

# Stakeholder involvement in the third-party assurance on corporate sustainability reports

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## **Abstract**

Current practices of the third-party assurance on the corporate sustainability report have been badly criticized as they failed the expectations from stakeholders. Stakeholder involvement was suggested as one idea to close the expectation gap in the third-party assurance. Literature review, case studies in leading-edge reports and interviews with 28 Swedish reporting organizations and their assurance providers were carried out to see if stakeholder involvement in the assurance would be the solution to the problem. As a result, ten cases identified from 50 leading-edge reports as stakeholder involvement cases. The cases demonstrated that the stakeholder involvement would have a potential to make the assurance function as accountability process, although in a few cases the role of stakeholders was confined as an alternative source of information for the assurance provider. It was found from the interviews that companies had a great interest in internal benefits from the third-party assurance, although only 32% of the companies interviewed had the third-party assurance last year. Half of interviewees could see the value of stakeholder involvement in the assurance, although they did not anticipate any radical change in the power structure governing the assurance exercise. This study, therefore, concludes that stakeholder involvement in the assurance would not happen extensively enough to close the gaps in the third-party assurance under the current setting.

-Key words: third-party assurance, stakeholder involvement, expectation gap, corporate sustainability report, accountability



## **Executive Summary**

The third-party assurance was born as an instrument to hold the reporting organisation accountable to its stakeholders. The growing number of literatures claims that organisations have a duty to demonstrate their accountability to stakeholders. Reporting the credible and verifiable information is the central element of this demonstration. By examining data and claims made in corporate sustainability reports from independent position, the third-party assurance is desired to add credibility on the sustainability report, as the financial audit has done for the annual financial report.

However, the previous researches indicated that third-party assurance had failed fulfilling the expectations from stakeholders (namely credibility gap and expectation gap). It has been problematic to increase the quality of third-party assurance due to the overwhelming interests from both the assurance provider and the reporting organisation. Then **how will the third-party assurance be able to function as accountability process?**

Stakeholder involvement was suggested as one idea to close those credibility and expectation gaps present in assurance. Literature review found that there were normative arguments supporting the stakeholder involvement in assurance. There were past examples in social audit tradition where stakeholders successfully managed the auditing process. Some of current assurance standards and guidelines recommend assurance providers to listen to stakeholders for various reasons. But, the literature review indicated that there had been arguments at conceptual level favoring stakeholder involvement in the assurance but not the real cases.

To find the real-life cases of stakeholder involvement in the assurance, assurance statements from leading-edge corporate sustainability reports were studied. To anticipate the future in the third-party assurance and stakeholder involvement therein, wider group of reporting organisations and their assurance providers were surveyed. Few research questions were introduced to guide these two parts of the research.

In short, the study of assurance statements from leading-edge reports showed that there had been a few examples where stakeholders such as independent experts, the independent panel, and NGOs managed to challenge the reporting organisation with different perspectives through the assurance process. The examples were classified with four distinct types according to the degree of stakeholder involvement including traditional assurance providers actively listening to stakeholder opinions (4 cases), traditional assurance providers and independent expert(s) running the assurance process in parallel (3 cases), an independent panel as an assurance provider (1 case), and an NGO as an assurance provider (2 cases).

However, among the reports with third-party assurance statement it was only 27% which could provide stakeholder involvement cases. In some cases, the role of stakeholders was confined as an alternative source of information for the assurance provider.

In Sweden only 32% of 28 companies interviewed had the assurance last year. Six companies are considering having the third-party assurance in the foreseeable future. About 40% of companies were affirmative that the third-party assurance would be the common practice in the near future, while only 11% of the interviewees anticipated that there would be any regulation requiring mandatory the third-party assurance on the sustainability reports in the near future. The third-party assurance will therefore evolve slowly but steadily without external driving forces.

The opportunity for the stakeholder involvement in the assurance is that about half of interviewees could see the value to be added by the stakeholder involvement in the assurance. But, they did not expect any radical change in the power structure governing the third-party assurance. Even if it would be the low level of involvement via traditional assurance provider as a mediator, there seems to be an opportunity that stakeholders will have a more regular channel to tell their views on the company.

Regarding the future perspective, few scenarios were drawn. If the voluntary development will continue, the reporting organisations will continue to seek possible internal benefits. Different ways to involve stakeholders will be explored as a value-added approach to the assurance. If there will be more demand for the disclosure of sustainability information in the annual report, the integration of environmental/sustainability report into the annual report will gain a momentum. The sustainability information will then be audited more by accountancies with a methodology mainly coming from their financial auditing experience.

Then would the idea of stakeholder involvement make sense as a solution to the problems with the third-party assurance? Would it really be helpful to close the credibility gap and expectation gap? The cases identified in the leading-edge reports showed that stakeholder involvement would be good to make the assurance process function as the accountability process. Certain companies which involved the stakeholders to challenge the companies could demonstrate the clear-cut cases in that. About half of Swedish companies interviewed anticipated that stakeholder involvement in the third-party assurance would add credibility on the process, and intensify the relationship they had with stakeholders.

However, interviewees from the Assurance Group did not see any credibility gaps and expectation gaps in their current approach to the assurance. They were very satisfied with current approach, even if there seemed to be problems with scoping, i.e. the assurance simply do not cover the whole report, the conclusion of the assurance, i.e. assurance providers do not judge the completeness of the report. The assurance approaches were clearly getting mature, harmonized and structured, but there were too much focus on the validation of the data.

For the future, all of the companies having a plan in the third-party assurance weighed the possible internal benefits much more than the credibility gains. Few explicitly mentioned that companies would not do it just for the credibility gains since the third-party assurance is very costly.

All in all, there is a strong managerial interest in the possible internal gains from the third-party assurance. Under the current setting, therefore, even if stakeholders are engaged along the assurance process, it will not imply any radical change in the governance. This strong managerial interest will undermine the value of assurance as the accountability process, and continue to deter some reporting organisations from seeking the third-party assurance for that reason.

In conclusion, this study shows that stakeholder involvement in the third-party assurance would be the solution to fix the assurance as accountability process, bringing the challenges to the companies. But it is not likely that it will be welcomed by the wide business communities. It is more likely that stakeholder involvement in the assurance will be the exercise only for the extremes — extremely value-oriented companies or extremely challenged companies. Stakeholder governance seems to be the far distant future which will never come to reality without any external push.



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# 1 Introduction

## 1.1 Background to the research

Recent decades have noticed the growth in number of companies voluntarily presenting its social and environmental performance and management under the name of corporate environmental, or sustainability, reports. This public self-reporting is designed to support and facilitate the achievement of the company's own objectives by assessing the risk, building up the reputation, maintaining the license to operate, and so forth. At the same time, it can serve the society's greater demand on accountability. Stakeholders increasingly demand that sustainability reports truly and fairly represents what the companies really achieved and what they will be able to do in the future (Gray, 2000; Owen & O'Dwyer, 2004).

The third-party assurance was born as an instrument to hold the reporting organisation accountable to its stakeholders. The growing number of literatures claims that organisations have a duty to demonstrate their accountability to stakeholders. Reporting the credible and verifiable information is the central element of this demonstration (Cumming, 2001; Kaler, 2002). By examining data and claims made in reports from independent position, the third-party assurance is desired to add credibility on the sustainability report, as the financial audit has done for the annual financial report. Roger Adams, Technical Director of the Association of Chartered Certified Accountants<sup>1</sup> (ACCA) notes (Dando & Swift, 2003) that;

All organisations want to show themselves in the best possible light. ACCA believes that independent external assurance is a vital part of the credibility and trust building process. The role of independent assurance is to ensure that the reporting entity presents an account that is *fair, complete, unbiased and relevant*. (emphasis added)

However, assurance practices throughout the 1990s have raised serious questions over the quality of such exercises and fundamental doubts concerning any value thereby added to the reports from the stakeholders' perspective. The assurance process has been closely managed by the assurance provider and the reporting organisation, with lacking the transparency it deserves. The role of assurance provider has been often confined into double-checking the data. The assurance statement disclosed as a result of such an exercise rarely included the comment on the degree of completeness of the report in question (Doane, 2002; Gray, 2000).

## 1.2 Research problem

The purpose of the sustainability report can be summarised as the satisfaction of both the intentions of strategic corporate social and environmental management (the left circle in figure 1-1) and the demands of corporate accountability (the right circle in figure 1-1). Whilst there is an overlap between both objectives, there is more conflict here than is generally recognised (Gray, 2000). For instance, when the reporting organisation attempts to yield the strategic value by way of presenting only benign aspects of its operation, the balance between these two objectives cannot be sustained any longer.

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<sup>1</sup> ACCA is the largest international accountancy body, with 320,000 students and members in 160 countries. ACCA has an extensive network of over 70 staffed offices and other centres around the world. They have been reputed in almost 100 years of providing accounting and financial qualifications (<http://www.accaglobal.com>).

The first generation sustainability reports, mostly titled as the environmental reports, provide a good example of those. Some of the reports appeared to be glossy. It was by then that the term “green-wash” was born. As a result more often than not, an increased level of voluntary disclosure on social and environmental performance could not lead to the greater levels of public trust (Dando and Swift, 2003; Doane, 2002). This past experience led to such expectations that the third-party assurance would put the accountability back in the centre of corporate social and environmental reporting.

Social and environmental accounting, auditing, and reporting

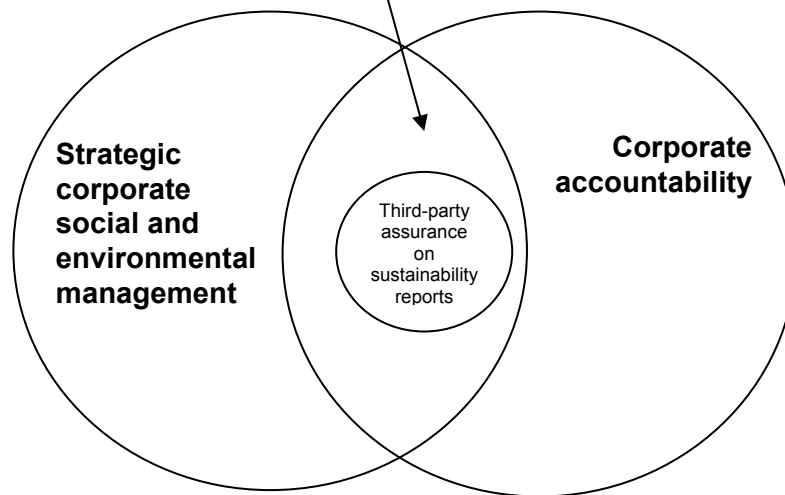


Figure 1-1 Relationship between research topic and adjacent disciplines

However, it is generally recognized that the third-party assurance has failed to gain a momentum to be the common feature in sustainability reports while it has failed to serve its genuine purpose towards enhanced accountability.

There have been a myriad of researches revealing the problems with current third-party assurance practices. In the context of the environmental reports, Power has concerned with a ‘professional capture’. Power insisted that the environmental audits and reporting exercises lacked the transparency in them because they have been very much dependent on narrow bodies of expertise located far from the society’s interest (Power, 1991;, 1994;, 1997). Another group of researchers have concerned the ‘managerial capture’ by the reporting organisation (Ball, Owen, & Gray, 2000; Maltby, 1995). In the recent study on third-party assurance statements, for example, Owen and O’Dwyer (2004) noticed that many of assurance statements were addressed to the directors of the reporting entities who often appeared to determine the scope of third-party assurance engagement.

The previous researches indicate that it has been problematic to increase the quality of third-party assurance due to the overwhelming interests from both the assurance provider and the reporting organisation. Then **how will the third-party assurance be able to function as an accountability process? Will stakeholder involvement in the third-party assurance be the help?**

Upon the recognition of this problem, this research seeks to evaluate current status of stakeholder involvement in the third-party assurance and see the possibilities and limitations of the approaches to the stakeholder involvement in enhancing the accountability of the

corporate sustainability reports. Although the legitimacy of stakeholder involvement in the third-party assurance has been emphasised (see, for example, Adams & Evans 2004; Owen & O'Dwyer 2004; Henriques 2001) and also standards and guidelines in social and environmental auditing and reporting increasingly refer to the stakeholders as a focal point to improve the quality of third-party assurance and reporting (see, for example, ISEA 2003; GRI 2002), the actual experiences and opinions of reporting organisations and traditional assurance providers on the stakeholder involvement in the third-party assurance have received little attention.

Third-party assurance statements appearing in a group of leading-edge sustainability reports will be explored to find to what extent they have included the stakeholders in the assurance and how. Research questions leading the study of leading-edge group are as follows:

- *What is the level of stakeholder involvement in the third-party assurance?*
- *How stakeholders have been involved in the third-party assurance?*

The study confined into the leading-edge group unveils only the tip of the iceberg. One could notice that among a few companies commissioning third-party assurance, again a few involved stakeholders in the third-party assurance process. Therefore, there is a need to check the reality within the wider business community to anticipate the future perspective. A group of Swedish companies experienced and/or highly performing in environmental /sustainability reporting and their assurance providers are interviewed in order to see how they perceive the problems with the third-party assurance and whether the stakeholder involvement would be the solution. Research questions leading the study of the Swedish group are as follows:

- *What are the opportunities as well as limitations with the third-party assurance?*
- *What are the opportunities as well as limitations with the stakeholder involvement in the third-party assurance?*

### **1.3 Justification for the research**

Third-party assurance of sustainability reports shows the slow but steady growth. According to the latest KPMG survey in 2002, 29% of top 250 companies of the Global Fortune 500 (GFT250) sustainability report issuers had their reports verified (19% in 1999). Similarly 27% of sustainability report issuers from top 100 companies of 11 countries included a third-party assurance statement in their report (18% in 1999) (KPMG, 2002). Amongst leading-edge reporting organisations, the third-party assurance is more prevalent. SustainAbility's analysis in 2002 indicated that 68% of the top 50 sustainability reports in the world carried a certain form of external assurance (SustainAbility, 2002).

What one can note in above-mentioned trend is the inexhaustible interest in the third-party assurance. With an increasing demand on enhanced credibility of sustainability reports, some companies predicted that the third-party assurance would be a norm in foreseeable future (SustainAbility, 1996). Concerned experts dared to say that the sustainability reports without the third-party assurance would not be something on which stakeholders would be able to rely (Gray, 2000; Power, 1997). Few even claimed that sustainability reports should contain only the verifiable information to increase their value to the readers substantially. This thesis aims to contribute to the improvement of this growing and important business practice by

stirring the discussion on quality aspect of current practice. This is the first justification for the research.

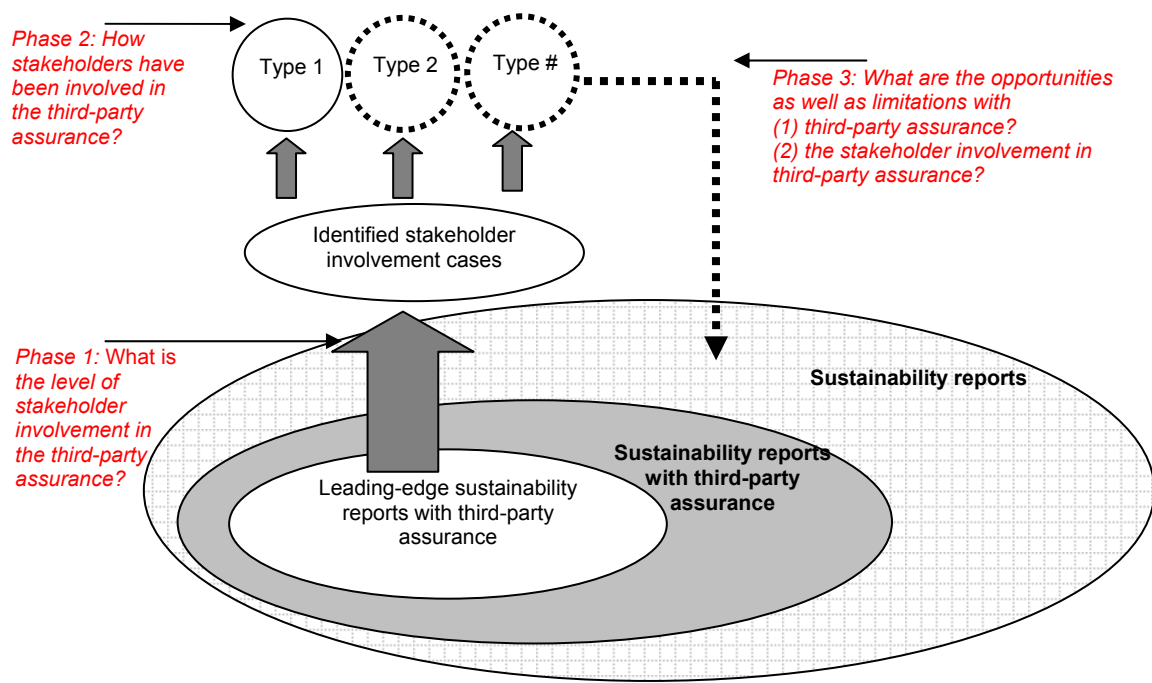
The status and trend of assurance are being periodically monitored in the international level through various report benchmarks. Apart from those overviews on the quantitative growth, a few researches have dedicated to monitor the qualitative development of the third-party assurance practices. These researches have been successful in revealing the problems. By focusing on one of the solutions rather than problems, this study aims to be the unique addition to the previous researches.

For Swedish companies participated in the interview, this thesis will provide an opportunity for them to contemplate on their own reports and assurance practices. For the practitioners in this field, this thesis can provide the learning from the best practices on how to tackle the rising stakeholder issue in the assurance process.

### 1.4 Research design

The approach to address the research problem can be described as a qualitative nature.

To address the research questions, this research is organised in three phases as shown in figure 1-2. It begins by exploring number of cases to select relevant cases (phase 1), and then will immerse in the details and specifics of the data to discover important categories, dimensions and interrelationships across the cases (phase 2). The findings from the multiple cases will be presented to the target group to test their external validity and acceptability through semi-structured interview (phase 3). In each phases the appropriate method to collect and analyse the data will be applied.



*Research problem:* How will the third-party assurance be able to function as an accountability process? Will stakeholder involvement in assurance be a help?

Figure 1-2 Research questions guiding research phases



Ultimately it is expected that this research journey would be useful to find an answer to the question if the stakeholder involvement in the assurance would be a solution to the problems with the third-party assurance.

## 1.5 Outline

The thesis is divided into six chapters. **Chapter 1** is the Introduction to the thesis. It introduces the research, including the background, presentation of research problem and research questions, the justification for the research, the research design as well as the scope and limitations. **Chapter 2** consists of the Literature Review. The literature review provides a brief overview of the field of social and environmental accounting, auditing, and reporting. In particular previous researches concerning problems with third-party assurance practices are presented to introduce the research problem in detail. The main purpose of the literature review is to highlight the gap between what is expected from third-party assurance and what the practices have demonstrated so far. Along the way it is expected to set the ground for stakeholder involvement in third-party assurance. **Chapter 3** attempts to outline the research. It also presents the research samples and different steps to collect and analyse the data. **Chapter 4** presents the analysis on best practices, named “stakeholder involvement cases”, identified from a study of the reports from leading-edge reporting organisations. **Chapter 5** presents the responses from wider business community concerning the prospects of the third-party assurance and stakeholder involvement therein. **Chapter 6** concludes the thesis.

## 1.6 Limitations

This research attempts to provide best practices in stakeholder involvement in the third-party assurance, so that future assurance providers as well as reporting organisations would find a way to fulfil its genuine purpose more easily than now. But data gathering for each of stakeholder involvement cases was often limited by availability of information regarding corporate internal affairs. Aware of this limitation, direct communication with corporate managers responsible for publishing sustainability reports has been tried. Other sources of information than corporate documents such as academic articles, newspapers were actively searched to verify the information provided by companies.

Since the analysis on future of third-party assurance and the stakeholder involvement therein was fairly based on interviews with Swedish companies and their assurance providers, the conclusions drawn from those would have a limitation. I found the indication that study from the countries with strong advocates for stakeholders with traditions in social audit, such as U.K. would have presented a slightly different picture. However, Sweden would present the cases valid for other Western European countries. Also, multinational companies based in Sweden have added some international perspectives.

Due to the limited time and resources, there are not enough inputs from the stakeholder’s perspective. Do stakeholders want the independent third-party to verify the report? Are stakeholders willing to be involved in the assurance process? Many questions addressed to the reporting organisations and assurance providers can be discussed with stakeholders. This highlights the need of further researches on this matter.

## 2 Literature review

### 2.1 Introduction

The literature review provides a brief overview of the field of social and environmental accounting, auditing and reporting. In particular the literatures concerning the problems with third-party assurance practices are presented to introduce the research problem in detail. The main purpose of the literature review is to highlight the gap between what is expected from the third-party assurance and what the current practices have demonstrated so far. Along the way it attempts to set the ground for stakeholder involvement in the third-party assurance.

### 2.2 Development of corporate sustainability reports<sup>2</sup>

The accounting, auditing and reporting is the central element in the management. Without measuring and communicating the correct information there would not be an improvement. Management of environmental and social performance is no exception. There is a full range of social and environmental accounting/auditing activities behind the reporting, which can be categorised as shown in figure 2-1.

Figure 2-1 A categorisation of social and environmental accounting/audits

|                                      | Accounting/auditing by Internal participants  | Accounting/auditing by External participants  |
|--------------------------------------|---|---|
| Report for the internal participants | <p><b>1. Private information from ‘management audits’</b></p> <p>Ex1. A company undertakes an environmental audit to identify the forms and classes of wastes produced by its processes;</p> <p>Ex2. A company details its internal audit department to assess how well the overseas subsidiaries comply with the corporate mission statement on employment conditions;</p> | <p><b>2. Private information from external sources</b></p> <p>Ex1. A company may either (a) have an external consultant come in to undertake a specific investigation into the forms and classes of wastes or (b) be subject to external audit by the environmental agency into its disposal of wastes;</p> <p>Ex2. External consultants are engaged to hold confidential dialogues with employees and other powerful stakeholders over whether the company is a ‘good’ employer;</p> |
| Report for the external participants | <p><b>4. Public self-reporting by the organisation</b></p> <p>Ex1. A company publishes an environmental report detailing the types and classes of wastes, their treatment and trends;</p> <p>Ex2. A company produces detailed reports about numbers and conditions of employees working in ‘developing’ countries.</p>  | <p><b>3. The public external social audits</b></p> <p>Ex1. A local activist group become anxious about the wastes produced by the organisation and undertake their own investigation-seeking maximum publicity for its activities;</p> <p>Ex2. International Labor Organization releases report about health of employees in counties in which the company operates.</p>  |

(Source: adapted from Gray (2000))

<sup>2</sup> The ‘sustainability report’ is typically defined as “the report that includes quantitative and qualitative information on organisation’s financial/economic, social/ethical and environmental performance in a balanced way” (KPMG, 2002). In this research, however, the ‘sustainability report’ is employed as an umbrella term for all the non-financial reports comprising triple bottom line (TBL) reports, sustainability reports, corporate social responsibility reports, stand-alone environmental, health, and safety, social community reports and combination of these.

It is when the organisation is systematically preparing and communicating social and environmental information to its stakeholders (quadrant 4) that the most visible form of social and environmental accounting arises. This is where corporate sustainability reports belong to.

Social and environmental reporting was still considered to be in its infancy just a decade ago, although its history can be traced back to the 1970s (Baue, 2004; Doane, 2000). During the years, companies have steadily increased public self-reporting for social and environmental issues. With a rising emphasis on triple bottom line approach and ethical implications on corporate decisions, the corporate environmental report evolves to corporate social responsibility report, and further down to the corporate sustainability report.

According to the triennial KPMG survey, there has been a clear increase in percentage of the large 100 companies in a number of countries publishing an environmental (or sustainability) report. It was observed as 12% in 1993, 17% in 1996, 24% in 1999, and 28% in 2002 (Kolk, 2004). 2001 annual corporate sustainability assessment on 996 companies around the world for the inclusion of Dow Jones Sustainability Indexes (DJSI)<sup>3</sup> also showed that about one-third had published environmental and social information covering its entire operations by then (Holliday, Schmidheiny, & Watts, 2002).

