essential information that appeared in the previous Guidelines.

Do you think that the Disclosure on Management Approaches ("DMA") currently proposed is generally appropriate and, if not, what are the key elements that should appear in it?

31. The DMA would benefit from an additional section on implementation and monitoring of policies, procedures, systems and indicators. There is also no reference to the supply chain in the DMA. In particular, we think that the DMA should include a discussion of how an organisation's sustainability policies are communicated and applied to other entities in its supply chain.

32. We also believe that some of the headings are inappropriate: fines, which ought to include sanctions and reprimands from public and regulatory bodies, and awards, are properly indicators and should not be included in this section.

33. In addition, whilst the indicators are much improved, some remain that are properly subjects for the DMA section. These include, for example: EC2 Financial Implications of Climate Change; EN15 Programmes for Managing Impacts on Biodiversity; LA8 Programmes to support employees, families and communities affected by HIV/AIDS; LA9 Elements of occupational health and safety management approach; LA12 Programmes for skills management and lifelong learning; HR3 Type of training on human rights; HR8 Procedures for complaints and grievances; SO1 programmes and practices for assessing and managing impacts of operations on communities; PR1 procedures for improving health and safety; PR3 Procedures for product and service information and labelling; Procedures related to customer satisfaction; Procedures and programmes for adherence to laws, standards and voluntary codes related to marketing communications.

Commenting on individual Disclosures on Management Approach

34. *Economic*. In the economic section, whilst tax is included as an item, its importance is overlooked. Tax has gained prominence recently in terms of responsible corporate practices and the level of tax paid. It is also a major way that companies contribute to economies in which they operate, and especially in developing and transitional economies. We believe that this should be reflected not only in some discussion in the DMA about the organisation's tax policies, its assessment of tax as a source of risk and where in the organisation these issues and policies are formulated and agreed, but also in the indicators. The indicators might include a comparison of the organisation's overall, global, tax liability and the total amount of tax paid in a given jurisdiction, and a comparison of the amount paid locally with the marginal corporate tax rate.

Performance Indicators and Technical Protocols

What was your overall assessment?

35. For the purposes of this section we focused only on the economic indicators and protocols. Overall we rated these as "Unsatisfactory".

36. Whilst the indicators are an improvement on G2, there is significant room for improvement. The economic indicators are not sufficiently detailed or defined to produce outputs that are really likely to be comparable or meaningful. Indeed EC2, EC3, EC6 and EC7 are not really indicators at all. Instead, they seek information around processes, practices, coverage and procedures that would be better placed in the DMA.

37. We fully recognise the challenges that measuring the economic impact of an organisation present. Indeed, we believe that some rigorous field-testing, as we noted in a more general context in paragraph 8, would have gone a long way to refining these metrics and assessing their value to organisations and their stakeholders.

To what extent are the G3 Performance Indicators an improvement on the Indicators contained in the 2002 Guidelines? **What has been improved?**

38. We rated these "Improved". For our explanation see paragraphs 10.c. and 30.

What could still be improved further? Please explain your answer

39. As we commented in paragraph 7 above, we do not think that the distinction between core and additional indicators sits comfortably with a principles-based approach.

40. It is also unclear how indicators were selected as core or additional. A truly principles-based approach would not have defined the outputs in this way but laid out the underpinnings of a process that would result in a set of indicators appropriate to the circumstances of the organisation.

41. Also as we noted in paragraph 8, the indicators are focused primarily on production and seem not to take into account other business sectors or indeed other types of organisation (e.g. not-for-profits and the public sector). This could well limit the accessibility of the reporting model.

42. The second version of the Guidelines contained cross-cutting indicators for the three categories (economic, environmental and social). It is unfortunate that this approach has been abandoned in this version. Indeed, we think that this could have been developed further. As they stand the indicators and the management discussions are divided across the triple bottom line. This is very inflexible in that it does not permit any analysis of the trade-offs that exist between these three areas. This is a very real issue for organisations and we would highlight as just one example of an expression of its importance the keynote speech made by Sir Mark Moody-Stuart, the Chairman of Anglo American plc, at the 2005 Chatham House Corporate Responsibility conference "Understanding and Managing Corporate Social and Environmental Impacts". There are examples of where such indicators are used. The UNCTAD Manual also makes some attempt to achieve cross-cutting metrics. For example, it measures environmental impacts per unit of value-added.

43. We have also commented in paragraph 33 that the indicators contain information that would properly be placed in the DMA.

In what ways are the Technical Protocols most helpful or useful?

44. The protocols will bring a greater standardisation to the indicators and clarify definitions and computation and compilation. They also provide a rationale for the relevance of the indicator.

What could be improved in the format of the Technical Protocols?

45. There are significant gaps in many of the protocols, particularly the economic ones. For example, there is an absence of guidance around definitions, documentation and references.

Commenting on individual Performance Indicators and Technical Protocols

46. Economic Performance Indicators and Technical Protocols

    a. EC1. The indicator is not well constructed. It confuses the basis on which financial information is presented – for example, cash and accruals – and this represents a worrying lack of accounting rigour. The concept of economic value is not one that exists in GAAP and we believe that closer alignment with value-added statements would be preferable as this concept has greater currency, certainly with commercial organisations. At the very least we would expect to see a reconciliation between the economic measures and the financial statements of an organisation. We have reservations about the practicability of this indicator and believe that it would have benefited significantly from field-testing.

b. EC2. This indicator does not seek to measure the economic impact of the organisation but rather the financial impact of climate change on the organisation. Whilst we recognise the importance of climate change and indeed this aspect of it, we wonder if this is the most appropriate place for it. EC2 is not framed as an indicator; the compilation section focuses on risk assessment and processes around that. We also wonder if organisations have the systems in place to measure a metric that might be framed on this issue and believe that further guidance is required.

c. EC3. This is not an indicator but rather a discussion of pension benefits and is also very narrowly drafted. It is therefore likely to be of limited value and would be better focused on employee benefits generally.

d. EC7. This is not an indicator but largely a description of processes. It is also lacking a definition of senior management

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