External factors played an important role in motivating the companies to increase the area of public disclosure. According to Gray (2000), as a consequence of the external social audit (quadrant 3)<sup>4</sup> an organisation may well undertake internal investigations or be subject to external investigations (quadrant 1 and 2) and move towards the publication of external reports (quadrant 4).

### **2.2.1 Driver for the development of the corporate sustainability report**

There have been many voluntary guidelines driving the development. The Global Reporting Initiative (GRI)<sup>5</sup> is aiming to set standards for economic, environmental and social disclosure. The OECD guidelines for multinational enterprises support enhanced disclosure of issues regarding employees and other stakeholders. The Global Compact led by the United Nations comprises an obligation for its members to report on their actions towards its principles.

Although corporate sustainability reports are published voluntarily encouraged by those guidelines and initiatives, legislation has been a strong driver for this quantitative development (see table 2-1).

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<sup>3</sup> The Dow Jones Sustainability Indexes (DJSI World) consist of more than 300 companies that represent the top 10% of the leading sustainability companies in 59 industry groups in the 34 countries covered by the biggest 2500 companies in the Dow Jones Global Indexes. ([http://www.sustainability-index.com/html/djsi\\_world/keyfacts.html](http://www.sustainability-index.com/html/djsi_world/keyfacts.html))

<sup>4</sup> This is often called 'social audit' in other literatures. Federation des Expert Comptables Européens (FEE) defines social audit as follows: "*An assurance approach in which an outside party comments on one or more aspects of a company's sustainability performance.*" Social auditors may be organisations carrying out investigations on many companies in a particular area of interest or the term could be applied to a journalist investigating one company. The audit takes place with or without the cooperation of the company (FEE 2002). In this context, 'social' aspects include other dimensions of sustainability such as environmental aspects.

<sup>5</sup> Independent as of 2002, the GRI was begun in 1997 by the Coalition for Environmentally Responsible Economies (CERES). It is an official collaborating center of the United Nations Environment Program (UNEP) and the UN Global Compact.

In the environmental field, reporting has been a significant element of the permitting process in many countries. The reporting to the environmental authorities is typically conducted at factory level, but it has provided a solid basis for publishing company-wide environmental report. A voluntary scheme from EU, The Eco-Management and Audit Scheme (EMAS) requires participants to publish independently validated reports on site-specific environmental programs and management systems (Clausen, 1996; European Commission, 2001). In addition, legislation has steadily increased the areas of corporate disclosure on such matters as employees, political and charitable donations and governance throughout the world (Gray, 2001).

Table 2-1 Statutory requirements on social and environmental disclosure from European countries

| Country  | Entry into force | Statutory requirements on social and environmental disclosure  |
|----------|------------------|--|
| U.K.     | 1999             | listed companies must release a risk management evaluation in their annual reports, including on environment and social matters  |
| Holland  | 1999             | companies that present a risk to the environment (the definition is fixed by the authorities) must release 2 environmental reports (one technical and one for the general public)  |
| Portugal | 1985             | all companies with over 100 employees must release a social report   |
| Sweden   | 1999             | all companies that are required to have environmental permits or must notify the environmental authorities, have an obligation to include a brief disclosure of environmental information in the board of director's report section of the annual report |
| Norway   | 1999             | all companies must release social and environmental information in their board of directors' report section of the annual report   |
| Denmark  | 1996             | certain listed activities/companies draw up green accounts   |

Source: (Sustainabledevelopment-reports.org, 2004)

There is a growing pressure on listed companies to report on environmental and social related issues (Mansley, 2003). In the US, the Securities and Exchange Commission (SEC) explicitly refers to environmental factors in its listing rules (Wallage, 2000). In France, 2003 witnessed the first implementation of the New Economic Regulation (NRE) decree compelling all listed companies to release certain environmental and social information in their annual reports. With effect from next year the new regulation by the UK government requires quoted companies to prepare an inclusive Operating and Financial Review (OFR). The OFR will bring together reporting of all the ingredients that a company requires for enduring success. For certain companies this would include its corporate social responsibility work (BT, 2004).

Other than mandates on reporting, in recent years there have been substantial changes in the investment community, leading to the greater interest in social and environmental performance of the companies. These changes are as follows (Woollard, 2002):

- A regulation requiring pension funds to disclose their policies on how they consider environmental and social issues.
- Growing consumer interests in Socially Responsible Investment (SRI) funds.
- Share prices that increasingly value brand, reputation and other intangible assets.
- The increasing importance of corporate governance and risk management, and notably the Disclosure Guidelines on Social Responsibility issued by the Association of British Insurers.
- Continuing concern over the short-termism of the markets.

- Interest in the idea of the “universal investor”, which justifies responsible investing.
- SRI indices developed in the 1990s, such as the DJSI, FTSE4Good<sup>6</sup> and Domini Social Index<sup>7</sup>, which track the best performers based on positive screening.

## 2.2.2 Emergence of the third-party assurance

Most would agree that we have witnessed the quantitative growth in number of corporate sustainability reports. However, there have been sceptical views on the qualitative aspects of those reports. Contrary to the expectations from the pioneers, reporting often failed to reach any performance improvements. Many reports still lack the key performance indicators (KPIs). The report could not provide the information which would be appreciated by the important group of report users such as the financial community (Doane, 2002; Kolk, 2004).

Another concern has been how trustworthy the reports would be. An external audit is now the accepted practice in financial reporting, environmental management and quality throughout the world. But, it is not the case for the sustainability reporting (see table 2-2)

*Table 2-2 Comparison between financial reporting and sustainability reporting*

|  | Financial reporting   | Sustainability reporting   |
|--|---|--|
| <b>Target group</b>                    | Shareholder (investors)   | Diverse audience   |
| <b>Accounting/reporting principles</b> | Reporting organisations are obliged to follow Generally accepted accounting principles/evolving international accounting standards. | Reporting organisations are free to choose one of the established principles, or to establish their own reporting/accounting principles. |
| <b>Accounting boundary</b>             | Legal ownership and direct control  | Foot print of organisation and its activities  |
| <b>Indicators</b>                      | Quantitative  | Many qualitative indicators included   |
| <b>Third-party audit</b>               | Statutory annual audit  | Non-obligatory   |

(Source: Summarised from GRI 2002 Sustainability Reporting Guideline)

### 2.2.2.1 What is the third-party assurance?

Responding to this concern, there has been an inexhaustible interest in auditing of corporate sustainability reports. “Assurance” is increasingly used for referring to this kind of audit, because assurance engagement for sustainability reports cannot offer the same level of assurance provided by financial statement audits (Deegan, Cooper, & Shelly, 2003).

The International Federation of Accountants<sup>8</sup> define the third-party assurance as “a process in which a practitioner expresses a conclusion designed to enhance the degree of confidence that intended users can have about the evaluation or measurement of a subject matter that is responsibility of a party, other than the intended users or the practitioner, against criteria

<sup>6</sup> A corporate responsibility investment index based in the UK. (<http://www.ftse.com/ftse4good/index.jsp>)

<sup>7</sup> The Domini 400 Social Index<sup>SM</sup> is a market capitalization-weighted common stock index. It monitors the performance of 400 U.S. companies that pass multiple, broad-based social screens. The Index consists of approximately 250 companies included in the Standard & Poor's 500 Index, approximately 100 additional large companies not included in the S&P 500 but providing industry representation, and approximately 50 additional companies with particularly strong social characteristics. ([http://www.domini.com/Social-Screening/creation\\_maintenance.doc\\_cvt.htm](http://www.domini.com/Social-Screening/creation_maintenance.doc_cvt.htm))

<sup>8</sup> IFAC is the global organization for the accountancy profession. IFAC members represent 2.5 million accountants employed in public practice, industry and commerce, government, and academia. (<http://www.ifac.org/>)

(IFAC, 2004)". By saying "a practitioner expresses a conclusion designed to enhance the degree of confidence", it left a room for all different range of work done by others than the accountant.

In practice, various terms such as attestation, audit, verification, validation, review, etc. are used interchangeably with assurance. Some would argue that the assurance does not refer to the process itself, but the outcome of the process.

### 2.2.2.2 Drivers for the development of the third-party assurance

With a lack of standardised approach and legislation, public concerns on glossy corporate self-reporting have been a major driving force for the third-party assurance. The public scrutiny can come as an extensive form of external social audit. This social audit challenged the credibility of information on social and environmental performance and policy reported by companies voluntarily. It sometimes led to the report containing alternative accounts to the company in question. An example would be the report titled 'RioTinto Behind the facade' published in 1998 by a group of different non governmental organisations (NGOs) led by the International Federation of Chemical, Energy, Mines and General Worker's Union (ICEM) (Henriques, 2001).

Another driver for the third-party assurance could be the internal benefits attached to the third-party assurance. In operational level, qualified third-party can be a great help to improve the data collection system and its outcomes. The third-party assurance can also help to bring the internal attentions on the weakness of the system, so that the company can easily adopt the changes needed for the improvement of performance (KPMG, 2002).

However, there are other factors believed to determine the credibility of the report (Clausen, 1996; GRI, 2002).

- The approach used by the reporting organisation to identify all significant sustainability issues so that the report can convey the complete and clear description of the sustainability issues facing the organisation.
- The process used by the reporting organisation to recognise the interests of stakeholders affected by its activities, to consult with them, to take their interests into account.
- The scope of concrete data and facts, presentation of actual performance against the concrete and verifiable targets.
- Use of the established accounting/reporting principle such as GRI

Even if there is an assurance provider looking at the report, the importance of aforementioned elements cannot be underestimated. It is also debatable if it is enough to have all those different elements are in the right place instead of the third-party assurance. GRI states clearly that consultation with stakeholders would be the best way to ascertain their perceptions and expectations about matters of credibility (GRI, 2002). Whereas, according to Institute for Social and Ethical Accountability (ISEA)<sup>9</sup> reporting organisations as well as their stakeholders increasingly accept the robust third-party assurance as a key means of

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<sup>9</sup> UK-based non-profit organisation, they launched the non-proprietary open-source Assurance standard last year, which emphasise the broader context in the assurance and analysis of materiality to stakeholders (ISEA, 2003)

increasing the credibility and effectiveness of their reporting, and ultimately their performance (ISEA, 2003).

### **2.2.2.3 Key elements of the third-party assurance**

Followings provide a brief overview of key elements of the third-party assurance.

#### **(1) Third-party relationship**

Assurance engagements involve three separate parties: assurance provider, a responsible party for producing accounts and an intended user (such as the stakeholder). The assurance provider needs to be independent of the responsible party, to be in a position to exhibit the highest standards of ethical and professional integrity and to have had a thorough training in the issues at stake (Gray, 2001).

#### **(2) Subject matter**

The subject matter of an assurance engagement is to be “identifiable, capable of consistent evaluation or measurement against suitable criteria and in a form that can be subject to procedures for gathering evidence to support that evaluation or measurement” (IFAC, 2004, para. 21). It can comprise data, system, and processes, and behaviour (IFAC, 2004, para. 20)

In case of sustainability reporting, the subject matter encompasses economic, environmental and social performance data. As KPIs are being developed in many organisations, data will gain the importance. On the other hand, sustainability includes many prospective elements. so some might suggest that systems and processes would be more important subject matters for stakeholders to be verified than retrospective behaviour and data (Wallage, 2000).

#### **(3) The criteria for the assessment**

Criteria are the standards or benchmarks used to evaluate or measure the subject matter. Using the criteria for the assessment and communicating the conclusion accordingly is the basis to gain the credibility of the assurance work. “Without this frame of reference any conclusion is open to individual interpretation and misunderstanding” (IFAC, 2004, para. 22).

IFAC states that criteria need to be suitable to enable reasonably consistent evaluation or measurement of the subject matter within the context of professional judgement (IFAC, 2004, para 22). The criteria for assessment to a large extent depend on which criteria were used to create the accounts (reporting/accounting principles). In financial accounting, there are established criteria such as International Accounting Standards or other Generally Accepted Accounting Principles (GAAP) against which financial data must be delivered.

However, there has been a lack of established criteria for sustainability reporting (Collison, 1996). The most comprehensive guideline is currently provided by GRI while still many reporting organisation use it just for the inspiration (Hedberg & Malmborg, 2003). Some criteria are available for a few specific issues of social and environmental performance (e.g. Social Accountability 8000) and for environmental reporting (e.g. EMAS requirement for the environmental statement).

#### (4) Evidence collection

To judge if the subject matter conforms with identified criteria, the assurance provider needs evidence. There is an opinion that additional sources to the data collection techniques used for financial audits may be necessary to gather sufficient and competent evidence for the sustainability report. Examples might include surveys of focus groups, expert commentary such as independent market research agencies, and stakeholder panels to advise the auditor (Wallage, 2000).

#### (6) Assurance statement

Upon the completion of assurance engagement, the conclusion should be made available to the public as a certain form of assurance statement. IFAC recommends that the conclusion should provide a level of assurance as to whether the subject matter conforms in all material respects with the identified suitable criteria (IFAC, 2004, para 25).

Foregoing description is fairly based on financial auditing model. But there is a range of approaches, models, and methodologies which has been applied in the third-party assurance on the sustainability reports. As GRI describes, “Models and methodologies that may be used or adapted include but are not restricted to those used in financial statement auditing, social and ethical auditing, comprehensive or value-for-money auditing and environmental auditing” (GRI, 2000) Following section presents brief description on most dominant approaches present in the field.

#### **2.2.2.4 Who is providing assurance and how?**

Each assurance engagement should have the principles and approaches governing the work. It was commonly acknowledged that the type of assurance provider would determine which approach is used in the assurance engagement in question (Ends Directory, 2003).

Accountancies commonly use the “structured approach”, inspired mainly by their financial audit experiences, involving the analysis of risk and collection of the evidence (FEE, 2002). They have been increasingly seeking skilled personnel from outside the financial auditors. For example, KPMG acquired the Body Shop Ethical Audit team to form their Sustainability Advisory Services unit (R. Adams, 2001). To date they are leading the assurance market. According to the KMPG 2002 survey, about 65% of assurance statements in corporate sustainability reports from Global Fortune 250 (GFT250) as well as top 100 firms in 19 countries were written by major accountancy firms.

However, the emphasis of their approach is placed very much on the accuracy of quantitative data and the robustness of accounting systems (ISEA, 2003). The level of assurance given by their work has been criticised badly for not providing reasonable levels of confidence to stakeholders neither about the relevance of the information disclosed nor the quality of the systems and commitments that are to deliver performance improvements (Gray, 2000; Dando and Swift, 2003).

Consultancies do not have a uniform approach. One aspect commonly referred is that they tend to be keen on giving out the praise or recommendation on features of performance. Accountancies raise the caution that those praises or recommendations might damage the independence of assurance providers (FEE, 2002). Upon the emergence of a non-proprietary, open-source standard AccountAbility 1000 Assurance Standard (AA1000 AS)



from ISEA, the consultancy is increasingly firming its ground in U.K. according to the latest study (see table 2-3).

*Table 2-3 Market share of the different assurance providers for corporate sustainability reports*

|                    | Accountancy (%) | Environmental consultancy (%) | Others (%)  | Number of reporting organisation surveyed |
|--------------------|-----------------|-------------------------------|-------------|---|
| Europe (except UK) | 59.6            | 19.2                          | 21.2        | 52  |
| UK                 | 22.9            | 54.2                          | 22.9        | 48  |
| Australia          | 16.7            | 40.0                          | 43.3        | 30  |
| Japan              | 37.5            | 6.3                           | 56.3        | 16  |
| <b>Total</b>       | <b>36.3</b>     | <b>33.6</b>                   | <b>30.1</b> | <b>146</b>                                |

(source: data available from Deegan et al. 2003)

Unlike corporate financial statements where relevant legislation stipulates the qualifications of auditors, no requirements exist for assurance providers on the sustainability reports (FEE 2002). This situation provides a ground for the stakeholders such as NGOs to play a role as an assurance provider. Their approach is partially descended from traditional social audits.

There is also a downside in approaches from NGOs. It was found from number of social auditing experiences that NGOs would be very political players with specific normative motivations. Their normative focus could be detrimental to the perceived neutrality of the audit function and be in conflicts with the interests from other key stakeholders. Given this, the separation of the audit and certification function from other NGO functions, as well as clearly defined, transparent, reproducible, and accessible audit procedures, have been recognised as critical to the legitimacy of audit led by NGOs (Courville, 2003).

For the future there is an aspiration to the integration of different approaches. FEE (2002) anticipated the emergence of the comprehensive approach as a form of the accountancy approach enhanced through the uptake of stakeholder dialogue inspired by social audit approach from NGOs and the well-developed understanding of management systems and processes strengthened by consultancy methods.

On the other hand, recent study on 161 assurance statements from worldwide observed wide varieties in approaches which could not be attributed to the type of assurance provider. For example, some accountancy tended to suggest recommendations on data collection system as well as the performance itself, whereas other accountancies focused on the confirmation of the data presented in the report. It shows the possibility that the reporting organisation would have added variety in the assurance practices. The reporting organisation could negotiate with assurance providers regarding the scope of work and the level of assurance in each assignment since current third-party assurance is carried out totally voluntary basis (Deegan et al., 2003).

Following figures present some of the findings from Deegan et al.'s study.

Based on the increasing adoption from European accountants, International Standards for Assurance Engagement from IFAC was listed as the most frequently used standard by the assurance provider (see figure 2-2). Among established standards, ISO 14010(Guidelines for Environmental Auditing: General Principles)/14011(Audit Procedures and Auditing of

Environmental Management Systems), International standards on auditing (issued by IFAC), and AA1000 AS are following up.



Figure 2-2 Standards governing the assurance work (source: data from Deegan et al. 2003)

Second, it was found that GRI Sustainability Reporting Guideline was the most frequently used as the criteria for assessment (see figure 2-3).

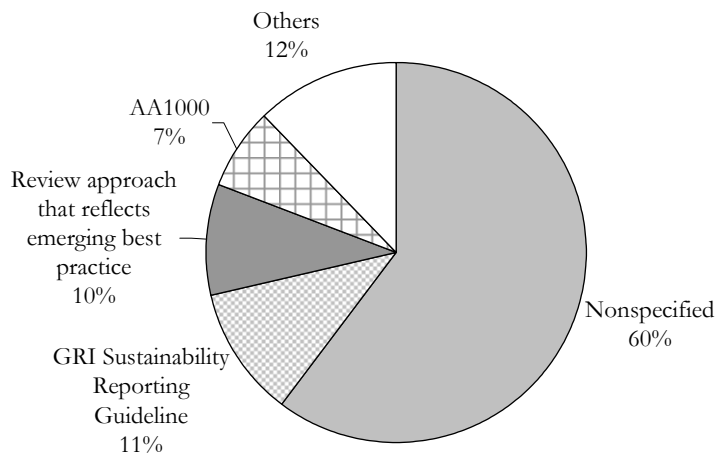


Figure 2-3 Reporting criteria used for the assessment (source: data from Deegan et al. 2003)

### 2.3 Expectations and practices of the third-party assurance

Compared to financial reporting, reporting for sustainability means a shift of paradigm in corporate management. It involves extending the accountability of organisations beyond the traditional role of providing a financial account to the owners of capital. In this regard, the

assurance provider is expected to enhance corporate accountability to stakeholders (Owen, 2003; Owen & O'Dwyer, 2004; Wallage, 2000).

### **2.3.1 Expectations- Third-party assurance as an advocate of corporate accountability to stakeholders**

Accountability has long been considered to refer to the requirement or duty to provide an account or justification for one's actions to whomever one is answerable (Swift, 2001). In essence, the accountability places the society at the heart of the analysis and questions the legitimacy of an organisation's actions, or perhaps even its right to exist (Gray, 2001). Therefore it can be regarded as the process redressing "the asymmetry of power" by giving a right to the powerless, to demand the information and feedback their opinions to the reporting organisation.

The 'social contract', the idea that business owes its existence to society, and that market forces serve to control business by either rewarding or punishing corporate behaviour is viewed by many as being sufficient to warrant corporate accountability. However, recent definitions of accountability tend to be more inclusive of other stakeholders in recognition of the social contract. With an increasing recognition of the social implications of the private business activities, for example, ISEA definition of accountability goes beyond the idea of specific contractual obligations. "To account for something is to explain and to justify the acts and omissions for which one is responsible to people with *a legitimate interest*." (Swift, 2001).

In the regard, the principal of third-party assurance would be a broad range of stakeholders. The assurance provider is expected to challenge companies on behalf of "stakeholders" while attempting to provide assurance on sustainability report. When the assurance providers play this role successfully, the trust between the company and stakeholders can be established and maintained.

### **2.3.2 Practices of the third-party assurance**

There have been some researches concerning different samples of reports and their third-party assurance statements over the years. These studies highlighted third-party assurance to large extent have failed the expectations from stakeholders.

#### **2.3.2.1 Credibility gap**

The lack of trust on traditional assurance providers is one root of the credibility gap in the third-party assurance. Power has concerned with a 'professional capture'. Power insisted that the environmental audits and reporting exercises lacked the transparency in them because they have been very much dependent on narrow bodies of expertise located far from the society's interest (Power, 1991;, 1994;, 1997).

There are many case studies accusing big financial auditing firms for not being independent and competent to comment on social and environmental issues. The most frequent criticism was that there was no attempt to systematically triangulate information from different sources (e.g. see (O'Rourke, 1997; O'Rourke, 2002)).

The joint research project between Investor Responsibility Research Center (IRRC) and Global Environmental Initiative (GEMI) in 1996 found that key stakeholder groups did not trust any of the potential assurance providers such as accountancies, environmental auditors, etc. As a result, the assurance statements did not lend much credibility to the corporate environmental reports. The absence of generally accepted standard or approach has worsened this situation because those who lack the trust on assurance providers could not believe the approaches considered best by assurance providers (IRRC, 1996).

### **2.3.2.2 Expectation gap**

Researches concerning the assurance statements from financial auditors and environmental consultants have shown that the statements differ widely as to their structure and with respect to the communication of the level of assurance. In conclusion, the need of generally acceptable assurance standard has been highlighted as a solution to the expectation gap arisen from differing assurance practices (Drieënhuizen, 2001).

Assurance providers in particular tend to blame a lack of generally accepted assurance standard as a reason why they are not able to provide a high quality assurance on corporate sustainability reports for the external stakeholders. Without authoritative guidance on the audit of sustainability reports and the associated degree of assurance, the expectation gap would arise. For example, stakeholders may expect the auditor to assure that the sustainability report as a whole gives a fair view of the company's ethical behaviour, while the auditor may not be capable or prepared to provide that level of assurance for the report as a whole (Wallage, 2000).

On the other hand, there is an accusation that lack of the standard is mere an excuse for the unwillingness to provide high quality assurance service to the external stakeholders. Doane (2002) found that there was a tendency in assurance to ignore what has not been included in the report despite of ready-made guidelines and best practices in the field. Gray (2000) as one of the experienced auditor argued, for instance, "Claims made by auditors that there are no guidelines on the completeness of the account to which they attest are incorrect..... At least for the environmental reporting there are many guides as to state-of-the-art reporting."

Deegan et al.'s study on 161 assurance statements worldwide also provided rather a striking snapshot of the current assurance practices. 55% of the assurance statements assessed failed to specify the standards governing their work, and 60% of them did not mention which criteria the assurance provider used for the assessment (see figure 2-2, and figure 2-3).

The prevailing managerial interest from the reporting organisation was pointed out as one main reason of the lack of rigor in current assurance practices. Some studies concerning the corporate environmental reports up until the late 1990s found that the assurance providers were typically acting under restrictive brief from the management that appointed them (management capture). Consequently a reader would only, at best, be able to rely on the fact that the organisation had an environmental management system (Ball et al., 2000; Maltby, 1995).

This situation does not differ much in the era of sustainability reporting. In the analysis of third-party assurance statements in corporate sustainability reports shortlisted for the 2002 ACCA UK and European Sustainability Awarding Scheme, Owen and O'Dwyer (2004) pointed out that many of assurance statements were addressed to the directors of the reporting entities who often appeared to determine the scope of third-party assurance

engagement. Despite of the assurance statement, therefore, it was still unclear whether corporate sustainability reports provided the type of information stakeholders consider valuable, or whether they presented the information favourable to the reporting organisations.

### **2.3.3 Will the stakeholder involvement in assurance help?**

The researches reviewed in the previous section highlight the fact that the assurance provider generally failed playing its role as the agent of stakeholders. If the credibility and expectation gaps continue to exist, it would be hard to expect any value added by the third-party assurance from stakeholders' perspective. How can we improve this situation?

There is an increasing expectation that stakeholder involvement would close those gaps in the third-party assurance, as European Union put it (Commission Proposal COM(2001) 366 final).

Verification by independent third parties of the information published in social responsibility reports is also needed to avoid criticism that the reports are public relations schemes without substance. Indeed such services are already beginning to be offered by a variety of companies, which would need to perform them following agreed standards. *The involvement of stakeholders, including trade-unions and NGOs, could improve the quality of verification.* (emphasis added)

Past experiences in social auditing as well as current assurance standards provide a favourable ground for the stakeholder involvement in the assurance.

#### **2.3.3.1 The normative ground of stakeholder involvement in the assurance**

In the agent-principal relationship it has been a universal problem that the agent does not always act according to the need of the principal (Eisenhardt, 1989). This has been an ongoing concern in financial auditing for many years given that, despite shareholders legally appointing auditors, auditors are left at the mercy of management. The nature of this power relation continues to exist in the third-party assurance on sustainability reports. It, therefore, calls upon the stakeholder involvement as a “countervailing power” against the management of reporting organisation (Owen & O'Dwyer, 2004).

Taken a logical extreme of this stakeholder involvement in the assurance, some anticipate a radical change in corporate governance systems giving stakeholders more power on issues such as appointment of auditors and determination of audit scope (C. Adams & Evans, 2004; Laufer, 2003).

#### **2.3.3.2 Experiences in the social audit**

In practice, it has been observed that NGOs were frequently called upon by community interests to provide a degree of assurance over the validity of information released by companies and/or to provide a meaningful interpretation of sometimes complex and technical data (SustainAbility, 1996). Although it is not directly related with the assurance on corporate sustainability reports, there have been some examples of the third-party auditing at site level where community members and environmentalists were invited in the site environmental audits (e.g. Community Advisory Panel in North America).

The methodologies and approaches used in external social audit have provided some inspirations in this regard. The New Economic Foundation (NEF) was instrumental in the development of social audit. Their methodology was taken up by other organisations including Traidcraft, the Body Shop and Ben and Jerry's Ice cream (Doane, 2000). They proved that in the case of external assurance it would be useful for the assurance provider to convene advisory panels of experts in particular to comment on the scope and adequacy of the draft accounts (Gray, Dey, Owen, Evans, & Zadek, 2001; Wheeler & Sillanpää, 1998).

NGOs have the legitimacy as an assurance provider of corporate sustainability reports over the financial auditors, according to the NEF. Henriques (2001), the former Head of Corporate Accountability at the NEF, emphasised, "successful social auditing is about conveying the legitimacy and credibility of a social report.<sup>10</sup> This is achieved for financial reports, through the use of accredited firms of auditors, such as KPMG, PricewaterhouseCoopers and others. However the same strategy will not necessarily be successful for social auditing. Just as financial auditing is addressed to the financial stakeholders and is given legitimacy through an organisation respected by the financial community, the legitimacy of a social audit with respect to the stakeholders much closer to civil society will only be fully provided by a civil society organisation."

### **2.3.3.3 Standards and guidelines**

Assurance standards currently available highlight the need for the assurance provider and reporting organisation to get in touch with stakeholders.

#### **(1) Sustainability reporting guidelines (2002) by GRI**

Although GRI guideline stays as the framework for the sustainability reporting, Annex 4 (credibility and assurance) comprises GRI's recommendation on assurance process considerations, selection of independent assurance providers, reporting entities' responsibilities to support independent assurance, and what assurance statements would include. Intriguingly, the assurance provider's ability to balance consideration of the interests of different stakeholders was referred as one important attributes and issues to be considered in selecting the assurance provider.

The focus of GRI's recommendation lies in the stakeholder consultations process with regard to the need of the third-party assurance and the value of its outcome. In considering and entering into assurance-providing arrangements, reporting organizations are encouraged to clarify following points with stakeholders.

- Whether the organisation has ascertained the expectations of its stakeholders regarding sustainability issues and performance, reporting requirements, and methods of improving credibility, including independent assurance.
- Whether adequate evidence is available to support the reported information, including corroborative statements and/or other evidence from external stakeholders, if necessary.
- Whether stakeholders have been consulted about the usefulness and credibility of the report content and the usefulness (including credibility) of assurance provided by an external assurance provider.

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<sup>10</sup> The social report as per the NEF may include the environmental report.

Also reporting organisations should continuously assess the results of the third-party assurance to monitor its value and to identify potential improvements in the process, possibly with stakeholders.

## (2) AccountAbility 1000 Assurance Standard by ISEA

ISEA is rooted upon the social audit tradition established by the NEF. Its assurance standard, AA1000 AS, is based on the AccountAbility1000 (AA1000) process model. The process model (shown in figure 2-4) emphasizes the integration of the aspirations and needs of all stakeholder groups at all points of social and environmental accounting, auditing and reporting process from issue identification through performance measurement and reporting to the final feedback stage at the conclusion of the cycle. Along this whole process, reporting organisation is expected to establish and embed systems (identified as “embedding” in figure 2-4) to implement and maintain values, to manage the collection and documentation of information and to perform the internal audit of the process (Owen, Swift, & Hunt, 2001).

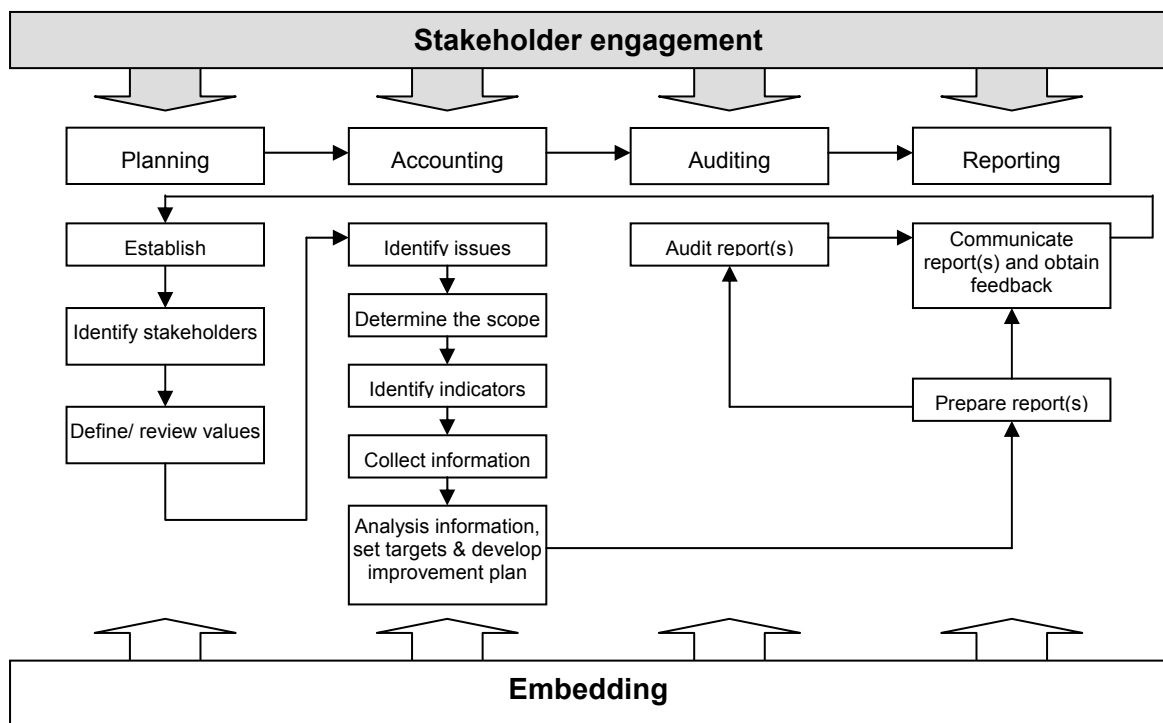


Figure 2-4 AA1000 process model (source: Peirce 2001)

As per this standard, assurance providers are expected to have an insight on the accountability process of the client and must express an opinion whether:

- The report provides a fair and balanced representation of material aspects of the reporting organisation’s performance for the period in question (i.e. materiality).
- The organisation has an effective process in place for identifying and understanding activities, performance, impacts and stakeholder views (i.e. completeness).
- The organisation has an effective process in place for managing aspects of sustainability performance and responding to stakeholder views, including any significant weaknesses in the underlying organizational processes, systems and competencies (i.e. responsiveness).

- The report can be used by the reporting organisation's stakeholders (i.e. responsiveness).

The standards stay fairly at the conceptual level. There is no concrete guideline on how to judge the materiality, completeness, and responsiveness of the report yet. But it highlights the need of reviewing the relationship which the reporting organisation had with stakeholders for the assurance provider. Therefore, in practice, it would be possible that assurance providers would feel more need to get in touch with stakeholders along the assurance process.

### (3) Providing Assurance on Sustainability Reports (2002) by FEE

Federation des Expert Comptables Européens (FEE) tries to fill the gap between financial assurance model and non-financial assurance model by providing practical advice. As per its discussion paper "Providing assurance on sustainability reports" published in 2002, the assurance provider is encouraged to observe stakeholder dialogue or, if necessary, communicate with stakeholders directly, since stakeholder dialogue is a significant issue in sustainability reporting. FEE speculates that involvement of the assurance provider in stakeholder dialogue may promote the adoption of criteria that are suitable for the reporting organisation in question.

## 2.4 Conclusion

Stakeholder involvement in the third-party assurance can be regarded as one way of increasing the quality of third-party assurance. The idea of stakeholder involvement in the assurance has been backed up by the normative arguments aspiring to the stakeholder governance. There are past examples in social audit tradition where stakeholders successfully managed the auditing process. Current assurance standards highlight the need for the assurance provider and the reporting organisation to listen to stakeholders along the assurance process for various reasons.

However, the literature review indicated that there had been arguments at conceptual level favoring stakeholder involvement in the assurance but not the real cases. It is a moot question if stakeholder involvement in the third-party assurance is happening around as it is desired.



## **3 Methodology**

### **3.1 Introduction**

The literature review highlighted the research problem, the third-party assurance failing to function as the accountability process. The possibility with the stakeholder involvement as a solution to this problem was explored through reviewing relevant literatures and assurance standards. Now is to see in reality to what extent the stakeholder have been or to be involved in the third-party assurance, so that we can speculate if the stakeholder involvement will be capable of closing the gaps prevailing in the assurance process.

To find the real-life cases of stakeholder involvement in the assurance, assurance statements from leading-edge corporate sustainability reports were studied. To anticipate the future in the third-party assurance and stakeholder involvement therein, wider group of reporting organisations and their assurance providers were interviewed. A few research questions were introduced to guide these two components of the research.

### **3.2 Research design- Leading-edge case studies**

The reports from a group of leading-edge reporting organisations were studied to identify any examples of stakeholder involvement cases in the third-party assurance.

Research questions leading the study of leading-edge practices were as follows:

- What is the level of stakeholder involvement in the third-party assurance?
- How stakeholders have been involved in the third-party assurance?

#### **3.2.1 Selection of the leading-edge corporate sustainability reports**

The reports from 50 reporting organisations highly ranked in the latest benchmark survey from SustainAbility<sup>11</sup> were examined to find how many of them had the third-party assurance since then. This sample can be justified as a leading-edge group because this benchmark survey has been well-accepted as a unique analysis dedicated to “identify and classify the best practice in corporate accountability across the triple bottom line of sustainable development” (SustainAbility, 2002). As a result, it turned out that the reports from 36 companies had an assurance statement (see appendix 1 for the list of reports with the third-party assurance and their assurance providers).

#### **3.2.2 Data collection and analysis process**

Through the analysis on assurance statements appearing in 36 reports, “stakeholder involvement cases” were identified. Different stakeholder involvement cases were grouped against the analytic framework. Some examples in each type of stakeholder involvement cases were analysed in detail to highlight the difference with other types. Also it was to see if

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<sup>11</sup> Founded in 1987, SustainAbility is the longest established international consultancy specializing in business strategy and sustainable development. (<http://www.sustainability.com>)

stakeholder involvement had contributed to increase the value of assurance as an accountability process.

Primary data collected through interviews and email communication with corporate managers as well as secondary data collected through the corporate documents, and academic publications were used as the underlying material for this analysis.

### 3.3 Research design- The interview with Swedish companies and the assurance providers

A group of Swedish companies publishing stand-alone sustainability reports as well as the assurance providers were questioned through the semi-structured interview to test the acceptance of the third-party assurance and different types of stakeholder involvement cases drawn from leading-edge case studies.

Research questions leading the study of the Swedish group were as follows:

- What are the opportunities as well as limitations with third-party assurance?
- What are the opportunities as well as limitations with stakeholder involvement in the third-party assurance?

#### 3.3.1 Selection of Swedish companies

To see the acceptability of the idea emerged from the leading-edge case studies, a group of Swedish companies who have published the environmental/sustainability reports for many years as well as have had experiences with the third-party assurance was contacted (non-random sampling).

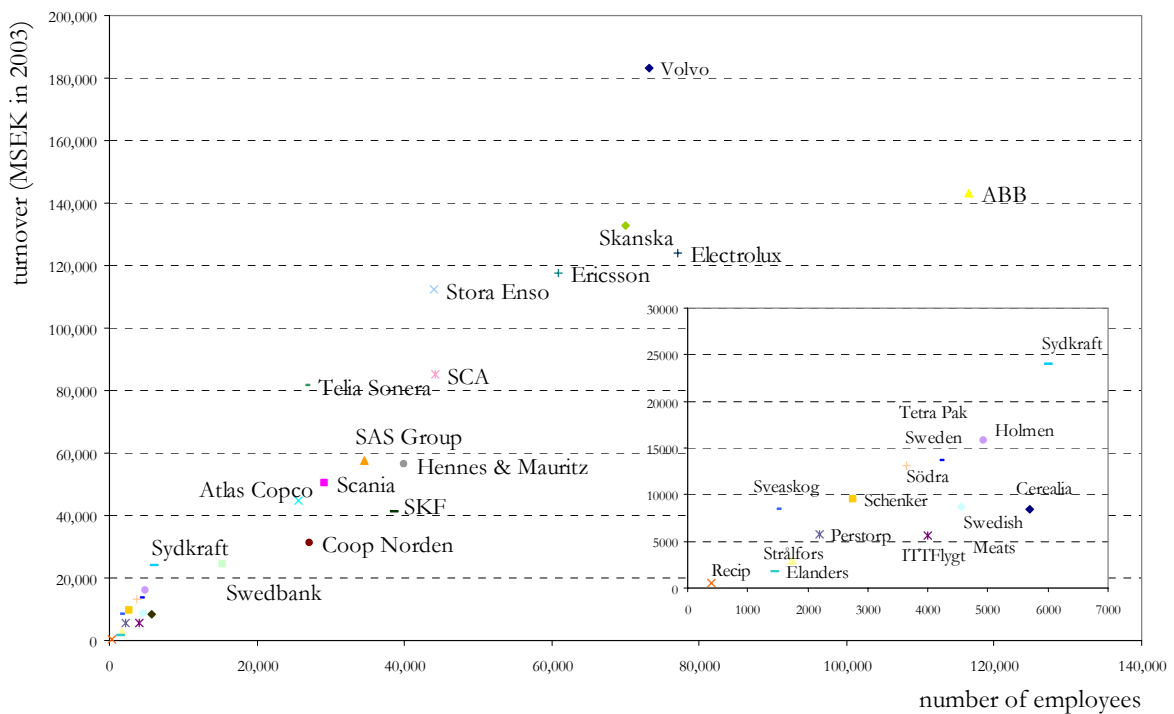


Figure 3-1 Size distribution of selected Swedish companies

The criteria used for screening the companies for this purpose were; experience with the third-party assurance at least once (criteria 1), years with publishing corporate environmental/ sustainability reports greater than five years (criteria 2), and good reporting practices commended by Swedish institute for authorised public accountants and other specialists (FAR)<sup>12</sup>(criteria 3). Two companies (Hennes & Mauritz, Atlas Copco) amongst were added in the list only because they were quoted by FAR as the best first-time report in 2001, and 2003 respectively.

As a result, 28 companies across the sector with a different size were selected (see figure 3-1 for size distribution, table 3-1 for full list of selected companies).

Table 3-1 Swedish companies selected for this study

| Company          | Sector                         | Number of employees (2003) | Turnover (2003) MSEK | Listed on Stockholm Stock Exchange | Assurance experience (Criteria 1) | Years with the reports (Criteria 2) | Awarded by FAR (Criteria 3) |
|------------------|--------------------------------|----------------------------|----------------------|------------------------------------|-----------------------------------|-------------------------------------|-----------------------------|
| Volvo            | Automobiles & Parts            | 73 156                     | 183 291              | Yes                                | No                                | 14                                  |                             |
| Scania           | Automobiles & Parts            | 29 112                     | 50 581               | Yes                                | No                                | 8                                   |                             |
| ABB              | Engineering & Machinery        | 116 500                    | 18 795 (MUSD)        | Yes                                | Yes                               | 10                                  |                             |
| Atlas Copco      | Engineering & Machinery        | 25 707                     | 44 619               | Yes                                | No                                | 3                                   | Yes (2002)                  |
| ITTFlygt         | Engineering & Machinery        | 4 000                      | 736 (MUSD)           | No                                 | No                                | 6                                   |                             |
| SKF              | Engineering & Machinery        | 38 700                     | 41 377               | Yes                                | Yes                               | 10                                  | Yes (2003)                  |
| Coop Norden      | Food retailers                 | 27 087                     | 86 054               | No                                 | No                                | 7                                   |                             |
| Ericsson         | Tele-communication services    | 60 940                     | 117 738              | Yes                                | No                                | 11                                  |                             |
| Tetra Pak Sweden | Diversified Industrials        | 4 200                      | 13 700               | No                                 | No                                | 6                                   |                             |
| Sydskraft        | Multi utilities                | 6 000                      | 24 000               | No                                 | No                                | 8                                   |                             |
| Swedish Meats    | Food processing                | 4 550                      | 8 684                | No                                 | Yes                               | 9                                   | Yes (2002)                  |
| Swedbank         | Financial services             | 15 366                     | 24 453               | Yes                                | No                                | 9                                   |                             |
| Strålfors        | Printing & Supporting services | 1 740                      | 2 991                | Yes                                | No                                | 9                                   |                             |
| Stora Enso       | Forestry & Paper               | 44 000                     | 112 300              | Yes                                | Yes                               | 9                                   |                             |
| SCA              | Forestry & Paper               | 44 191                     | 85 338               | Yes                                | Yes                               | 6                                   | Yes (2002)                  |
| Holmen           | Forestry & Paper               | 4 927                      | 15 816               | Yes                                | No                                | 11                                  |                             |
| Södra            | Forestry & Paper               | 3 638                      | 13 177               | No                                 | No                                | 9                                   |                             |
| Sveaskog         | Forestry & Paper               | 1 500                      | 8 420                | No                                 | No                                | 10                                  |                             |
| Elanders         | Media& Photography             | 1 440                      | 1 714                | Yes                                | No                                | 8                                   | Yes (2000)                  |

<sup>12</sup> FAR is the professional institute for authorised public accountants (*auktoriserade revisorer*), approved public accountants (*godkända revisorer*) and other highly qualified professionals in the accountancy sector in Sweden. It plays a leading role in the development of professional standards, education and information for the audit profession in Sweden (<http://www.far.se>).

|               |                             |        |         |           |                |           |                  |
|---------------|-----------------------------|--------|---------|-----------|----------------|-----------|------------------|
| Skanska       | Construction                | 70 000 | 133 000 | Yes       | No             | 8         |                  |
| Schenker      | Logistics                   | 2 748  | 9 571   | No        | No             | 8         |                  |
| The SAS Group | Transport                   | 34 544 | 57 754  | Yes       | Yes            | 9         | Yes (2000, 2003) |
| Recip         | Pharmaceuticals             | 400    | 512     | No        | No             | 9         | Yes (2002)       |
| Perstorp      | Chemicals                   | 2 200  | 5 700   | No        | Yes            | 10        |                  |
| H&M           | General Retailer            | 40 000 | 56 550  | Yes       | No             | 2         | Yes (2003)       |
| Electrolux    | Household appliances        | 77 140 | 124 077 | Yes       | No             | 10        |                  |
| Telia Sonera  | Tele-communication services | 26 694 | 81 772  | Yes       | Yes (as Telia) | 8         |                  |
| Cerealia      | Food processing             | 5 700  | 8 391   | No        | Yes            | 6         |                  |
| <b>Total</b>  | <b>28 Companies</b>         |        |         | <b>17</b> | <b>10</b>      | <b>26</b> | <b>7</b>         |

### 3.3.2 Data collection process

#### (1) Interviews with the reporting organisations

Telephone interviews were carried out over two months from 29<sup>th</sup> of June until 26<sup>th</sup> of August with the personnel responsible for the environmental/sustainability reporting in 28 selected companies. As shown in figure 3-2, most of interviewees were from environmental affairs. Others included hybrid titles such as public and environment affairs, quality, risk and environment, etc.

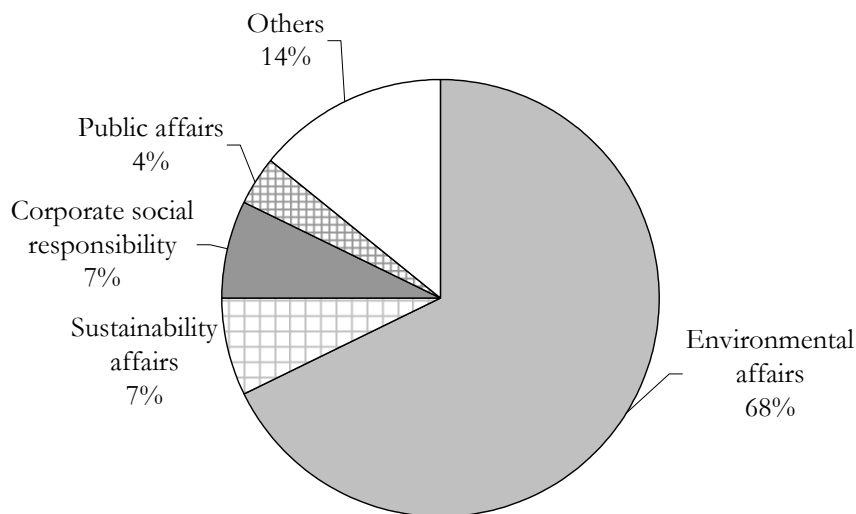


Figure 3-2 Background of interviewees from Swedish sample (Total: 28 interviewees)

Interview guideline was made and distributed to the interviewees to introduce the research topic. It was expected to reduce the risk of misunderstanding so that we can be sure about the validity of the data. The guideline consisted of three sections (see appendix 2). The first section concerned the background information on environment/sustainability reports. The second section explored the company’s experience and position on the third-party assurance. The last section sought the opinion from interviewees about stakeholder involvement in the

assurance exercise. Most of questions were open-ended formats reflecting the explorative nature of the study.

## (2) Interviews with assurance providers

In Sweden, only a handful of assurance providers has been active in this field; Deloitte, KPMG, Ernst & Young, and DNV Consulting.<sup>13</sup> Recently UK-based consultancy CSR Network opened up the relationship with Stora Enso. All aforementioned assurance providers were contacted to get the information regarding their experiences with the third-party assurance engagement, how they organise the process attributes, stakeholder involvement in third-party assurance, and future perspectives (see appendix 3 for the interview guideline).

## (3) Procedures after the interview

All but one interview with reporting organisations were telephone interviews (One was personal interview). Telephone interview have a disadvantage that the level of interaction would be limited than the one in personal interview. On the other hand, it was suitable in this case since the interview with reporting organisations did not intend for the open discussion (Rubin & Rubin, 1995).

In case of assurance providers, personal interviews were preferred. There are only a few companies operating in this market. The high level of interaction during the interview was deemed necessary. But the opportunities with personal interviews were limited by availability of both interviewees and the interviewer. Three Swedish accountancies and DNV Consulting provided the information through personal interviews (Deloitte, KPMG), telephone interview (DNV Consulting), and email communication (Ernst & Young).

As part of attempts to increase the validity of the empirical data gathered through the interview, most of the interviews were recorded on tapes, but in some cases notes only were taken. A summary of the interviews with each company were then sent to the interviewee for verification, further information being sought where necessary. In all but few cases there were few or no changes to the summaries made by companies. Access to interviewees was granted on the understanding that the results would be used only for academic publications. Job titles of interviewees and information on company therefore were given, if necessary.

### **3.3.3 Data Analysis process**

Based on the transcript and summary, the answer to the each question was condensed into few words or phrases. After looking into the pattern in all the answers, several categories were established and used for classifying different answers.

It was deemed desirable to provide open-ended format questions to the interviewees and go through these analytic procedures by the researcher, rather than to provide alternatives to choose. Multiple-choice questions can limit the answers of interviewees, although they can help to make the statistics (Riley, Wood, & Clark, 2000).

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<sup>13</sup> DNV Consulting has been providing an assurance on ABB's report. This year DNV Certification Sweden is preparing its service to Swedish companies.

## 4 Analysis of practices of stakeholder involvement in the third-party assurance (leading-edge cases)

### 4.1 Introduction

The analysis was carried out in order to find to what extent and how stakeholders are involved in the third-party assurance. Arnstein's ladder of citizen participation (Arnstein, 1969) was used as a conceptual model for both evaluating the level of stakeholder involvement in the assurance and characterising different approaches present in the field.

### 4.2 Analytic procedures

#### 4.2.1 Identification of stakeholder involvement cases

27% of assurance statements studied indicated that a direct contact with stakeholders was made along the assurance process either by reporting organisation or the assurance provider. They were classified as stakeholder involvement cases. Table 4-1 shows different ways used to stay in touch with stakeholders.

*Table 4-1 Stakeholder involvement cases identified from assurance statements from 36 leading-edge reports*

| Company                | Report   | Assurance provider (AP)                    | Stakeholder contacts made during the assurance   | Reason of the stakeholder involvement  |
|------------------------|--|--|--|--|
| British Petroleum (BP) | Sustainability report 2003                       | Ernst & Young LLP                          | Observation of a limited number of stakeholder engagement activities that coincided with the planned work schedule of AP   | For AP to review the stakeholder engagement process  |
| Rio Tinto              | Social and environmental review 2003             | ERM <sup>14</sup>                          | Interview of local opinion formers, people from the local community and ten external opinion formers corporate level<br><br>Diagnostic workshops with supervisor level employees | For AP to assess the alignment between policies and implementation at operational level<br><br>For AP to use it as basis of opinion concerning the relevance, completeness, and responsiveness of the report |
| Shell                  | The Shell report 2001, 2002                      | KPMG (Hague) Pricewaterhouse Coopers       | Interview of external experts and external panel   | For AP to see underlying evidence supporting certain data and claims   |
| United Utilities       | Social and environmental performance report 2002 | CSR network Ltd.                           | Contacts with selected stakeholders  | For AP to discuss about United Utilities reporting   |
| Novo Nordisk           | Reporting on the triple bottom line 2001         | Simon Zadek<br>Deloitte & Touche (Denmark) | Independent experts take part in the assurance process as one of assurance providers   | To provide stakeholders with some assurance of the relevance and completeness of the report and its underlying processes   |

<sup>14</sup> Environmental Resources Management,

|   |   |   |  |  |
|---|---|---|--|--|
| The Co-operative Bank<br>(CFS since 2003) | Partnership report 2000, 2001, 2002                         | Ethics etc... <sup>15</sup><br>Business in the community<br>The Centre for Tomorrow's Company<br>The Natural Step       | Independent experts from NGOs make an assessment of different aspects of sustainability such as delivering value, social responsibility, and ecological sustainability | To provide the commentary on the actual performance  |
| Co-operative Insurance Society<br>(CIS)   | Social accountability report 2001                           | KPMG Audit Plc<br>Simon Zadek   | An independent expert takes part in the assurance process as one of assurance providers  | To provide a broader perspective on the quality of the published information and the underlying process of social accounting, i.e. that bears on completeness and relevance. |
|   | Social accountability report 2002                           | KPMG Audit Plc<br>Business in the Community<br>Prof. Paul Ekins   | Independent experts take part in the assurance process as one of assurance providers   | To provide the commentary on the actual performance  |
| British Telecom (BT)                      | Social and environmental report 2001, 2002, 2003            | Independent panel<br>LRQA ltd.  | Independent panel takes part in the assurance process as one of assurance providers.   | To see right issues are in the report  |
| Chiquita                                  | Corporate responsibility report 2001, 2002                  | Rainforest Alliance <sup>16</sup><br>COVERCO <sup>17</sup> (2001, 2002)<br>COSIBAH <sup>18</sup><br>GMIES <sup>19</sup> | Different NGOs run the assurance process concerning the environment and implementation of corporate code of conduct  | To provide stakeholders with assurance on the actual performance and its correct presentation in the report<br>To drive the improvement in actual performance                |
| Matsushita Electric Group                 | Environmental report 2001, 2002, Sustainability report 2003 | The Natural Step <sup>20</sup>  | The NGO run the assurance process alone as an assurance provider   | To provide stakeholders with assurance on the actual activities and policy<br>To drive the improvement therein   |

#### 4.2.2 Classification of stakeholder involvement cases

To categorise those ten different stakeholder involvement cases, Arnstein's ladder was adopted as a framework (Arnstein, 1969). Arnstein's ladder is one of the oldest, but still widely used measures of citizen participation in the area of urban design and related fields. Arnstein's definition of real citizen participation is "the redistribution of power that enables the have-not citizens, presently excluded from the political and economic processes to be

<sup>15</sup> A U.K. based social accounting consultancy and assurance provider

<sup>16</sup> A U.S. based non-profit organization focused on the advancement of sustainable agriculture (<http://www.rainforestalliance.org/>)

<sup>17</sup> The Commission for the Verification of Codes of Conduct : a Guatemalan non-profit organization dedicated to providing accurate and credible information about working conditions (<http://www.coverco.org/eng/>).

<sup>18</sup> Coordinator of Banana and Agroindustrial Unions of Honduras

<sup>19</sup> Independent Monitoring Group of El Salvador

<sup>20</sup> An international non-profit environmental organization founded in Sweden

deliberately included in the future.” (Cumming, 2001) Drawn on her experiences, Arnstein suggested eight classification of different citizen partnership project (see figure 4-1). Each rung conceptually represents the degree of power given to citizens in community decisions (Arnstein, 1969).

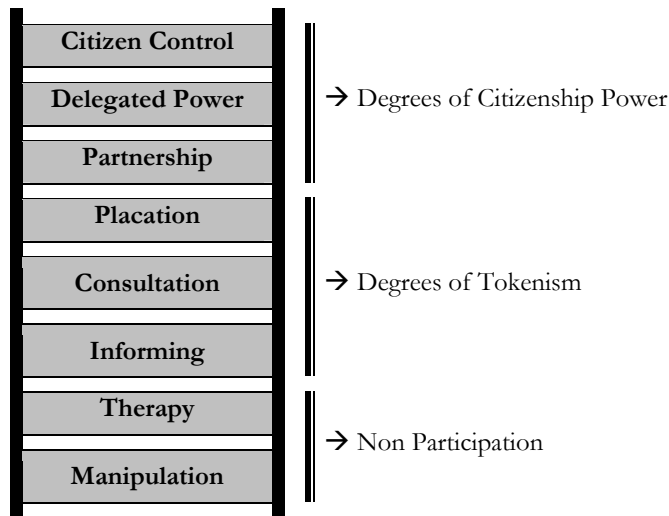


Figure 4-1 A ladder of citizen participation (Arnstein, 1969)

According to Arnstein,

- Some participation project is implemented not to enable people to participate in planning or conducting programmes, but to enable power-holders to educate or cure the participants. It can be called “therapy” or “manipulation” cases which does not incur any participation.
- “Informing” is the first step to legitimate participation. However, the emphasis at this level is on the one way flow of information, with no channel for feedback.
- “Consultation” is a further legitimate step, which can include attitude surveys, neighbourhood meetings and public enquiries.
- “Placation” allows citizens to advise or plan, but reserves the right for power-holders to judge the legitimacy or feasibility of the advice.
- “Partnership” means the redistribution of power through negotiation between citizen and power-holders. Planning and decision-making responsibilities are shared.
- “Delegated power” means that citizens hold a clear majority of seats on committees with delegated power to make decisions. The public now has the power to assure that programs are accountable to them.
- “Citizen control” means that citizens handle the entire job of planning, policy making and managing a program with no intermediaries between it and the source of funds.

To map different stakeholder involvement cases against this framework, attention is paid to the relationship among the assurance provider, stakeholders and the reporting organisation in each example. In the case of third-party assurance, major power-holders would be the assurance provider and the reporting organisation. Therefore, it would be important to see how those power-holders share the power with stakeholders (have-nots as per Arnstein’s model) in each example.



Some examples where the assurance provider met the stakeholders through interviews, workshops, and informal contacts can be named as “consultation.” The traditional assurance provider, typically accountancy or consultancy, plays its role as a mediator between stakeholders and the reporting organisation. Although stakeholders got an opportunity to tell their good or bad views on the reporting organisation, power of organising the assurance process clearly remains with this traditional assurance provider. Therefore, the boundary of assurance process still excludes stakeholders from the assurance process (see figure 4-2).

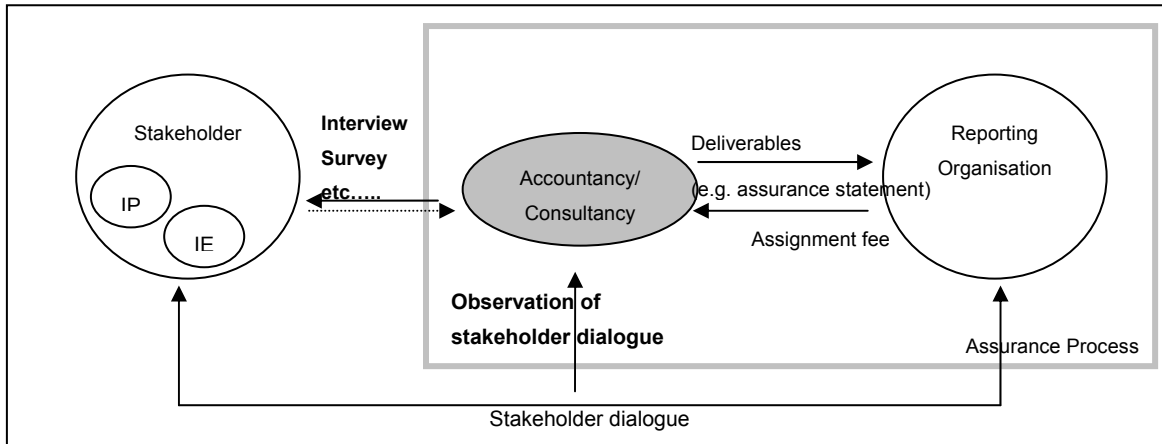


Figure 4-2 Conceptual model 1: Inclusion of stakeholders in the assurance process by actively listening to their opinions (IE: Independent experts, IP: Independent Panel)

Other examples where the independent expert was appointed as one of the assurance providers signal the power distribution to the stakeholders. Stakeholders such as independent expert(s) participate in the assurance process by running their own assurance process parallel to the process from the traditional assurance provider (see figure 4-3).

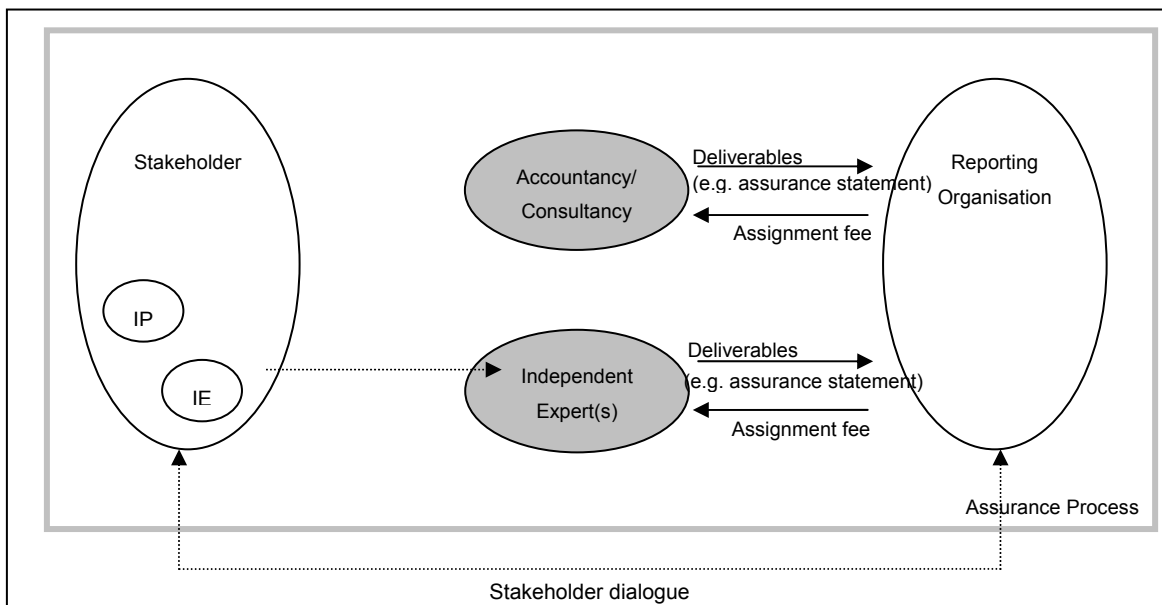


Figure 4-3 Conceptual model 2: Inclusion of stakeholders in the assurance process by appointing the independent experts as an assurance provider (IE: Independent experts, IP: Independent Panel)

These cases are classified as “partnership” or “placation,” depending on to what extent independent experts may have exercised their power along the process.

In the case of BT, the independent panel run its own assurance process parallel to the process from traditional assurance provider. This is different from the case where independent experts are recruited as the assurance provider. Appointment of the independent panel implies that power is partly redistributed from the reporting organisation to stakeholders (see figure 4-4).

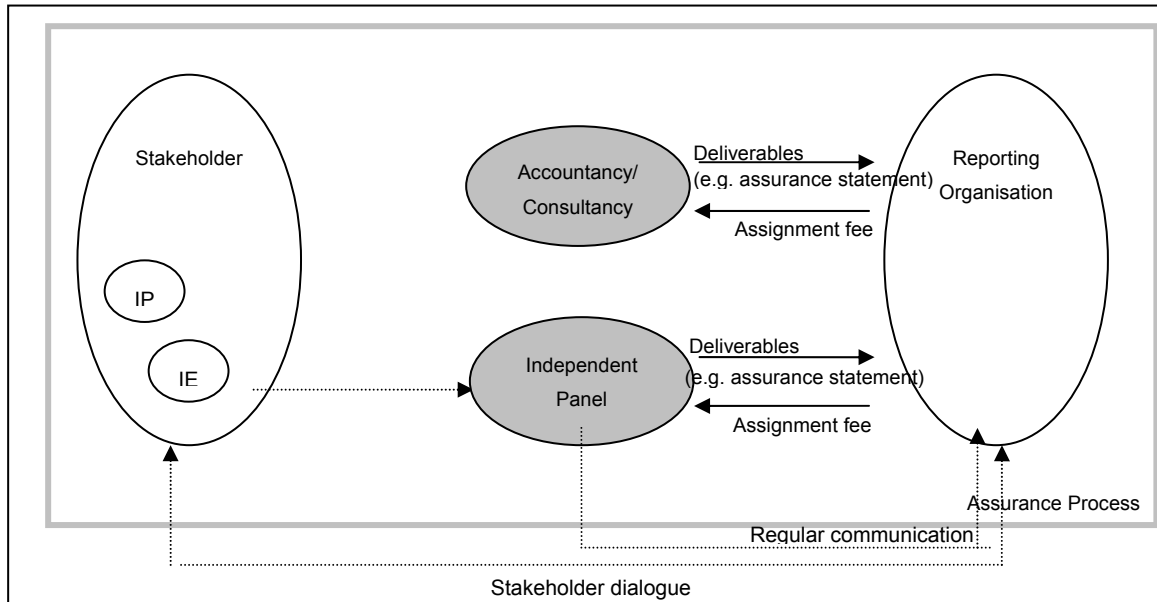


Figure 4-4 Conceptual model 3: Inclusion of stakeholders in the assurance process by appointing the independent panel as an assurance provider (IE: Independent experts, IP: Independent Panel)

In the rest two examples, stakeholders such as NGOs run the assurance process alone as an assurance provider (see figure 4-5).

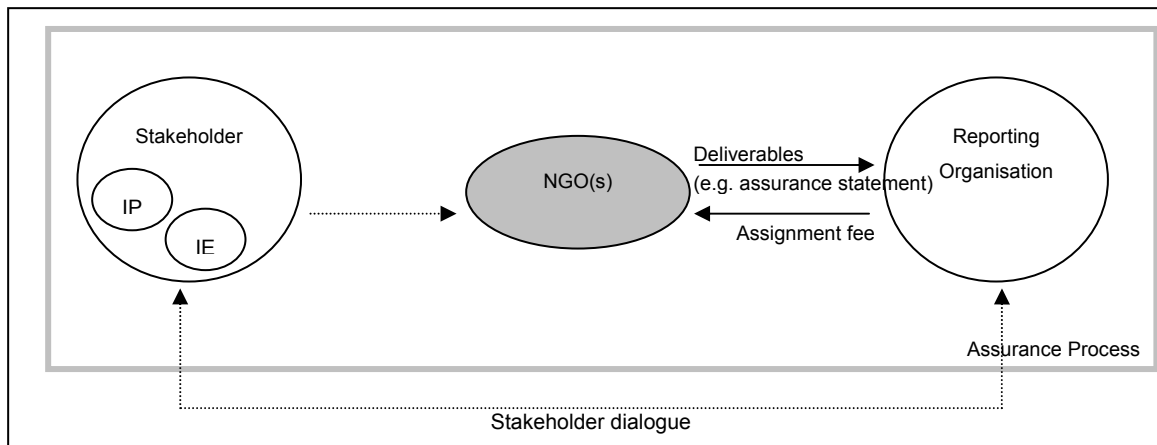


Figure 4-5 Conceptual model for type 4: Inclusion of stakeholders in the assurance process by appointing NGOs as an assurance provider (IE: Independent experts, IP: Independent Panel)

Based on foregoing analysis, various stakeholder involvement cases are mapped against the Arnstein’s ladder. To make the original model fit into the setting in the third-party assurance cases, citizen control was adapted as ‘stakeholder control.’ This mapping makes it possible to

categorise the different examples present in the assurance with four distinct types of stakeholder involvements in assurance (see figure 4-6).

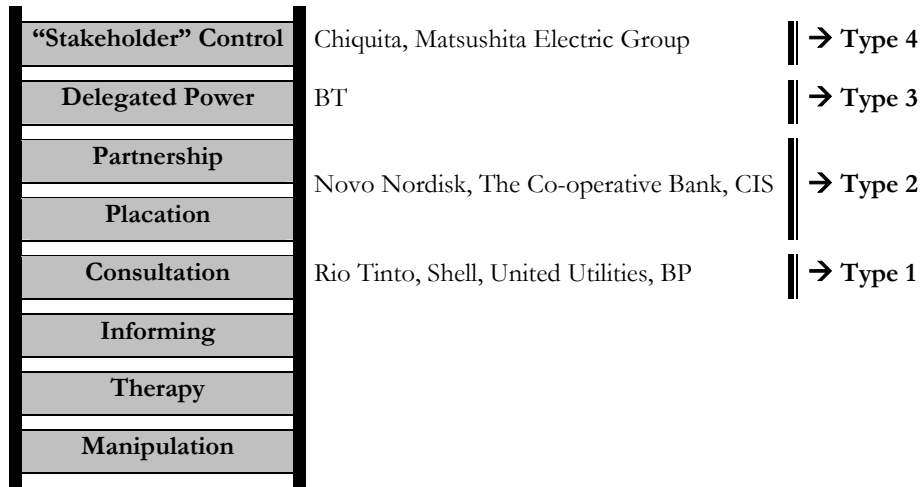


Figure 4-6 Mapping of different stakeholder involvement cases against Arnstein’s ladder

This categorisation would be the simple representation of the reality. Since the information regarding each example were fully drawn from the assurance statement, there would be a risk that stakeholders were not involved as mentioned in the statement or the inputs from stakeholders did not play an important role for assurance providers to form their opinion (especially in type 1). Also, it would be possible that the independent experts or panel are employed only to give their names on paper. Some can doubt how closely independent experts and panel were connected with stakeholder interests. It highlights the need to look at more in detail how stakeholders had carried out their roles in each type of involvement.

### 4.3 Analysis of stakeholder involvement cases

To learn more about each stakeholder involvement cases, at least one example in each stakeholder involvement case was closely analysed by looking into following components: the motivation behind involving stakeholders in the assurance, who has been involved as stakeholder(s), the desired end result of the involvement, the objective of the involvement, and the process attributes.<sup>21</sup>

#### 4.3.1 Traditional assurance provider actively listening to stakeholder opinions (type 1)




##### 4.3.1.1 The Royal Dutch/Shell Group of companies (Shell)

Shell, a multinational energy company operating in over 145 counties with 119 000 employees, published its first group-wide Shell Report in July 1998. This report carried the verification statement from KPMG and Price Waterhouse (Shell, 2004). Since 1997, Shell has implemented a comprehensive system of assurance for its health, safety and environment procedures and reporting from operating company level up to the group level (Pensions & Investment Research Consultants, 1998).

<sup>21</sup> These are the critical components of stakeholder engagement activities found in a study from Cumming (2001).

Their group-level assurance providers have been communicating their work by using the symbol system since 2000. Three different symbols have been assigned to the data and claims examined by external assurance providers, in order to give a clear indication on what is verified and how. But, it was not outspoken how assurance providers selected subject matters suitable for each type of analysis.

Table 4-2 Symbol system used for assurance on the Shell Report since 2000

| Symbol  | The work done by assurance provider to assign this symbol on specific data and/or claims  |
|---|---|
| 1  | At Group, Business and Operating unit level the assurance provider obtained an understanding of the systems used to generate, aggregate and report these data. They assessed the completeness and accuracy of the data reported by visiting operating units, performed a review of all data reported, and assessed the appropriateness of data trends in discussions with management. |
| 2  | The assurance provider assessed systems and processes and underlying evidence supporting the data and statements. Their assessment included interviewing Shell people and external experts, reviewing documentation and confirming the accurate use of data derived from external sources.  |
| 3  | Only at a Group level, the assurance provider tested the integrity and accuracy of the data aggregation process, including sample-testing of the data input from a complete set of operating unit responses. They did not verify the reliability of the data reported by operating units.   |

(Source: The Shell Report 2000)

As shown in table 4-2, the assurance providers interviewed external experts for providing assurance on selected subject matters (marked with the second symbol). The subject matter which was put through this analysis had a qualitative process behind and/or quite a contentious nature; three subject matters in the report 2001 such as *KPI consultation process, case studies on environmental data quality in Nigeria, and Nigeria upgrade project*, four subject matters in the report 2002 such as *case study on SAPREF incidence, Nigeria, and China, and animal testing*. It was often to confirm the claims made by Shell. For example, in the case of the development of the Bribery and Corruption Primer presented in the report 2000, external experts were interviewed to confirm their involvement (Wallage, 2000).

The approach to assurance at Shell has evolved over time. In its latest report, the role of assurance provider was refined as a verifier of safety and environmental data.<sup>22</sup> Only one symbol (the first one in the table) is now used to indicate which data were examined by verifier, upon this decision. The group-level assurance providers do not seek external contacts any longer. Shell began to use the word from independent panel or community members directly in corresponding section instead of making assurance provider interview the independent panel or experts to assure the Shell's claim and case studies. Shell claimed that this assurance approach made the Shell report as part of their ongoing dialogue with stakeholders.

#### 4.3.1.2 Analysis of type 1

Another oil giant British Petroleum (BP)'s assurance provider Ernst & Young observed the stakeholder dialogue as part of the evidence collection process. They based their opinion regarding BP's stakeholder engagement process on their observation of the limited number of stakeholder dialogue.

<sup>22</sup> KMPG and PricewaterhouseCoopers said in their assurance statement that "although we are confident in the overall reliability of the data reported ... We have not provided assurance over the contents of the entire Shell Report 2003, nor have we undertaken work to confirm that all relevant issues are included".

In the case of Rio Tinto,<sup>23</sup> its assurance provider ERM has interviewed external stakeholders (opinion formers, community representatives, etc.) as well as internal stakeholders (employees at operational level). Assurance statement indicates that those interviews formed a strong basis of the assurance opinion regarding the assessment of policy implementation at Rio Tinto and completeness, relevance and responsiveness of the report.

However, in the case of United Utilities, it was not clearly described who were contacted for what purpose by the assurance provider, CSR Network. Consequently it was unclear that the result of those contacts affected any of the assurance opinion.

The cases reviewed here demonstrate that there are two purposes in involving stakeholders. One is to confirm the claims made by the reporting organisation (stakeholders as an alternative source of information). Another is to make a conclusion on completeness, relevance and responsiveness of the report from the stakeholder's perspective.

*Table 4-3 Summary of analysis: Traditional assurance providers actively seeking stakeholder opinion (type 1)*

|                                  |  |
|----------------------------------|--|
| <b>Motivation</b>                | Decided as a part of the assurance process by the assurance provider   |
| <b>Who has been involved</b>     | Independent experts, Independent panel formed by the reporting organisation, Opinion formers at different level, local community   |
| <b>Objectives for engagement</b> | To collect the evidence as a basis of assurance opinion from outside the reporting organisation  |
| <b>Desired end result</b>        | Provide stakeholder with assurance on specific subject matter such as contentious issues (Increase the credibility)<br>Provide the reporting organisation with feedback (only the case of Rio Tinto) |
| <b>Process attributes</b>        | Stakeholders are contacted to tell their views during the assurance period → one-way communication from stakeholders to assurance provider (agency of the reporting organisation)                    |

### **4.3.2 Stakeholders (Independent experts) and traditional assurance providers together on the process (type 2)**

#### **4.3.2.1 Novo Nordisk A/S<sup>24</sup>**

Novo Nordisk, a Danish pharmaceutical company with 18 756 employees, has been instrumental in developing the third-party assurance practices. Their first environmental report was published in 1993 with an assurance statement from SustainAbility.

Since 1999, Novo Nordisk had a “dual approach” to the assurance engagement. The motivation was to get an assurance on the qualitative part as well as the quantitative part performed with two different approaches. Under that approach, an independent expert, Simon Zadek, looked at what would be then known as material issues of sustainability reporting to judge the completeness and relevance of the report and underlying processes. It was desired that an external expert would challenge the different parts of the organisation so that Novo Nordisk can make sure that they are on the right track. On the other hand another assurance provider Deloitte went through the details and information published in the

<sup>23</sup> A mining company having total 83 active operations over the world

<sup>24</sup> This case description regarding Novo Nordisk is based on telephone interview with Assurance Specialist at Novo Nordisk A/S on July 28, 2004

report, which would also under build some of the assurance that another assurance provider did.

To assess the qualitative information, Simon Zadek carried out visits to production facilities and/or affiliates as well as interviews with different employees at Novo Nordisk. An interview was an important way to collect the evidence for qualitative assessment. The purpose of this exercise was to check that everybody in the organisation would agree on what were the major issues in the past year. The consistency of the answers would be the evidence for the qualitative information. The information regarding stakeholder dialogue, i.e. how Novo Nordisk had done the stakeholder dialogue, was also collected and confirmed through these interviews. Since Novo Nordisk has very issue-related stakeholder engagement activities, it has been hard for the company to document those.

In the end of the process, Simon Zadek had a brief meeting with Deloitte to discuss the findings. Through that meeting they confirmed whether there were any overlapping tasks done and whether there were any major findings another party missed out.

Over the years of engagement from 1999 to 2001, Simon Zadek challenged Novo Nordisk in various issues. It had led to the improvement of reporting. But, he could no longer do the assurance when he was elected as a CEO of AccountAbility in 2002. Although Novo Nordisk could not keep two different approaches to the given issues any longer, the objectives of the dual approach are still fulfilled in the single approach.

“The single or dual approach depends very much on the assurance provider. Does the assurance provider have the competencies? Does the organisation need to be challenged? There are many factors that are part in decision whether an organisation should choose the single or dual approach and this might change from year to year.” (Specialist Corporate Responsibility Management Novo Nordisk A/S, 2004, July 28)

#### **4.3.2.2 The Co-operative Financial Services (CFS)<sup>25</sup>**

This year, The Co-operative Bank and Co-operative Insurance Society (CIS) have published their first sustainability report under the name of Co-operative Financial Services. Both of them have a long experience in engaging the independent experts in addition to the engagement with accountancy (KPMG for the CIS) or consultancy (ethics etc...for The Co-operative Bank). The Co-operative Bank has found it useful in providing stakeholders with a detailed assessment of its pursuit of sustainable development.

To ensure that their activities were subject to the same level of scrutiny, CFS also commissioned three experts from NGOs (Business In the Community, The Natural Step, and The Centre for Tomorrow's Company) to provide the opinion statements, in addition to the third-party assurance done by JustAssurance.<sup>26</sup> The commentators are chosen on the basis of their impartiality, reputation and expertise. CFS expected that the commentators with different expertise would bring their specialist knowledge to the assessment and offer the direction on how performance can be improved.

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<sup>25</sup> This case description regarding The Co-operative Financial Services is based on email communication with Sustainability reporting manager at Co-operative Financial Services on August 16, 2004

<sup>26</sup> JustAssurance is a social enterprise dedicated to working with stakeholders, or 'Partners' in Co-operative Financial Services' (CFS) language, to provide assurance of sustainability reports (<http://www.justassurance.org/>)

The three commentators were provided with a final draft of the report and were asked to comment on respective sections, drawing on their wide-ranging expertise. The opinion statements had went through a number of iterations before the commentators and CFS agreed on the final version that was printed in the report. If necessary, CFS chose to respond to some of the commentators' concerns by amending the report. CFS could also choose to debate some of the comments that have been made. The statements from commentators were regarded as an additional input which did not belong to the scope of assignment given to the assurance provider, JustAssurance.

CFS was confident that this engagement with three independent experts had been equipped with a high level of rigour and insights enough to provide such a useful way of driving actual performance improvement. For the future, it is likely that CFS continue to commission independent commentators in addition to its use of specialist social and environmental auditors, such as JustAssurance.

#### 4.3.2.3 Analysis of type 2

The internal work behind those two cases is fairly different. In one case the independent experts were entry into the process after the report was ready. In another case an independent expert was involved early in the process just like other assurance providers did, which implies a deep impact of the assurance internally.

However, those two cases commonly present that bringing the independent experts were expected to increase the level of assurance to the stakeholders and make sure the direction that reporting organisations have chosen.

*Table 4-4 Summary of analysis: Traditional assurance providers and stakeholders together (type2)*

|                                  |  |
|----------------------------------|--|
| <b>Motivation</b>                | Decided by the reporting organisation to equip the assurance process with a full set of competences necessary  |
| <b>Who has been involved</b>     | Independent experts (from NGOs)  |
| <b>Objectives for engagement</b> | Provide stakeholders with an additional assurance -the assessment of performance itself in the case of CFS<br>Divide the assurance work with another assurance provider -the assessment of qualitative part (i.e. completeness and relevance of the report and underlying process) in the case of Novo Nordisk |
| <b>Desired end result</b>        | Increase the level of assurance to the stakeholders<br>Influence the way reporting organisation manage their work by challenging them with a different perspective   |
| <b>Process attributes</b>        | Stakeholders have a contact with the reporting organisation during the certain period of the reporting project. (a constant dialogue during the assurance process between stakeholders and the reporting organisation)   |

#### 4.3.3 Independent panel as an assurance provider (type 3)

##### 4.3.3.1 British Telecom (BT)

BT has a long history of environmental/sustainability reporting. Environmental reports were published annually from 1992 to 2000, with a social report published in 1999. BT is very ascertain that verification by independent third parties of the information published in social

and environmental reports is important to ensure that they contain substance rather than ‘corporate spin’ (European Commission, n.d.)

Currently BT features two types of assurance statement on their external website. The Leadership Panel produces the statement that sets out stakeholders’ perspective on the report. This panel is to help BT shape the report and ensure that the right things are in the report. Their work is complemented by Lloyds Register Quality Assurance (LRQA) who is recruited to ensure that the things in the report are right. LRQA worked as a verifier since 1999 (ACCA, 2003; European Commission, n.d.).

The Leadership Panel consists of six independent experts drawn from NGOs, investors and opinion formers. The purpose of the panel is to encourage innovation and leadership on sustainable development and corporate social responsibility in BT, not only to provide an independent assurance statement for inclusion of BT social and environmental report. (BT, n.d.-b).

They have influenced the contents of report in several ways. For example, last year the panel has participated in KPI consultation process. They also approved the selection criteria used by BT to identify three controversial issues to be included in the report– the Digital Divide, Mobile Health and E-Business as “Hot Topics” (BT, n.d.-a). Also they are working to drive changes in corporate governance. The panel briefed the report to BT Board this year. For the first time, the Board signed off the Report’s Summary and Highlights.

### 4.3.3.2 Analysis of type 3

There is the only example in this type of stakeholder involvement in assurance. But, it presents clearly that the independent panel is able to share the task with traditional assurance provider. The panel constantly works to make sure that difficult but material issues are included in the report. Within this boundary set by the panel, traditional assurance provider checks the accuracy and reliability of the report.

But in the case of BT, it is uncertain that the panel would continue to play a role as an assurance provider to see right things are in the report. With an adoption of AA1000 AS, LRQA begins to make their own opinion regarding the completeness, materiality, and responsiveness of the report in the latest assurance statement.

*Table 4-5 Summary of analysis: Independent panel as an assurance provider (type 3)*

|                                  |   |
|----------------------------------|---|
| <b>Motivation</b>                | Decided by reporting organisation to bring the scrutiny in the management of critical social and environmental issues.  |
| <b>Who has been involved</b>     | A panel of independent experts drawn from professionals with different background   |
| <b>Objectives for engagement</b> | Divide the assurance work with another assurance provider – a panel to see if the right issues are in the report  |
| <b>Desired end result</b>        | Increase the credibility to the external stakeholders<br>Bring the different perspectives in the course of the management   |
| <b>Process attributes</b>        | A panel has a constant level of contacts with the management of reporting organisation all around the year, although the number of meetings is limited (close cooperation with the reporting organisation). |



#### **4.3.4 Stakeholders alone as an assurance provider – NGOs (type 4)**

##### **4.3.4.1 Chiquita Brands International, Inc. (Chiquita)**

Chiquita, an international producer, distributor and marketer of fresh and processed foods, has published its corporate responsibility report since 2001. Since the inception of the report, Chiquita have featured the verification statement from Rainforest Alliance and independent experts from NGOs such as The Commission for the Verification of Codes of Conduct (COVERCO) who accompanied the internal audit process as observers. This development was welcomed as the best practice of third-party assurance in various report benchmarks. For instance, it was one of only five reports to score full marks on verification and assurance in SustainAbility's 2002 survey (SustainAbility, 2002).

The assurance statement attached in Chiquita's report concerned certifying the actual performance itself against the specific standards such as Rainforest Alliance's Better Banana Project and Social Accountability 8000 (SA8000) standard. These external experts from NGOs stated their experiences with audit and attested that Chiquita presented the audit results correctly in the report.

It was in 1992 when the Rainforest Alliance first contacted Chiquita and opened a discussion on sustainable agriculture in its banana farms. The Rainforest Alliance was part of the larger network of environmental NGOs, the Sustainable Agriculture Network. They proposed the Better Banana Project (BBP) standards in order to reduce the negative environmental impacts of banana cultivation and to improve working conditions in the industry (Were, 2003). In 2000, after eight-year efforts with spending 20 million USD, all 127 Chiquita owned banana farms in Latin America achieved certification by the Rainforest Alliance against the Better Banana Project standards (Chiquita, 2001).

To maintain the certification, an annual inspection against Better Banana Project standards should be completed in each farm. Independent experts representing the Rainforest Alliance and Latin American environmental NGOs (the Conservation Agriculture Network "CAN") annually verify compliance with the criteria in all the banana farms owned by Chiquita. Their audits include both unexpected physical inspections of farm facilities and interviews with farm workers and managers. All farms of Chiquita are thus audited and re-certified annually.

This Better Banana Project played an important role to trigger the corporate responsibility management activities at Chiquita. The close cooperation and dialogue with the Rainforest Alliance exposed Chiquita's management to a radically different point of view and gradually changed their outlook. The opening of farms to outsiders for audits was also instrumental in promoting transparency in corporate culture especially at the operating unit level (Were, 2003).

Inspired by the positive experience with verifiable performance standards like Better Banana Project, Chiquita adopted SA8000 standards as their core labour standard (Chiquita, 2001). Initially Chiquita hired the independent auditing firm SGS ICS, Inc. to conduct pilot audits of its compliance with SA8000. Between September 1998 and February 2000 sample audits were performed across Chiquita's operations. Despite of some non-conformances found by then Chiquita decided to work with SA8000 for the future, because the management considered that SA8000 would provide higher credibility with external stakeholders and an excellent driver for improvement in comparison to the self-developed standard (Were, 2003).

Since then, Chiquita have carried out the internal audit to measure the performance against its Code of Conduct and SA8000 together with external experts from local NGOs such as COSIBAH in Honduras, GMIES in El Salvador, and COVERCO in Guatemala. In 2002, Chiquita’s banana division in Costa Rica became the first major agricultural operation in Central America to earn SA8000 certification. The operations in Panama and Colombia obtained SA8000 certification. All in all, SA8000 certifications now cover operations that employ more than half of Chiquita’s total employees.

#### 4.3.4.2 Analysis of type 4

Matsushita Electric Group also provides an example of NGO participation in the third-party assurance. Since 2001 they have presented the result of sustainability analysis made by The Natural Step as a third-party statement in the report. According to the Matsushita, they regarded the statement from Natural Step as a verification statement because “whereas the purpose of a third-party verification is to assure the reliability of disclosed information, a sustainability analysis is a process of verifying whether the principles of Matsushita’s environmental initiatives, its specific measures taken, and the products created as a result are consistent with the goal of creating a sustainable society.” (Matsushita Electric Group, 2003) Each year they chose the different subjects within Matsushita for the analysis (e.g. product portfolio for 2002, recycling plant for 2003 report). The result of analysis has been used for the internal education and development of future strategy.

Both cases in type 4 can be characterised as the strong intention for performance improvement, and willingness to learn from outsiders. On the other hand, they clearly challenge the mainstream thinking of what the third-party assurance should be, since the assurance statements concern the management and performance themselves, not the reported information.

Table 4-6 Summary of analysis: NGO as an assurance provider (type 4)

|                                  |   |
|----------------------------------|---|
| <b>Motivation</b>                | Engaged by reporting organisation as part of their improvement cycle.   |
| <b>Who has been involved</b>     | NGOs  |
| <b>Objectives for engagement</b> | To certify the social and environmental performance against renown standards and help the reporting organisation present the result in a credible way                   |
| <b>Desired end result</b>        | Increase the credibility to the external stakeholders<br>Drive the improvements internally  |
| <b>Process attributes</b>        | Independent experts have the contacts with different parts of organisation all around the year in an ongoing basis (close cooperation with the reporting organisation). |

## 4.4 Conclusion

### 4.4.1 The level of stakeholder involvement in third-party assurance

In the study of leading-edge reports carrying the third-party assurance statement it was found that only 27% companies could present the stakeholder involvement cases. Why the majority of companies do not involve stakeholders along the assurance process? Reasoning was made from reading the assurance statements from the rest companies.

First of all, the reporting organisations generally did not have a high level of stakeholder involvement which could influence such a regular management exercise as the third-party assurance. Therefore the whole assurance process remained as an exclusive exercise between the assurance provider and the reporting organisation.

Once the reporting organisation appointed the assurance provider, why did not the assurance provider seek the stakeholder contacts then? The objective of assurance and scope of assignment given to the assurance provider seemed to bear on the stakeholder involvement. If the assurance provider were asked to focus only on checking the accuracy of the environmental data, stakeholder contacts would not have been desired necessarily. The typical work carried out in those cases was as follows: “The entire database was reviewed and interviews were carried out with those responsible for the areas that contributed directly or indirectly to the data contained in the publication” (excerpt from Aracruz Celulose 2003 environmental and social report).

Even when the assurance providers make a qualitative assessment on completeness of the report other than double-checking of the data, they tended to depend on their professional judgement or, at best, the specific reporting standard such as GRI. Using the GRI guidelines as criteria for assessment would reflect stakeholder concerns indirectly, since these guidelines were created through the stakeholder consultation process.

There were a few cases where the assurance provider made such a conclusion from the stakeholders’ perspective as “report reflects the material information stakeholders want”, and “the systems for stakeholder engagement are in place” without direct contacts of stakeholders. In those cases, the assurance provider would have collected evidence from the reporting organisation with regard to how it had kept in touch with stakeholders. But it was not unveiled how reporting organisation would have presented the evidence of stakeholder engagement to the assurance provider.

#### **4.4.2 The classification of stakeholder involvement cases**

As a result of categorization and analysis made previously, the description on four types of stakeholder involvement cases was made as shown in table 4-7. The role of stakeholders in each case dramatically changes from type 1 (as an alternative source of information) to type 4 (as the assurance provider). The degree of involvement was not so high, since four cases were classified as type 1, the lowest degree of involvement.

It seems that contentious companies tended to involve stakeholders more to confirm the claims made in the report. Chiquita also had a difficult case with media in the late 1990s just before they started an extensive corporate responsibility program (Were, 2003).

This table provides examples of how stakeholders could be involved in the assurance. This classification and description were used for the interview with Swedish companies to assess the possibility and limitation given in each idea as well as the value of involving stakeholders in the assurance.

Table 4-7 Presentation of stakeholder involvement cases

| Types  | Description   | Examples                                       |
|--------|---|--|
| Type 1 | <b>Traditional assurance providers actively listening to stakeholder opinions</b><br>→ Accountants and environmental consultants play their role as an assurance provider. Also, they actively seek stakeholder opinions outside the company by interviewing stakeholders concerned or attending the stakeholder dialogue.  | Shell, BP, Rio Tinto, United Utilities         |
| Type 2 | <b>Traditional assurance providers and stakeholders together</b><br>→ Typically the traditional assurance provider shares the task with independent experts. Independent experts in specific subject (e.g. strategic environmental management, corporate social responsibility, etc.) give a commentary on the completeness and relevance of the report or a review of the actual performance       | Novo Nordisk, CFS (CIS & The Cooperative Bank) |
| Type 3 | <b>Independent panel as an assurance provider</b><br>→ The panel consist of external experts plays a significant role as an assurance provider, typically together with traditional assurance provider. The panel tends to influence the reporting process by identifying hot issues to report, standards to be used for reporting, in addition to providing the assurance statement in the report. | BT   |
| Type 4 | <b>NGO as an assurance provider</b><br>→ The company appoints a non-profit organisation as an assurance provider.   | Chiquita, Matsushita Electric Group            |

When it comes to the third-party assurance, the reporting organisation still has very much to decide. The detailed analysis on different types of stakeholder involvements indicated that there had been different expectations on the third-party assurance and its provider from reporting organisations' side. Presumably the choice on different type of stakeholder involvement would be closely related with

- The reporting organisation's perception on the third-party assurance, i.e. what the third-party assurance should be, what value it should bring to the reporting organisation;
- The reporting organisation's perception on different assurance providers, i.e. who can provide us with what; and
- The relationship reporting organisation have had with its stakeholders

These issues were addressed in the interviews with 28 Swedish companies with questions regarding the competencies necessary to provide an assurance, the value of involving stakeholders in the third-party assurance and the preferences on different type of stakeholder involvement.

Also the first type of stakeholder involvement shows that there would be a room for the assurance provider to make a decision where they would get the information regarding the stakeholder concerns. This issue was addressed through the interviews with assurance providers.

## 5 Analysis of opportunities and limitations with stakeholder involvement in the third-party assurance

### 5.1 Introduction

This chapter presents the result of interviews with 28 Swedish companies. Opinions from assurance providers active in Sweden are also presented in the relevant section. The analysis is carried out in order to predict the opportunities and limitations with the third-party assurance itself as well as stakeholder involvement in the third-party assurance.

The results of the interviews and analysis are organised under following sub-chapters.

- The general trend in environmental/sustainability report;
- Experiences and opinions on the third-party assurance; and
- Stakeholder involvement in the third-party assurance

### 5.2 The general trend in environmental/sustainability report

Among 28 Swedish companies interviewed, the total number of companies publishing environmental/sustainability reports has been steadily increased over the years as shown in figure 5-1. The increase was prominent in the late 1990s. The number of reports published has been downwards slightly for the last two years.

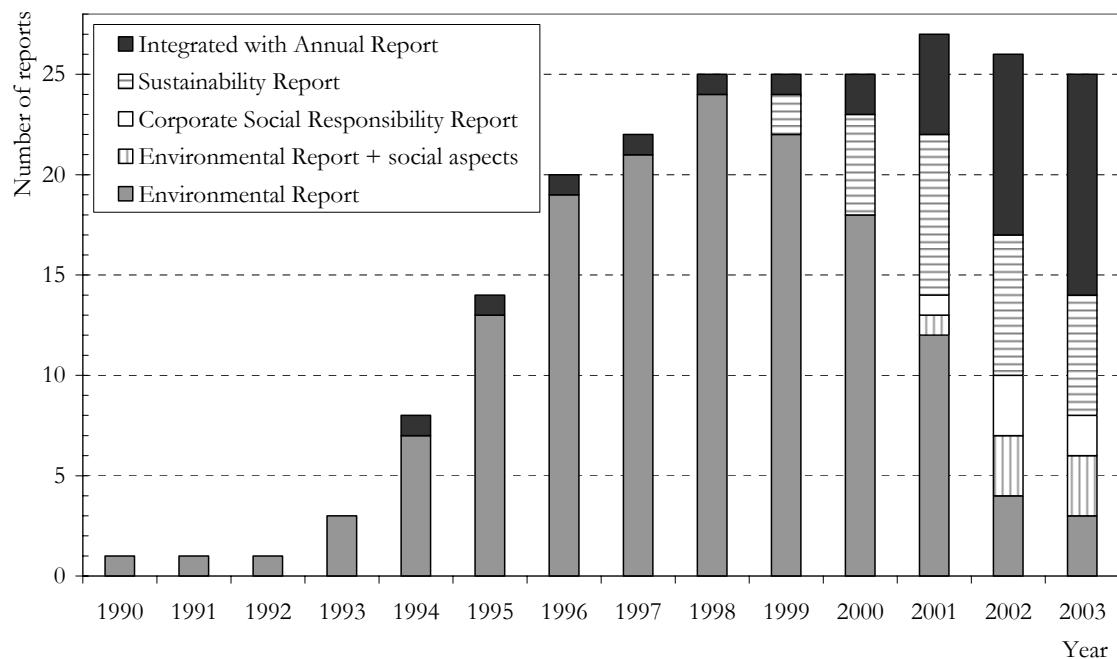


Figure 5-1 The general trend of environmental/sustainability reports in 28 Swedish companies interviewed

The last five years added a variety in contents and formats of the environmental reports. Having more social aspects or sustainability information into the environmental report was the most frequently mentioned as major changes made in their reports by interviewees. The first report titled as “sustainability report” came out in 1999 from ITT Flygt and Swedish

Meats. While many companies contemplated on what “sustainability report” would mean for them, the environmental report evolved as environmental & social report and corporate social responsibility report. In the last reporting year 2003, only three companies published the standalone environmental report.

Another significant trend was the integration with the annual financial report. The most frequently mentioned reason for the integration was as an attempt to incorporate with triple-bottom-line concept. Two other reasons mentioned here were to give more weight in environmental/sustainability information and to reach more readers.

However, it is questionable that all the integrated publication can be called as a triple-bottom-line report. In reality the result of the integration came out as either two publications bound together in one volume or one set, or one publication heavily geared towards the financial information.

It turned out that half of companies were still struggling to establish the firm and reliable reporting line in a new reporting area. When asked about the critical development in need in order to increase the quality of the report, finding relevant indicators and developing the reporting system in unreported area was most frequently mentioned as a future development to be made. There were only four companies making a reference to the stakeholder demands. Among them, one company had a routine of reflecting the results of customer and employee survey into the plan for the next report. Only one interviewee mentioned the sort of assurance would be needed in a long run to enhance the quality of report.

### **5.3 Experiences and opinions on the third-party assurance**

During the history of reporting among selected companies, 12 companies (43%) had an experience with third-party assurance at least once. Those were questioned in detail regarding their third-party assurance practices (Assurance Group). All the rest companies were questioned the reason why they did not seek the third-party assurance so far and what kind of measures have been in place to assure that the report would provide the true and fair view of the company (Non-Assurance Group).

#### **5.3.1 Experiences on the third-party assurance (Assurance Group)**

After two companies, Perstorp and Stora Enso (as Stora), came out with third-party assurance in 1995, third-party assurance steadily grew up throughout the 1990s. BTL<sup>27</sup> embarked on this exercise in 1996. It was in 1997 when the biggest increase was observed. Three more companies began commissioning the third-party assurance on their standalone environmental report. By the time Telia decided to have the third-party assurance in 2000, they thought that the third-party assurance was quite common among the big companies.

There has been no growth in the number of companies working with third-party assurance for the last four years (see figure 5-2). If we exclude silent third-party assurance cases from the picture, the trend in third-party assurance seems to be downwards. Only nine companies have commissioned the third-party assurance in the last year.

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<sup>27</sup> BTL was acquired by Schenker AG and changed its name into Schenker AB. Due to this change, it was impossible to get the detailed information on the past experience at BTL. Accordingly Schenker AB was classified as the “Non-Assurance Group.”

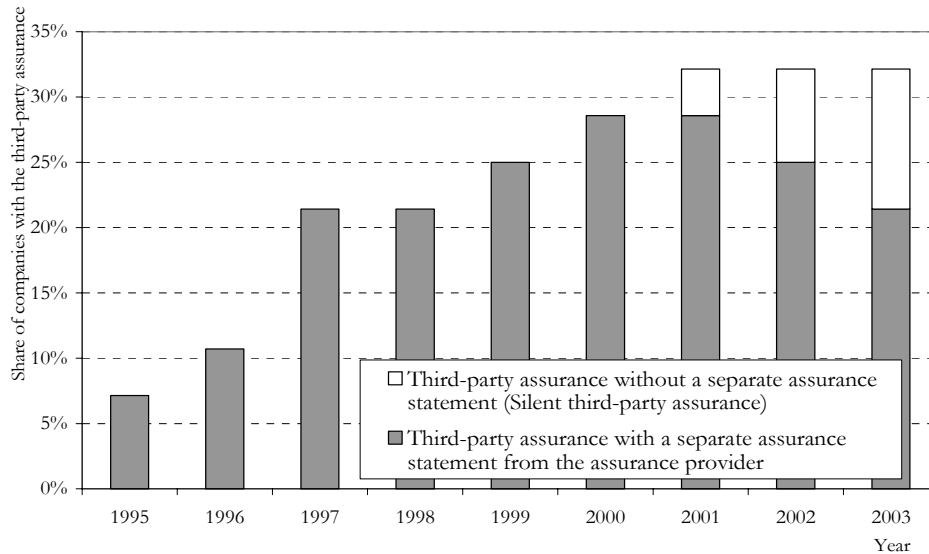


Figure 5-2 The general trend of third-party assurance in 28 Swedish companies interviewed

This figure is very close to the whole picture of Swedish assurance market. In 1995, KPMG began providing assurance on the corporate environmental report. Ernst & Young and Deloitte started selling this service in 1996, and 1997 respectively. Two market leaders, KPMG and Deloitte, signed off about 20 and 25 assurance statements respectively to date.

For the last few years, a new trend was observed. Three companies (Volvo, Scania, and Swedbank) claimed that they started having third-party assurance the moment they have integrated their standalone reports into the annual financial report. In those cases, external financial auditors audited the sustainability accounts (including various accounts such as environmental accounts, social accounts, etc.) in the annual report. But there was neither a separate statement concerning the sustainability part nor any lines in financial auditor's report indicating that sustainability part is audited. Therefore, it was impossible for users to know that the sustainability section of their annual report was audited. These cases can be named as "silent third-party assurance".

It is not always the case that environmental/sustainability report integrated with the annual report belongs to the silent third-party assurance. SKF and The SAS Group attach the separate assurance statement in the end of the sustainability section, although they produce one integrated publication. It reflects the level of ambition they had on the environmental/sustainability reports. All three companies with the silent third-party assurance had not experienced the third-party assurance on their standalone reports before the integration. To the contrary, other two companies having a separate assurance statement concerning the sustainability part had experienced the third-party assurance on stand-alone reports before the integration.

### 5.3.1.1 Why companies seek the third-party assurance

Most of companies said it was a purely internally-driven decision to have the third-party assurance. Two pioneers decided to have the third-party assurance in order to obtain the credibility that they deserve. They also perceived the third-party assurance as a natural step to maintain their position as a front runner in the environmental management.

Among followers, large companies were more interested in achieving better credibility. A few others were attracted to the improvement of internal system, not only the credibility gains. One could mention the link with the improvement of environmental performance; “It (third-party assurance) is to get the credibility to our environmental activities and environmental performance and also to improve the environmental performance by having a non-SCA people that can provide a good suggestion for improvement involved in the process” (Strategic analyst Resource Management System SCA, 2004, July 16). Smaller companies were especially interested in this link to any internal improvements by having external experts looking into their own system.

For the companies operating in the industry where public scrutiny is high, enhanced credibility was regarded as something they could see the tangible benefits. Two companies found it useful to have the third-party assured report when they were questioned by stakeholders. Take the airline industry as an example. There is a growing attention in their environmental implication, as the industry has been growing very fast. Therefore, it was perceived as more than necessary to have the reliable data examined by the third-party in case of public debate.

### 5.3.1.2 Managing the assurance process

Typical assurance process drawn from interviews is described in figure 5-3. Depending on the reporting organisations and assurance providers, the time span and the steps can be organised differently. Also the actual work behind each step would be varied greatly depending on the objective of the assurance, and the level of ambition from the reporting organisation as well as the assurance providers.

Table 5-1 summarises how critical elements of the third-party assurance were organised in 12 companies in the Assurance Group (see the chapter 2.2.2.3, for detailed description of key elements).<sup>28</sup> For most of companies it presents how they did in the latest assurance engagement although each company have experienced the development in their assurance practices over the years. If possible, the changes over time were described.

#### (1) The scope of assurance assignment

Immature underlying reporting systems and processes seem to have limited the scope of assignment. If the system is underdeveloped, it is questionable how far the assurance provider can go beyond the data and claims presented in the report.

ABB proved that through their experiences. ABB started publishing standalone environmental report since 1994. Their engagement with DNV has begun in 1997. During the early years, ABB asked DNV to focus more on what are relevant to report than the figures. It was because ABB were in the beginning of collecting the figures and establishing the reporting system. Now DNV is able to review the quality of figures and how ABB collected figures. For the last two years, DNV says in their statement that “we have found strong indications that the information presented in the Sustainability Review does give a balanced and accurate view of ABB’s sustainability performance”.

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<sup>28</sup> The information presented in the table is based on the information provided from interviewees as well as the assurance statements attached in the reports.



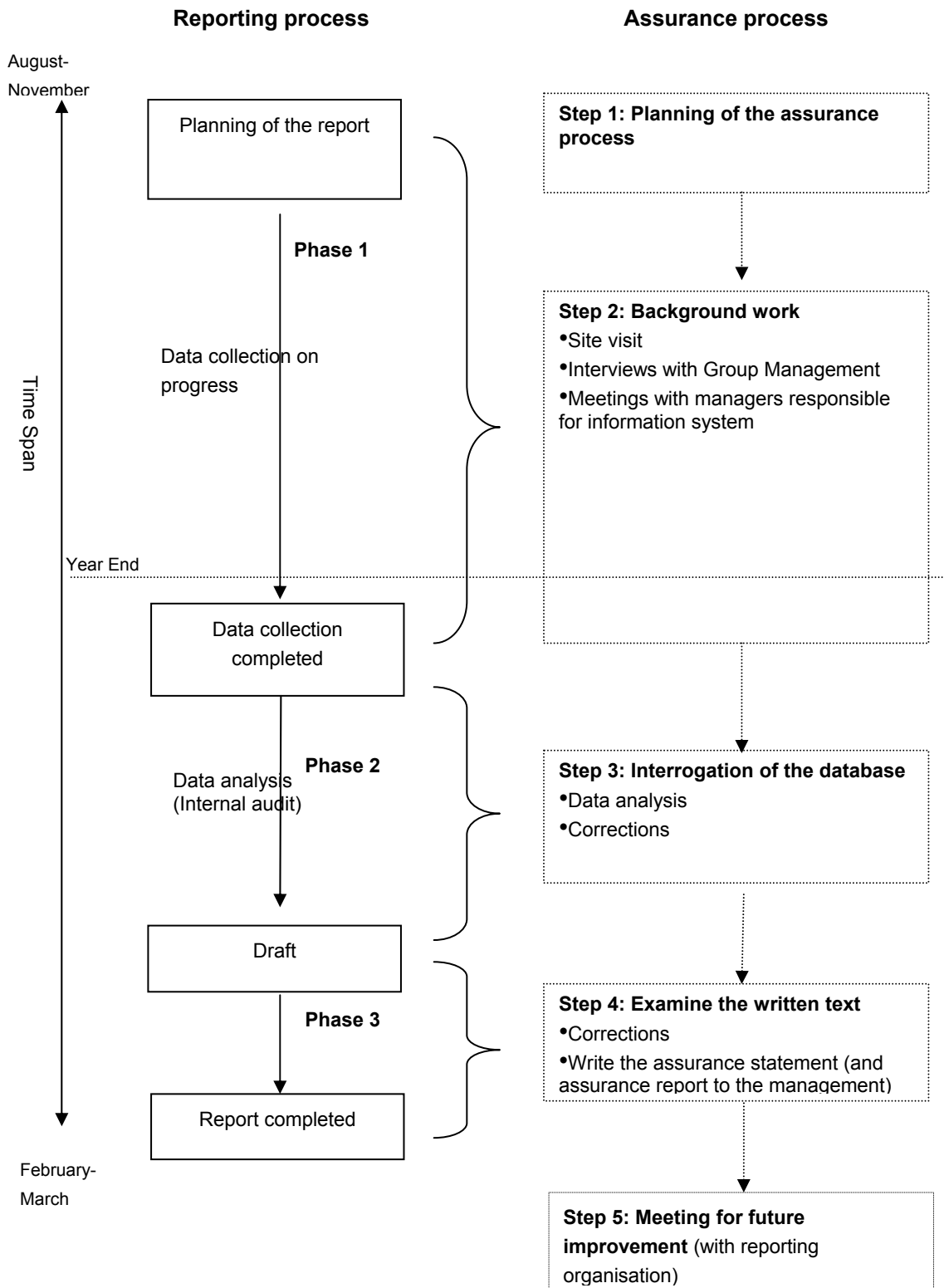


Figure 5-3 Example of how the assurance process would be along the timeline of reporting

Table 5-1 Third-party assurance practices from the Assurance Group

| Companies     | Years with assurance | Scope of the assurance (subject matter)  | Site visit | AP was involved from                | Meeting for improvement |
|---------------|----------------------|--|------------|-------------------------------------|-------------------------|
| Stora Enso    | 9 years              | Data and claims presented in the report except case studies<br>Review of systems and processes for data collection and analysis                                  | Yes        | phase 1 (Fall -)                    | Yes                     |
| ABB           | 7 years              | Changed over time (Seeing what to report → Review of data quality and system for data collection and analysis)   | Yes        | phase 2                             | Yes                     |
| The SAS Group | 7 years              | Data and claims presented in the report<br>Review of systems and processes for environmental data collection and analysis (excluding the social part)            | Yes        | phase 1 (Aug -)                     | Yes                     |
| SKF           | 6 years              | Data, claims, and case studies presented in the report<br>Review of systems and processes for data collection and analysis                                       | Yes        | phase 1 (Oct or Nov-)               | Yes                     |
| Swedish Meats | 6 years              | Data and claims presented in the report<br>Review of systems and processes for data collection and analysis  | Yes        | phase 1                             | Yes                     |
| SCA           | 5 years              | Environmental data and claims drawn from that data<br>Review of systems and processes for environmental data collection and analysis (excluding the social part) | Yes        | phase 1 (Nov or Dec-)               | Yes                     |
| Cerealia      | 5 years              | Data and claims presented in the report<br>Review of systems and processes for data collection and analysis  | Yes        | phase 1 (Sep or Oct)                | N.A.                    |
| Perstorp      | 3 years              | Data and claims presented in the report<br>Review of how the facts and numbers are handled in group level  | Yes        | phase 2                             | N.A.                    |
| Telia         | 2 years              | Data and claims presented in the report<br>Review of how the facts and numbers are handled in group level  | No         | phase 1                             | N.A.                    |
| Volvo         | 2 years              | Data and claims presented in the report<br>Review of how the facts and numbers are handled in group level  | No         | phase 1 (Nov -)                     | No                      |
| Swedbank      | 1 year               | Data and claims presented in the report<br>Review of an integration document made for collecting data in group level   | No         | phase 1 (most work done in phase 3) | Yes                     |
| Scania        | 3 years              | Data and claims presented in the report<br>Review of how the facts and numbers are handled, mostly in a group level. (sometimes the source of information)       | No         | phase 1 (most work done in phase 3) | No                      |

\*Phase 1: Planning of the report, Phase 2: after the data collection process completed, Phase 3: after the written text is made (see figure 5-3 for this classification)

It is prominent that even among the companies which have developed a firm line of environmental reporting the system for social data collection and analysis is insecure. Assurance engagement for SCA and The SAS Group is confined into the environmental part for that reason. This is another indication that there is nothing much to be done by assurance without underlying system for reporting.

Also, the low level of ambition limited the scope of assurance. In the case of silent third-party assurance, assurance providers mostly looked into how the reporting organisation handled the data at the group level. In this regard, it was the level of ambition rather than the maturity of system that limited the scope of assurance.

All in all, it was more of reporting organisation than the assurance provider who decided the scope of assignment; “We have such an excellent verification process with EMAS reporting and ISO14001. We don’t want to pay for any verification already done through environmental management system. So, we left out that part. But, we asked for them (the assurance provider) to look into the economy reporting related to the environment which is not covered in the EMAS and ISO14001. CSR issues in particular as well. We don’t have any similar third-party verified management system for CSR issues.” (Stora Enso Environment, 2004, August 3)

In only one case, it was explicitly mentioned that the assurance provider decided the scope of assignment enough to confirm the validity of the report.

## (2) Site visits

The reporting organisations perceived ‘site visits’ as important element indicating the rigor of the work given to the assurance. Many companies were confident about the calculations done in the group level. Therefore, it was deemed essential to go up to the reporting units and check how they produce the figures in order to drive any improvements in the quality of figures and avoid any mistakes.

However, how effective the random spot check would be questionable. Commonly the group headquarter informed the sites that the assurance provider would pay a visit there sooner or later, although the assurance provider selected the sites to inspect. One interviewee was ascertained that the rigor of site visits was not enough to find any mistakes.

## (3) Meeting for the improvement

The assurance has been a learning exercise between the reporting organisation and the assurance provider. The assurance team write the assurance report, not only the assurance statement appearing in the report, to the management of reporting organisation. In most of cases there is a meeting between the assurance provider and reporting organisation where they discuss about the improvement to be made for the next year after publishing the report for current year (as shown in table 5-1).

## (4) Silent third-party assurance

Silent third-party assurance cases appear to be fairly different from other third-party assurance practices. None of the silent third-party assurance cases included the interrogation of reporting system and the site visits as part of the assurance process. There was typically no meeting arranged for the discussion with the assurance provider on what to improve next

year. Two interviewees from silent third-party assurance cases were in doubt why the assurance provider would have to make a recommendation for the future improvement of underlying system.

(5) Approaches used by the assurance providers

Last year there were only six separate assurance statements published from Assurance Group. All the assurance providers looked at the accuracy of the report, i.e. if the things are right in the report, through random spot checks and review of information system for data collection and analysis as shown in table 5-1.

Table 5-2 Benchmarking assurance practices from six companies from Assurance Group

| Company       | Assurance Provider | Standards governing the assurance work | Reporting criteria used by the company | What AP did to see if right things are in the report |   |  |
|---------------|--------------------|--|--|--|---|--|
|               |                    |  |  | Review against the reporting criteria                | Review company's own reporting principles | Others   |
| Stora Enso    | CSR Network        | AA1000 AS                              | GRI**                                  | No   | —   | Web-based limited research of the views of stakeholder groups done by university professor   |
| ABB           | DNV Consulting     | None                                   | GRI                                    | Yes  | —   | —  |
| The SAS Group | Deloitte           | FAR's draft standard*                  | Reporting principle by SAS             | Yes  | Yes                                       | Review of information of the scope and limitations of the content of the sustainability report   |
| SKF           | Deloitte           | FAR's draft standard                   | GRI                                    | Yes  | Yes                                       | Review of information of the scope and limitations of the content of the sustainability report   |
| SCA           | Deloitte           | FAR's draft standard                   | Reporting principle by SCA             | Yes  | Yes                                       | Review of the scope and limitations of the content of information  |
| Cerealia      | KPMG               | FAR's draft standard                   | Reporting criteria by Cerealia         | Yes  | Yes                                       | A holistic assessment of the environmental report's relevance, based on an analysis of the business's significant environmental impact and its environmental risks |

\*FAR's draft standard on independent limited reviews of voluntary separate sustainability reports

\*\*2002 GRI Sustainability Reporting Guidelines

Since virtually all the assurance providers active in Sweden belong to the accountancy, FAR is leading the development in this field. Recently FAR proposed the recommendation on how to provide an assurance on standalone environmental/sustainability report (titled Oberoende översiktig granskning av frivillig separat hållbarhetsredovisning). Around this standard, methodologies and approaches in Sweden are getting harmonised (see table 5-2).

In the communication of the assurance work, there was a difference between the accountancy and consultancy. Consultancies wrote the commendation on what reporting organisation has done in current year and recommendation for future reporting and management in the assurance statement.

Table 5-2 provides an overview on how the assurance providers look at the completeness of the report i.e. if all material issues are included in the report. Five assurance providers made a review against the reporting criteria. If the report was made against the accounting principles created by the reporting organisation, the assurance provider reviewed that accounting principle as well. But in the end, the assurance provider made rather a short conclusion confirming that the report was prepared against aforementioned criteria. Only one assurance provider made a reference to their research on stakeholder views and made a conclusion on the completeness of the report.

Judging the completeness of the report is not an easy task. One assurance provider commented that the most difficult part of the assurance on environmental/sustainability accounts would be to find out the information which is not disclosed but should be disclosed. There is a need for the assurance provider to develop their audit techniques on how to find the omitted information. Other difficulties mentioned by the assurance providers were poor documentation at the reporting organisation which makes the assurance process very time-consuming and premature reporting system lacking the reporting criteria and accounting principles.

### **5.3.1.3 Cost and benefits of the third-party assurance perceived by companies**

Since the scope of assignment and the level of ambition would be different case by case, resources spent are varied in each assurance engagement. The available information from seven companies indicated that the fee paid to the assurance provider would be ranged from 100 000 SEK up to 1 MSEK. Estimation of total cost was not possible for most of companies, since they did not know how much time they spent internally due to the third-party assurance. One company estimated that third-party assurance involved 8-10 man-days of internal work in addition. Including the fee paid to the assurance provider, the total cost of the third-party assurance was about 200 000 MSEK.

About 75% of companies in Assurance Group perceived that the third-party assurance did not involve any difficulties along the process. It was found that companies took very positive stance towards any difficulties incurred during the process. Some believed that any difficulties (e.g. when the assurance provider demand for better internal system and more specific documentation) were necessary to strengthen their reporting system. Therefore, they did not want to name those as difficulties; “Some mills were not used to be questioned by the external party and have had difficulties in understanding what the assurance provider is really looking for. However, when the assurance provider completed analysis, we could notice that those mills once having had problems improved their routines. This is the benefit for our company” (Strategic analyst Resource Management System SCA, 2004, July 16)

Only three companies could point out following difficulties; providing documentation to support the figures, tight schedule for reporting, and time-consuming to be available for the assurance provider and help them to find their way to internal system. Judging these together with the claims from the assurance provider, the premature reporting system is really a hindrance to make assurance process more efficient.

Most of companies except the silent third-party assurance cases agreed that the report from assurance provider and the follow-up meeting have been a strong driver for internal improvement. The most frequently mentioned example of the improvement concerned the development of underlying system and processes (see table 5-3).

Table 5-3 Where did the assurance provider help you most? (13 examples from 9 companies)

| Examples of internal improvement driven by the third-party assurance  | Number of answers |
|---|-------------------|
| Improve underlying system and processes <ul style="list-style-type: none"> <li>• Development of some of Key Performance Indicators (KPIs) and eco-efficiency index</li> <li>• Structuring the documentation regarding the various legal requirements</li> <li>• Improvement of system and processes for the data collection from different reporting units</li> </ul> | 5                 |
| Create more respect for the process and the area of reporting concerned   | 3                 |
| Advice on what to report/where to focus   | 2                 |
| Improve the presentation of the report <ul style="list-style-type: none"> <li>• Clear description on estimated figures</li> <li>• Improve the comparability of indicators over time</li> </ul>  | 2                 |
| Help the company to elicit the stakeholder opinions by providing stakeholder dialogue   | 1                 |
| Total   | 13                |

It can be proven by the fact that the companies working with the third-party assurance for a long time are able to get their “systems and processes” for data collection and analysis examined by the assurance provider to dates. Another significant impact of third-party assurance was that it created more internal respect for the process and the area of reporting concerned.

#### 5.3.1.4 Relationship with the assurance provider

Nine companies appointed their group financial auditing firm as an assurance provider. Companies tend to go for the financial auditing firm asking for this service. It coincides with the claims made by the accountancies interviewed. All accountancies claimed that reporting organisation came to them to ask for the assurance on environmental/sustainability report. The accountancies did not persuade any companies to buy their service. This is a clear advantage of the accountancy over other assurance providers such as consultancy.

Stora Enso which used to work with their financial auditing firm for a long time organised the tender process last year. As a result, UK based consultancy, CSR Network, was appointed as an assurance provider. It is very rare to change the assurance provider in that way. Overall there were only two more companies who changed the assurance provider during the period (see table 5-4). In the case of SKF, they switched to group financial auditor Deloitte upon the integration of sustainability report with the annual report. In another case, SCA selected Deloitte over the independent expert since they needed more structured approach to examine such a big reporting system they have in SCA. Compared to the financial reporting where companies change their auditor after a number of years, this relationship between the assurance providers and reporting organisations appears to be quite stable.

Table 5-4 Relationship with the assurance provider

| Companies               | Assurance Provider  |
|-------------------------|---|
| Stora Enso              | CSR Network (2003) PricewaterhouseCoopers Finland (1998-2002)<br>KPMG (1995-1997) |
| ABB                     | DNV (1997-2003)   |
| The SAS Group           | Deloitte (1997-2003)  |
| SKF                     | Deloitte (2002-2003) LRQA (1998-2001)   |
| Swedish Meats           | KPMG (1997-2002)  |
| SCA                     | Deloitte (2000-2003) Christine Jash (1999) <sup>29</sup>                          |
| Cerealia                | KPMG (1999-2003)  |
| Perstorp                | Ernst & Young (1995-1997)   |
| Telia Sonera (as Telia) | Ernst & Young (2000-2001)   |
| Volvo                   | PricewaterhouseCoopers (2002-2003)  |
| Swedbank                | Deloitte (2003)   |
| Scania                  | KPMG (2001-2003)  |

Possible explanation is the industry-specific, even company-specific, nature of the environmental/sustainability report requires some time for the assurance provider to learn about the reporting organisation. This adds the cost burden to the reporting organisation; “In the first year of assurance engagement, our assurance provider was very focused on the exact details on emission figures such as carbon dioxides data. Over the time they realised what would be the focus here. This is the case with other assurance providers. Often, they do not have the real understanding of what is important in a certain company. They need to go through the learning process. In this regard it is not easy to replace the current assurance provider with other assurance providers. If we have a new assurance provider, we will have to pay the new one for few years to learn about our business.”

Most of all companies have been very comfortable with the relationship they had with their assurance provider. When questioned if they have any suggestions to their assurance providers on what to improve in the process of assurance providers, interviewees expressed the high level of satisfaction with their assurance provider as follows.

We have a mutual understanding on each other. I think throughout the discussions with each other, both of us learned a lot about sustainability reporting.

We had a long relationship with our assurance provider. They know about us very well, which makes the assurance process easy. We have not organised any bidding process during the years.

Only two companies were able to raise some suggestions to the assurance provider such as; assurance provider should learn a lot more about the industry as well as processes and conditions specific to the company and they should improve the communication of the result to report readers.

<sup>29</sup> Independent expert from Institute for Environmental Management and Economics (Austria)

### **5.3.1.5 Continue in the future?**

Most of companies in Assurance Group were very convinced of the value of the assurance. All of nine companies which had the third-party assurance in the last year will continue with the assurance in following years, although some elements would be changed (e.g. the adoption of the AA1000 AS, the change in the assurance provider, etc.).

Among other three companies which did not commission the third-party assurance in the last year, two companies would consider resuming it when they have better financial situation and when they are listed on the stock exchange again. Another company is not likely to have it since they do not have any plan to disclose more sustainability information in the near future.

### **5.3.2 Opinions on the third-party assurance (Non-Assurance Group)**

The responses from 16 companies which have not commissioned the third-party assurance on environmental/sustainability reports are presented and analysed here.

#### **5.3.2.1 Why companies do not seek the third-party assurance**

Like many other business decisions, the companies would not get the third-party assurance unless they think they would get more benefits than the cost. When asked “why you have not commissioned the third-party assurance on the environmental/sustainability report,” most of responses could be summarised that “it is too expensive (compared to the value),” “it does not add much value (compared to the cost),” which are two sides of the same coin. Based on where the emphasis of each argument was placed, four types of argument could be identified (shown in figure 5-4).

(1) The fee to the assurance provider is too high

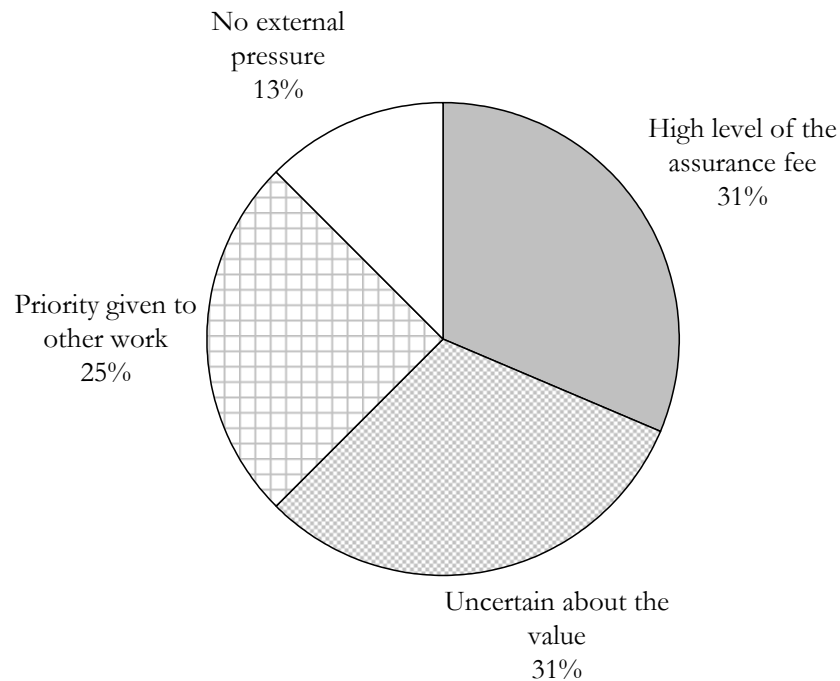
The companies using this argument have many things in common. They are not listed on the stock exchange, while having a close tie with owners. Since the owners have thorough knowledge about the company, they would not need any report in public scrutinised by the third-party. Four of them operate only in Sweden or in Scandinavia. They do not see any lack of trust on themselves.

Since they are smaller than other companies, there is a clear resource constraint to commission the third-party assurance. According to the offers they got from accountancies or consultancies, the fee paid to the assurance provider was too a large portion of the reporting budget for company of this size. For one company the fee was ten fold to the cost of producing the report. For other two companies the fee was estimated as one third or fourth of the reporting budget.

There is only one company which is likely to commission the third-party assurance in a foreseeable future. Despite of high cost, they would like to have the third-party assurance as a project to know how to make a good sustainability report and how to integrate all different system into one sustainability system.



Figure 5-4 Four types of arguments used by the Non-Assurance Group of companies (Total: 16 companies)



(2) Under the current setting, the third-party assurance cannot add any value to the report

Companies with this argument are sceptical about any value to be added by the third-party assurance. Since they all have a long experience in environmental/sustainability reporting (average 10 years), they have confidence in their report and underlying processes. Four of them have checked with an assurance provider so they know the resources necessary for the third-party assurance and assurance processes they would have to go through. This group of companies demonstrate that the credibility and expectation gaps partly hindered the diffusion of the third-party assurance.

There are many doubts raised by this group of companies. One of them concerns how assurance providers currently active in the field can add credibility on the report. One company commented that third-party assurance has been ruled by the interests of accountancy or consultancy running after the money.

Other three companies see the third-party assurance as a double (or triple) checking of the data which are already quite trustworthy and under control by other measures taken by them. They have done a lot of work internally to improve the reporting system, sometimes with a help of external auditors (who belong to the same company providing the assurance on the environmental/sustainability report). They are scrutinised regularly by authorities and by other certification audits. All of those experiences have given them quite a confidence on the figures they produce.

Another argument from this group is that reporting organisation knows much better than the assurance provider about what would be behind different numbers and how reliable those numbers are. If assurance is needed only to gain the credibility from the users, there are numerous alternatives to increase the credibility. Responding heartfully to any doubts from readers would be one way of that kind.

Nevertheless, it is interesting that two of them are likely to have the third-party assurance in the near future. One company will work with the assurance provider who claimed that they could do much more than double-checking the data. Another one will have this assurance in the near future to lift up their brand value in Nordic market with possible changes in their names. In addition, another company is closely monitoring the trend in the sector and contemplating the way to go.

(3) There are many things to be done before the third-party assurance

Companies with this argument have either relatively a short history of reporting or struggle alone in the sector where environmental/sustainability report is not common at all. Since their system is still evolving, they think that the third-party assurance is not up in the agenda for the time being; “For us it is more important to develop the systems for gathering and evaluating a relevant data, in other words to have a broader database, rather than to focus on verifying a few data we may have down to the last decimal point. Especially in the outside of the environment, we see that it is more important to develop procedures and data rather than go down to the path towards verification.”

They know little about the third-party assurance. Two of them did not know what kind of process they have to go through to get the third-party assurance. The other two had more detailed knowledge, since they had checked with the group financial auditors. But all of them did not have any estimation on how much they will have to pay to the assurance provider.

For the future, the most experienced reporting organisation within this group has a plan to seek the third-party assurance on their environmental report. Other three companies had no plan to seek the third-party assurance in the near future.

(4) There is no pressuring need for us to commission the third-party assurance

Companies with this argument think the third-party assurance is only needed for the large multinational company. They did not even discuss about this seriously internally.

### **5.3.2.2 Measures being taken to assure the credibility of the report and to be sure material information is not missing**

Companies are further questioned about measures taken to increase the credibility of report and to be sure that material information is not missing from the report. 18 answers provided are categorised as shown in table 5-5.

Since it is also the interest of reporting organisation to have the quality in figures, companies mentioned that there had been measures in place such as internal audits. Increasing the comparability of the figures would help them to look at if there is any abnormal deviation in the figures. Many interviewees believed that regular check from authorities and frequent external certification audits would assure that things are going right in their company.

However, in fact, certification audits as well as the check from authorities are not necessarily related to things are right in the report. For example, it is not always the case that certification audit would go through the figures in public reports (except EMAS); “The reporting is organised in the EMS system (ISO14001), but it still needs a lot of phone-calls, running around the different plants, and looking at different logbooks. Some of the managers do not report the data as they should do” (Miljöchef Recip, 2004, August 5)

*Table 5-5 Measures taken to increase the credibility of the report and to be sure that material information is not missing in the report (18 answers from 14 companies)*

| Measures taken  | Number of Answers |
|---|-------------------|
| Internal quality control on the figures (including internal audit)          | 6                 |
| The judgement from reporting organisation                                   | 3                 |
| Scrutiny from the authority   | 2                 |
| Improve the basis of reporting constantly with external certification audit | 3                 |
| Work with external people (experts, student) to improve reporting processes | 2                 |
| Strictly follow the GRI guideline   | 1                 |
| Increase the responsiveness to stakeholder inputs                           | 1                 |
| Total   | 18                |

There seem to have been a lack of the measures which can be used for making sure that material information are not missing in the report. Only a few answers presented in the table 5-5 could be relevant for that purpose; following GRI guideline, and increase the responsiveness to stakeholder inputs.

One company claimed that reporting based on the issues regulated by law would assure that they report on all material environmental impact of their operation. Also it is rare that stakeholders give a comment on what they want to see more from the report; “I was responsible for eight environmental reports. This issue that some important issues are missing in the report has never been raised to me.” (excerpt from the interview)

Considering there are not many reporting organisations actively seeking the feedback, it would be fairly true that companies report on what they want to report, based on their own judgement. Half of the companies in the Non-Assurance Group mentioned in the report that the report is prepared based on GRI guideline. But, only one company provided a CRI Content Index.<sup>30</sup>

### **5.3.3 Future perspectives on the third-party assurance**

There were quite different expectations between Assurance Group and Non-Assurance Group for the future of the third-party assurance. Assurance Group thought more positively towards the possibility that third-party assurance would become a common practice. One interviewee even said, “Among the multinational companies, the third-party assurance is already a common practice.”

However, including Non-Assurance Group overall 61% of interviewees thought that third-party assurance would not be the common practices in the near future (see table 5-7). Sceptical interviewees highlighted that there were many companies not publishing standalone report or any kind of integrated publication. Some thought that companies would not have the third-party assurance just for the credibility gains due to the high cost.

<sup>30</sup> A table identifying the location of each element of the GRI Report Content, by section and indicator. If the report does not have a content index, it cannot be regarded as the report “in accordance with guideline” (see further explanation: <http://www.globalreporting.org/>).

Table 5-6 Do you think third-party assurance would be the common practice in the near future?

| Answers            | Non-Assurance Group |      | Assurance Group |      | Total |      |
|--------------------|---------------------|------|-----------------|------|-------|------|
|                    |                     |      |                 |      |       |      |
| Yes                | 4                   | 25%  | 7               | 58%  | 11    | 39%  |
| Yes in a long term | 3                   | 19%  | 2               | 17%  | 5     | 18%  |
| No                 | 9                   | 56%  | 3               | 25%  | 12    | 43%  |
|                    | 16                  | 100% | 12              | 100% | 28    | 100% |

So far there was no regulatory push in the third-party assurance. According to the group interviewed, the possibility of regulatory push is not very high. Only 11% of interviewees thought that there would be a direct regulation on the third-party assurance in the near future (see table 5-7). Interviewees generally saw the development in this field continue to be driven by voluntary practices.

Table 5-7 Do you think regulation require the third-party assurance mandatory in the near future?

| Answers            | Non-Assurance Group |      | Assurance Group |      | Total |      |
|--------------------|---------------------|------|-----------------|------|-------|------|
|                    |                     |      |                 |      |       |      |
| Yes                | 1                   | 6%   | 2               | 17%  | 3     | 11%  |
| Yes in a long term | 6                   | 38%  | 1               | 8%   | 7     | 25%  |
| No                 | 8                   | 50%  | 8               | 67%  | 16    | 57%  |
| Do not know        | 1                   | 6%   | 1               | 8%   | 2     | 7%   |
|                    | 16                  | 100% | 12              | 100% | 28    | 100% |

It seems that companies from Assurance Group moved down to this path, although they did not expect any kind of regulation in the future. Assurance group was slightly more pessimistic towards the possibility of regulation. 67% of assurance group thought there would not be any regulation in the near future, 17%p higher than non-assurance group.

However some interviewees could foresee that the regulation on the reporting itself would influence the growth in the third-party assurance. Suppose there is a regulation on what the report should be, it is more likely that the third-party assurance will be the common practice. Companies are closely monitoring the situation on the possibility of EU regulation after NRE decree in France (see chapter 2.2.1). On the other hand, other interviewees thought that it would be difficult to lay down the common regulation on what to report in this area, especially environmental reporting, since the indicators are quite industry-specific contrary to the financial reporting.

Among factors mentioned as drivers for the third-party assurance are;

- Any media cases where large companies cheated with their reports;
- Pressure from companies in the same sector or the front runners having the third-party assurance already;
- Financial auditing firms moving into the third-party assurance market;
- Integration of the environmental/sustainability report into the annual report;
- A regulation as it does for financial reporting; and
- Stock market regulator’s requirement for the listed companies.

Assurance providers interviewed were uncertain about any possibilities with regulation, although three of them thought the third-party assurance will increase in the future. Spin-off

effects from the regulation calling for companies to report on new performance area were also mentioned as a driver for the development in the third-party assurance.

## **5.4 Stakeholder involvement in the third-party assurance**

To set the right context for questioning stakeholder involvement in the third-party assurance, each interviewee was questioned first about the relationship between his or her company and stakeholders. Then different types of stakeholder involvement in the assurance were suggested to the interviewees to draw their preferences. Possibilities and limitations resided in the stakeholder involvement in the assurance were addressed with the question regarding the assurance provider. Since the questions were hypothetical, it should be noted that the opinions on the stakeholder involvement in the assurance would represent the personal view of interviewees not the official view from the companies.

### **5.4.1 Where companies seek the stakeholder opinions**

All the companies in the sample have been proactive in providing the information, since they have been publishing the environmental/sustainability reports annually. In most of companies the report functions as a central organ for communicating their environmental/sustainability management performance and future plans to stakeholders. As an attempt to make it as a two-way communication channel, many companies have made use of various means such as a contact card, interactive CD-Rom, a list of contacts, etc., inviting readers to write them a feedback. But no interviewees thought they got enough feedback from report users so far. Few interviewees even felt that the feedback has been gone down during the recent years. A little feedback they might have was not so negative.

However, companies are not searching for the feedback actively, either. Seven interviewees were able to provide where they actively sought the feedback from report users; GRI sectoral initiatives where they discuss about sector-specific reporting guidelines, various survey (employee survey, consumer perception survey, stakeholder survey etc.), meetings with stakeholders and dialogue with SRI funds analysts.

Stakeholder dialogue is largely carried out in an informal fashion along the meetings. When asked to provide examples where they seek stakeholder opinions regarding environmental/sustainability management, it turned out that companies make best out of established dialogue occasions such as various formal or informal meetings. Two companies occasionally carried out the stakeholder survey. Three companies had an ongoing partnership project with NGOs. A few companies begin investigating how they can perform the stakeholder dialogues in more structured fashion. It was obvious that other companies did not have a high ambition for stakeholder involvement.

Difficulties in stakeholder dialogue have been observed in some occasions. Following points were raised by interviewees.

- Organising stakeholder dialogues require some resources.
- Stakeholder dialogue is not a balanced representation of the reality (like voting)
- Stakeholders are afraid of open communication in some cases.
- Some stakeholders do not want to keep the relationship with the companies.

- Some stakeholders lack the resources to participate in the dialogue. They asked the company to cover their expenses.
- There is a disparity between what stakeholders tell companies to do and what they actually do.
- Some stakeholders have very specific interests. It is impossible to please them.
- One opinion can be in contradiction with another one from someone else.
- The concept of stakeholder dialogue is not well acknowledged in the business organisations. It is hard to get the internal support sometimes.

## 5.4.2 Stakeholder involvement in the assurance- The view from reporting organisations

In the Assurance Group, there was one case of involving stakeholders in the assurance. In one case, the assurance provider organised several stakeholder dialogues with and without the reporting organisation. The reporting organisation highly appreciated those dialogues.

### 5.4.2.1 Will stakeholder involvement increase the value of assurance?

When questioned if stakeholder involvement would increase the value of assurance for reporting organisation, half of interviewees said ‘yes’ (see table 5-9).

Table 5-8 *Would stakeholder involvement increase the value of third-party assurance for your organisation?*

| Answers                                  | Non Assurance group |      | Assurance group |      | Total |      |
|--|---------------------|------|-----------------|------|-------|------|
| Yes                                      | 9                   | 56%  | 5               | 42%  | 14    | 50%  |
| Partly yes                               | 1                   | 6%   | 1               | 8%   | 2     | 7%   |
| No                                       | 2                   | 13%  | 5               | 42%  | 7     | 25%  |
| Do not see the value of assurance itself | 4                   | 25%  | 0               | 0%   | 4     | 14%  |
| Do not know                              | 0                   | 0%   | 1               | 8%   | 1     | 4%   |
|  | 16                  | 100% | 12              | 100% | 28    | 100% |

As shown in table 5-9, Non-Assurance Group was slightly more positive to this idea than the Assurance group. Four interviewees from Non-Assurance group were hesitant to say yes to this idea because they were not sure of the value of assurance itself.

Interviewees expected that involving stakeholders in the assurance would intensify their relationship with stakeholders as well as changing the nature of assurance exercise. These are the list of reasons why stakeholder involvement would increase the value of assurance.

- Stakeholder involvement in the assurance would add more credibility to the report.
- It would help the reporting organisation to challenge its own perspective.
- It would be needed to check if the figures reported are relevant.
- It would be another way to get in touch with stakeholders.
- It can be one way of engaging stakeholders in a systematic way.
- It would change the nature of assurance from tick-box exercise to the relationship building exercise.

### 5.4.2.2 Preference to the different types of stakeholder involvement

When it comes to the question on how they would involve stakeholders in the assurance,<sup>31</sup> 52% of interviewees wanted traditional assurance provider such as accountancy and consultancy to be the mediator (see figure 5-5).

Half of the interviewees preferred type 1 made their choice because they thought the traditional assurance provider would be needed to control the assurance process. According to them, stakeholders alone are not able to provide an assurance on the report because they do not often have a balanced view of the company. They would need somebody who can give a balanced feedback such as a traditional assurance provider.

Two interviewees clearly pointed out stakeholder dialogues carried out as part of the assurance process by the assurance provider would have an additional value. They appreciated the independent role of assurance providers between the company and stakeholders; “If we have an assurance provider, they may have an independent role (between the reporting organisation and stakeholders) and it might make it easier to get the right answers from stakeholders.” (excerpt from the interview) One company which experienced this type of assurance for years had a same view about the stakeholder dialogues organised by the assurance provider.

Interviewees preferred type 2 took it important to have different perspectives running the assurance. If they engage the independent experts or NGOs to provide an assurance, they would get the additional input which cannot be provided by assurance provider.

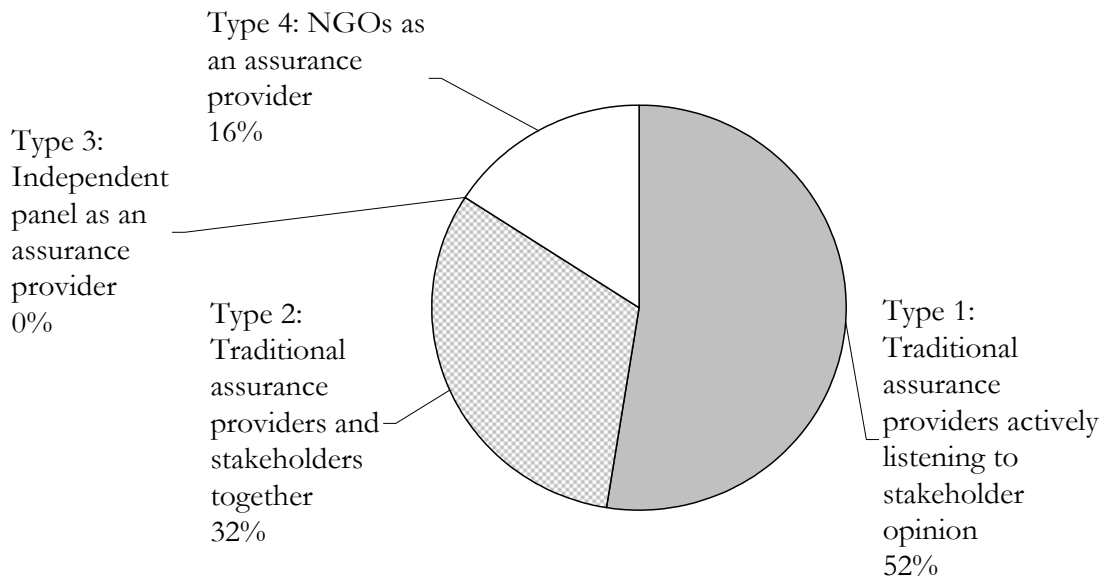


Figure 5-5 What type of stakeholder involvement would describe your organisation best? (total: 19 answers from 17 interviewees)

<sup>31</sup> Interviewees were suggested with four different types of stakeholder involvement identified in leading-edge case studies (as presented in table 4-7, detailed description in each type of stakeholder involvement can be found in chapter 4.3).

No interviewees preferred the independent panel as an assurance provider. Two out of three interviewees preferred NGOs as an assurance provider had a strong distrust towards what consultancies and accountancies are doing currently. These interviewees commonly had a very positive picture of NGOs (see the next section for further discussion regarding the independent panel and NGOs as an assurance provider).

The potential benefits and difficulties engaged in each type of stakeholder involvement mentioned by interviewees are summarised with a table below. It shows the different expectations attached to the different model of stakeholder involvement.

*Table 5-9 Benefits and difficulties from different types of stakeholder involvement foreseen by interviewees*

|  | Potential benefits   | Potential difficulties  |
|--|--|---|
| <b>Type1</b><br>Traditional assurance providers actively listening to stakeholder opinions | Possible to obtain the balanced review of stakeholder concerns   | Require more resources to do it (time consuming)  |
|  | Demonstrate a good will by going out and asking about the company  | Same difficulties when engaging stakeholders in other occasions   |
|  | Help the reporting organisation to focus on the relevant issues.   | To make sure the assurance provider has a capability to do it   |
|  | Create the active relationship with stakeholders   | Hard to get the input from stakeholders regarding the report  |
|  | The assurance provider would make it easier to get the right answers from stakeholders.  |   |
| <b>Type 2</b><br>Traditional assurance providers and stakeholders together                 | Run the assurance process with two different perspectives  | Keep them in the separate process.  |
|  | Depends on who you engage as a stakeholder: specialists will bring additional knowledge, NGOs will look at the grey zones of the company |   |
|  | Enhanced credibility   |   |
| <b>Type3</b><br>Independent panel  | Not mentioned  | Not mentioned   |
| <b>Type 4</b><br>NGOs as an assurance provider   | Maintain the relationship with one of the important stakeholders and an opinion makers   | Find right NGOs as an assurance provider (They will have to be willing to cooperate, big and structured with a global network, and have an agenda relevant to the issues) |
|  | They are competent to cover the global issues.   |   |
|  | Drive the improvement of actual performance  | The process would be political  |

As one can notice from the table, the choice regarding the stakeholder involvement in the assurance would be very much dependent on who will be the assurance provider. Again, interviewees were questioned concerning their preference to different type of assurance provider.



### 5.4.2.3 Preference to different types of assurance provider

One important factor affecting the choice of assurance provider would be the “competencies.” Open-end format question regarding the competencies of the assurance provider was given to the interviewees before the talk of different assurance providers. A wide range of answers were received (see table 5-11).

*Table 5-10 What kind of competencies would be necessary to provide assurance on environmental/sustainability report? (total: 35 answers from 24 interviewees)*

| Competency necessary to provide the third-party assurance                    | Number of answers |             |
|--|-------------------|-------------|
| Experiences in audits (financial auditing, EMS certification auditing, etc.) | 10                | 29%         |
| Knowledge on issues related with business and sustainability                 | 5                 | 14%         |
| Knowledge on major aspects of industry                                       | 7                 | 20%         |
| Knowledge on processes specific to the company                               | 4                 | 11%         |
| Business background  | 2                 | 6%          |
| Natural science background   | 2                 | 6%          |
| Knowledge on sustainability reporting  | 2                 | 6%          |
| Others   | 3                 | 9%          |
| <b>Total</b>   | <b>35</b>         | <b>100%</b> |

Only one third of the interviewees pointed out the audit experiences as part of the competencies necessary to provide an assurance on the environmental/sustainability report. There were only five interviewees who thought that audit experiences alone would be enough to provide the third-party assurance. Interviewees perceived the meaning of the audit experiences differently. For one, audit experiences would mean the ability to find a balance among various issues although he or she may not know about the issues very well. But for others audit experience alone would not be enough to find that balance. He or she should have a deep understanding of major social and environmental aspects of the company.

Four interviewees insisted that assurance providers should have a knowledge specific to their company. It would be needed to judge if the company chose the right KPIs and difficult issues are not avoided in the report. For this reason one interviewee criticised that the current third-party assurance practices appeared to be glossy. He doubted how closely assurance providers would have been able to examine the figures and the underlying system.

When it comes to the choice of the assurance provider, interviewees had a clear preference towards either accountancy or consultancy. Interviewees were questioned regarding their preferences among five different entities such as accountancy, consultancy, independent experts in specific subjects, an independent panel, and NGOs. Among them, accountancies was clearly on the lead (see table 5-12).

If we compare this with the previous result on competencies where only 29% of interviewees thought the auditing experience would be important, there are other factors making accountancy attractive as an assurance provider. The main reason to choose the accountancy is that the market perceives accountancies as independent although they get paid by the client. Their work is generally respected (by financial community), since they have been active in financial auditing for many years. Also, they may have competencies to complete this

assignment since they have a global coverage with a pool of expertise, and routines for auditing and capacities thereby to learn new things in emerging field such as environmental/sustainability reporting.

Table 5-11 Who would you most prefer as an assurance provider (Total: 29 answers from 27 interviewees)

|                                    | Assurance Group | Non-Assurance Group | Total |      |
|------------------------------------|-----------------|---------------------|-------|------|
|                                    |                 |                     |       |      |
| Accountancy                        | 62%             | 44%                 | 15    | 52%  |
| Consultancy                        | 23%             | 19%                 | 6     | 21%  |
| Independent experts                | 0%              | 6%                  | 1     | 3%   |
| Independent panel                  | 0%              | 0%                  | 0     | 0%   |
| NGOs                               | 8%              | 6%                  | 2     | 7%   |
| Difficult to answer, no preference | 8%              | 25%                 | 5     | 17%  |
|                                    |                 |                     | 29    | 100% |

This preference would be related with the trend in reporting. The environmental/sustainability report is increasingly integrated with the annual report. As financial community shows more interest in social and environmental performance of the companies, companies may well design their reports according to the expectations from the financial community.

Still, 21% of interviewees prefer the consultancy over the accountancy as an assurance provider. They expected that consultancies might have a deep understanding of issues and technical expertise. On the other hand, 13% of interviewees said they would never commission the third-party assurance to the consultancy due to the problem with credibility (see table 5-13).

Table 5-12 Who would you least prefer as an assurance provider (Total: 30 answers from 27 interviewees)

|                                    | Assurance Group | Non-Assurance Group | Total |      |
|------------------------------------|-----------------|---------------------|-------|------|
|                                    |                 |                     |       |      |
| Accountancy                        | 0%              | 0%                  | 0     | 0%   |
| Consultancy                        | 8%              | 18%                 | 4     | 13%  |
| Independent experts                | 8%              | 0%                  | 1     | 3%   |
| Independent panel                  | 0%              | 6%                  | 1     | 3%   |
| NGOs                               | 46%             | 18%                 | 9     | 30%  |
| Difficult to answer, no preference | 38%             | 59%                 | 15    | 50%  |
|                                    |                 |                     | 30    | 100% |

NGO was least preferred as an assurance provider. The least preferred entity as an assurance provider was NGO. In particular, 46% of interviewees from Assurance Group gave the lowest rank to NGOs. A variety of reasons were ranged from the problems with competencies to the role of NGOs in the society as follows;

- NGOs do not have competencies necessary to provide an assurance.
  - Many NGOs are limited in a very specific interest which is too narrow to cover the whole report.

- They will have feelings but not technical expertise necessary to provide an assurance.
- It is also questionable if they have special insights on corporate affairs.
- For global company it is difficult to answer who are the legitimate stakeholders for company and which NGOs should represent different stakeholders all over the world.
- NGOs have a different role to play in the society. In a long run, there is a possibility that NGOs can be perceived as corrupted and cannot play their own role any longer as an alarm watch in the society, if they work as assurance providers.
- NGOs cannot be trusted by all of our stakeholders.
- Our company is not mature enough to appoint NGOs as an assurance provider.

The argument that NGOs would have a different role to play in the society as an alarm watch is particularly interesting. It signals that some interviewees would rather see the assurance provider as the co-operator of the business, than as the independent commentator.

There were not enough interests about the independent panel and independent experts as an assurance provider. The penal was considered to be time-consuming. Competencies to check the figures up to the level of auditors and the credibility of their work were questioned by some companies. Others were afraid that the independency and the credibility of the panel and experts would be questioned, as long as they got appointed by the company.

Since many companies have not had any experiences with the assurance, half of interviewees were open to all different kinds of assurance providers (see table 5-13). Some could think of the possibility that NGOs and independent experts or panel can be used in a local level.

### **5.4.3 Stakeholder involvement in the assurance- The view from assurance providers**

Since many companies prefer to have traditional assurance providers in the assurance process, it seems important to listen to the opinion from assurance providers regarding how they see the value of involving stakeholders as well as how they would use the stakeholder input in their process.

Among four assurance providers questioned if they would see any need of making direct contacts with stakeholders along the assurance process, three of them were affirmative to the general idea.

So far, the main source of information in the assurance process has been the reporting organisation. The reporting organisations had to back up their claims with underlying documentation to have the data and claims in the report. Part of that evidence would concern how the client manages the relationship with stakeholders. In that regard, one interviewee could see the need of having a dialogue with stakeholders directly. “So far, we have not thought about it because we were in the stage of developing our methodologies and approaches in this area. For the future, this (actively listening to stakeholder opinions) would be something we should focus on.”

One interviewee acknowledged that they happened to contact the external stakeholders along the risk assessment process. Just like other accountancies, they make the risk assessment in the beginning of each engagement regarding what would be the material issues to be covered

for the clients. In that assessment stakeholder concerns are typically considered. It can be also the case that they contact the external stakeholders to know more about the client.

On the other hand, one interviewee said if they would keep the accountancy approach, the assurance provider should not seek any direct contacts with stakeholders due to the possible damage in the independence. She pointed it out as a main difference between AA1000 approach and the accountancy approach.

In general, there is an indication that the accountancies would be in favour of integrating financial auditing methodology based on risk assessment and random spot check more into the sustainability audit.

## 5.5 Conclusion

### 5.5.1 What are the opportunities as well as limitations with third-party assurance?

The development of the third-party assurance has been fairly slow but steady. Recently there seems to be no growth in the number of companies commissioning the third-party assurance on environmental/sustainability reports.

However, the result of the interviews shows that the incremental development will continue into upcoming years. More than half of companies expected that third-party assurance would be the common practice in the near future or in a long term. Three out of four assurance providers were ascertained that the third-party assurance would increase in the future. Some companies which used to be uncertain about the value of assurance said that they would give it a try in foreseeable future.

Based on the discussion with interviewees regarding the future perspectives, possible scenarios can be identified as follows:

- I. Incremental development through benchmarking best practices (Voluntary development).
- II. Development around the annual financial report backed by national legislation or stock market regulator's requirement (Regulatory push).
- III. In the aftermath of significant fraud cases, public pressure will be uprising and legislation would require mandatory the third-party assurance on the environmental /sustainability report (Public push).

The opportunities as well as limitations with the third-party assurance in each scenario are speculated here.

#### **Scenario 1: Voluntary development**

There is a desire to develop environmental/sustainability reporting like a financial reporting. Then third-party assurance is more than necessary. As reporting system as well as third-party assurance standards mature, the third-party assurance will become more wide-spread. It will be regarded as the added value in the beginning. Multinational companies will take up the

third-party assurance faster than others with leading the learning curve. Then in the end it can trickle down to companies under less pressure.

This scenario would mean an extension of the current situation. According to the interview, nine companies having the third-party assurance currently will definitely continue. Four from Non-Assurance Group, and two from Assurance Group are likely to have the third-party assurance in the near future. So it would be true that adoption of the third-party assurance would slowly increase for the future without any external push.

Under this situation, every reporting organisation would face lots of questions. Upon the lack of any regulation and generally accepted standard, it would be up to them how to answer those questions; “When should we start the third-party assurance?”, “When will our reporting system be mature enough to get the third-party assurance?”, “Does our company belong to that type of companies deadly in need of approval from the third-party?”, etc.

The high assignment fee would be the hindrance for many small companies to commission the third-party assurance. Available rough estimates provided by the interviewees show that there would have been many other factors than the size of the reporting organisation affecting the level of the fee to the assurance provider (see figure 5-6). Since the start-up cost is high, the fee cannot be lower than the certain level, according to the assurance provider interviewed.

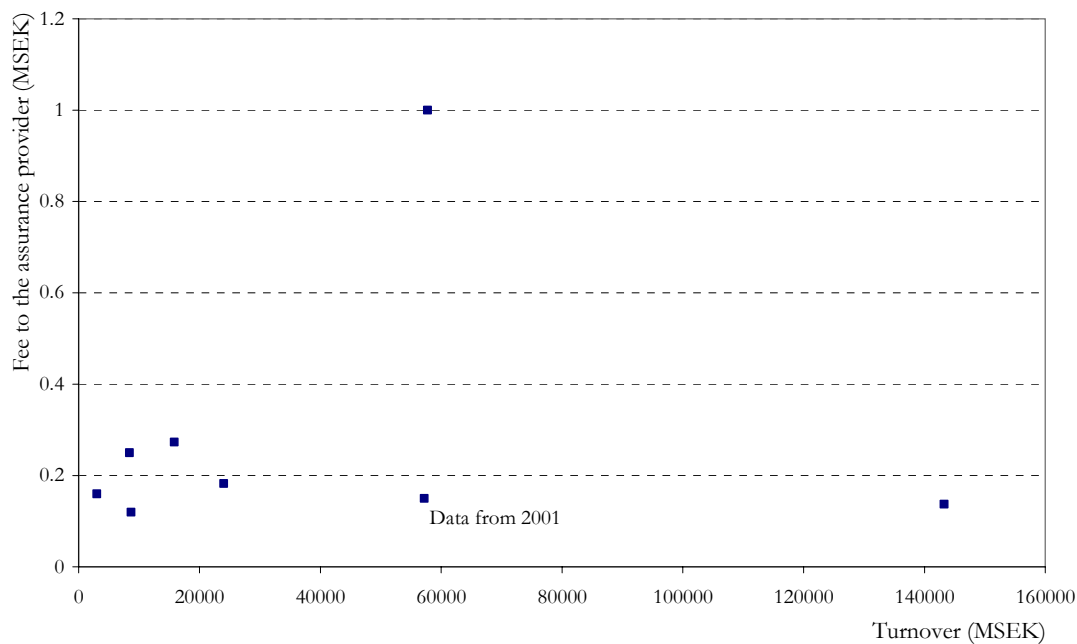


Figure 5-6 The rough estimate of the fee to be paid to the assurance provider (including offers proposed to the Non-Assurance Group, data from nine companies)

In many cases, the third-party assurance will start from environmental/sustainability accounts presented in the annual report. It was observed that a few companies in Non-Assurance Group already belongs to this case, i.e. their financial auditor examines the environmental information in the annual report while they do not get the assurance on the separate environmental/sustainability report. Since accountancies are increasingly getting

equipped with necessary skills, the audit on environmental/sustainability information in the annual report would increase in the future.

One trend prominent in this scenario would be that companies would like to see more internal benefits through the assurance. Then the tension between third-party assurance as an accountability process and as the management exercise will be inevitable. External stakeholders will be confused then if they would hail the increase of the third-party assurance or not.

### **Scenario 2: Regulatory push**

This is also the realistic scenario, considering the general trend shown in figure 5-1. More and more companies are integrating the standalone environmental/sustainability report into the annual financial report. If there is any regulation requiring more sustainability information in the annual report, integration will gain the momentum.

However, it is not always the case that all the integrated report is audited by external financial auditors. According to the interviews, five of 11 companies publishing the integrated report (environmental/sustainability report integrated with the annual report) claimed that their environmental/sustainability information was not audited; “Financial auditors did read all text in the Annual Report and regarding the environmental reporting they gave comments to text improvements and asked questions when the meaning was not obvious. However they did not verify the figures given or any claim regarding performance and so on, so it was not the third party assurance”(Head of Environmental Department Södra, [sodra.com](http://sodra.com)), 13 August 2004 #2122).

Therefore, the expectation that the integration will be the driving force of third-party assurance on environmental/sustainability information would not be completely true. Reporting organisations would have to declare more clearly which information in the annual report is examined by the auditor and how. Otherwise there would be some level of confusion to the report users. Also, in this scenario, how thoroughly financial auditors will look at the sustainability information should be questioned. It is likely that the rigor given to audit of sustainability information will not go further than the one appeared in “the silent third-party assurance cases” (see 5.3.1 for the definition).

### **Scenario 3: Public push**

This is rather a radical scenario. In the aftermath of significant case of fraud, the direct regulation on the third-party assurance could come into place. Even when there are no regulations, public distrust on the industry would then push the companies to adopt the third-party assurance. But, it would be questionable if the broken trust can be re-built easily by having the third-party assurance.

## **5.5.2 What are the opportunities as well as limitations with the stakeholder involvement in the assurance?**

Half of the interviewees could see the value of the stakeholder involvement in the third-party assurance. They anticipated that stakeholder involvement in the assurance would add a new dimension in the assurance by seeing relevant issues are in the report, enhance relationship and enable the systematic engagement with key stakeholders, and then generate credibility gains thereby. It turned out that many of reporting organisations would like to get closer to

the stakeholders. In addition, they want to get the assessment of the qualitative aspects of the report such as completeness from the stakeholders' perspectives.

But they did not want any radical change in the power structure. Majority of interviewees wished that the traditional assurance providers like accountancy could keep in touch with stakeholders or manage the assurance process together with stakeholders. Only three interviewees preferred NGOs alone as an assurance provider. Whereas, about half of companies said they would never commission NGOs as an assurance provider. No interviewee mentioned they would like to work with the independent panel for the assurance.

During the discussion with interviewees from the Assurance Group, there were five interviewees who were negative to this idea of involving stakeholders in the assurance. They provided interesting arguments reflecting what would be going on in reality with regard to reporting and stakeholder involvement.

In reality certain companies and stakeholders seem to have regarded the report as a formality, just one of the pamphlets produced by the company every year. One interviewee argued that it would be difficult to get the stakeholder inputs just "about the reporting". In this case, it would be more important to set up the improvement cycle around the accounting, auditing and reporting system first. The report should contain all important operating issues and could drive the improvement by showing the strength and weakness of the management of those.

Some of them said that reporting organisation is not ready to open the assurance process to stakeholders. Assurance providers are also not used to involve the stakeholders in their process, especially when they check the accuracy and reliability of data. Most of all, they think that stakeholders are not ready for it. One interviewee commented, "In practice, it is difficult to maintain the circle of consultation, act, and check with stakeholders. It would be difficult to use stakeholders as part of the regular management process such as auditing. Stakeholders do not want to take all the responsibility as part of our organisation. They would rather maintain their independence. We would use the stakeholder input as a broad input which we take into the consideration."

This argument raises the important question concerning where we should engage the stakeholders more, with a fundamental dilemma in stakeholder engagement such as "listening to stakeholders is one thing but making a decision responsible is another thing".

One interviewee raised the point that there is no such a thing like "stakeholder involvement" in financial auditing. He argued that the problem with financial auditing could not be impaired through the stakeholder involvement. The society is trying to solve it in many other ways, i.e. other legislations, increase the transparency in the reporting system, etc. But, he ignored the fact that in financial auditing shareholders and other owners of capital have had a channel to influence the selection of auditors and other settings in audits, which is completely different from what stakeholders have got for the sustainability auditing.

For the future, the opportunity for the stakeholder involvement in the assurance is that there is distrust on the traditional assurance providers and many interviewees were able to see any value added by the stakeholder involvement in the assurance. Even if it would be the low level of involvement via the traditional assurance provider as a mediator, there is an opportunity that stakeholders would have more regular channel to tell their views on the company.

Different opportunities will be given to the stakeholder involvement in the assurance under each scenario identified in previous section. Scenario 1 and 3 would be favourable towards the stakeholder involvement in the assurance. Some companies would involve stakeholders as an innovative approach to the assurance. It is highly uncertain that stakeholder involvement would occur in the assurance process under the scenario 2.



## **6 Conclusion**

### **6.1 Introduction**

Based on the literature review, this study started from the accusation that current assurance practices are failing the expectations from stakeholders. Stakeholder involvement in the third-party assurance was suggested as one idea to close those gaps.

### **6.2 Conclusions about research questions**

Detailed conclusions about each research question would be found in chapter 4.4 and 5.5.

In short, the study of assurance statements from leading-edge reports showed that there had been a few examples where stakeholders such as independent experts, the independent panel, and NGOs managed to challenge the reporting organisation with different perspectives through the assurance process. The examples were classified with four distinct types according to the degree of stakeholder involvement including traditional assurance providers actively listening to stakeholder opinions (4 cases), traditional assurance providers and independent expert(s) running assurance process in parallel (3 cases), an independent panel as an assurance provider (1 case), and an NGO alone as an assurance provider (2 cases).

However, it was only 27% of the reports with third-party assurance which were classified as the stakeholder involvement cases. A few reporting organisations and their assurance providers who contacted stakeholders directly might have felt a pressuring need to do it due to the lack of trust between the reporting organisation and stakeholders. In those cases, the role of stakeholders stayed as an alternative source of information for the assurance provider.

Among 28 Swedish companies interviewed, only 32% had the third-party assurance on their sustainability reports last year. Six companies are considering having the third-party assurance in the foreseeable future. About 40% of companies were affirmative that the third-party assurance would be the common practice in the near future, while only 11% of the interviewee anticipated that there will be any regulation requiring mandatory the third-party assurance on the sustainability reports in the near future. The third-party assurance will therefore evolve slowly but steadily without external driving forces.

About half of interviewees could see the value to be added by the stakeholder involvement in the assurance, although they did not anticipate any radical change in the power structure governing the third-party assurance. They expected it would add credibility on the process, and intensify the relationship they had with stakeholders. This suggests an opportunity that stakeholders will have a more regular channel to tell their views on the company, even if it would be the low level of involvement via traditional assurance provider as a mediator.

Regarding the future perspective, a few scenarios were drawn. If the voluntary development will continue, the reporting organisations will continue to seek possible internal benefits. Different ways to involve stakeholders will be explored as a value-added approach to the assurance. If there will be more demand for the disclosure of sustainability information in the annual report, the integration of environmental/sustainability report into the annual report will gain a momentum. The sustainability information will then be audited more by accountancies with a methodology mainly coming from their financial auditing experience.

### **6.3 Conclusions about research problem**

Then would that idea of stakeholder involvement make sense as a solution to the problems with the third-party assurance? Would it really be helpful to close the credibility gaps and expectation gaps in the third-party assurance?

The cases identified in the leading-edge reports showed that stakeholder involvement would be good to make the assurance process function as the accountability process. Certain companies which involved the stakeholders to challenge the companies could demonstrate the clear-cut cases in this.

Contentious companies involved stakeholders more to confirm the claims made in the report. Intriguingly, or naturally, it did not seem to change the fundamental perception on the company itself. For example, Shell is still quoted as socially irresponsible company by many NGOs (e.g. Christian Aid's "Behind the Mask" published this year). This summer Friends of the Earth UK published the alternative accounts to the Shell Report, "Behind the Shine- The other Shell Report 2003". It clearly shows that using the stakeholders just as an alternative source of information would not be enough to rebuild broken trust as well as to gain the credibility on the report.

Then how other companies see the value of stakeholder involvement in the third-party assurance? Would it be successful in increasing the value of assurance?

It should be noted here that interviewees from the Assurance Group did not see any credibility gaps and expectation gaps in their current approach to the assurance. They were all very satisfied with current approach, even if there seemed to be problems with scoping, i.e. the assurance simply do not cover the whole report, the conclusion of the assurance, i.e. assurance providers do not judge the completeness of the report. The assurance approaches were clearly getting mature, harmonized and structured, but there were too much focus on the validation of the data.

For the future, all of the companies having a plan in the third-party assurance weighed the possible internal benefits much more than the credibility gains. Few explicitly mentioned that companies would not do it just for the credibility since the third-party assurance is very costly.

All in all a strong managerial interest in the possible internal gains seem to be inevitable. Under the current setting, therefore, even if stakeholders are engaged along the assurance process, it will not imply any radical change in the governance. Managerial interests prevailing in the assurance process will undermine the value of assurance as the accountability process, and continue to deter some reporting organisations from seeking the third-party assurance for that reason.

In conclusion, this study shows that stakeholder involvement in the third-party assurance would be the solution to increase the accountability in the process, bringing the challenges to the companies. But it is not likely that an extensive form of stakeholder involvement in assurance will be welcomed by the wide business communities. It is likely to be the exercise only for the extremes- extremely value-oriented companies or extremely challenged companies. "Stakeholder governance" seems to be the far distant future which will never come to reality without any external push.

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## Appendix 1. The list of reports subject to the analysis (Leading-edge group)

| Company                          | Report after the nomination (by Sustainability) up till June 2004 | Assurance provider  |
|----------------------------------|---|---|
| Anglian water                    | Sustainable Development Report (2001-2003)                        | Enviros Aspinwall   |
| Aracruz Celulose                 | Social and environmental report 2003                              | ICF consulting  |
| BASF                             | Social Responsibility (2001-2003)                                 | Deloitte & Touche   |
| Baxter                           | Sustainability report (2000-2002)                                 | ERM   |
| Bayer                            | Sustainable development report (2001, 2004)                       | Arthur D. Little  |
| BP                               | Environmental and social review (2001, 2002)                      | Ernst & Young   |
|                                  | Sustainability report 2003  |   |
| Bristol-Meyers Squibb            | Sustainability Progress Report 2001                               | ERM   |
| British Airports Authority       | Annual report (2001/02, 2002/03)                                  | Casella-Stanger   |
|                                  | Annual report (2003/04)   | ERM   |
| British Airways                  | Social and environmental report (2001/2002, 2002/2003)            | CSR network Ltd.  |
| BT Group                         | Social and environmental report(2001-2003)                        | Leadership panel, LRQA                                    |
| Cable & Wireless                 | Annual environmental report 2002                                  | PricewaterhouseCoopers                                    |
| Chiquita Brands International    | Corporate responsibility report 2000                              | Rainforest Alliance, SGS ICS                              |
|                                  | Corporate responsibility report (2001-2002)                       | Rainforest Alliance, COVERCO, etc.                        |
| CIS                              | Social accountability report (2001-2002)                          | KPMG Plc, Simon Zadek                                     |
| Credit Suisse Group              | Sustainability report(2001-2003)                                  | SGS ICS   |
| Kesko                            | Corporate responsibility report (2002-2003)                       | PricewaterhouseCoopers                                    |
| Kirin Brewery                    | Kirin Brewery environmental report (2001-2003)                    | Asahi & Co.   |
| Manaaki Whenua Landcare Research | Annual report (2001-2003)   | Tonkin & Taylor Ltd                                       |
| Matsushita Electric Group        | Environmental Sustainability Report (2001-2002)                   | The Natural Step  |
|                                  | Sustainability report 2003  |   |
| Novartis international           | Annual report (2000-2001)   | Arthur D Little   |
|                                  | Annual report (2002-2003)   | PricewaterhouseCoopers                                    |
| Novo Nordisk                     | Sustainability report (2001-2003)                                 | Deloitte & Touche   |
| Ricoh Japan                      | Ricoh Group Sustainability Report 2001                            | Asahi & Co  |
|                                  | Sustainability (environmental) report 2002-2003                   | BVQI  |
| Rio Tinto                        | 2001 Social and environment performance                           | Synergy, The Prince of Wales International Business Forum |
|                                  | 2002 Social and environment performance                           | ICF Consulting, ERM                                       |
|                                  | 2003 Social and environmental review                              | ERM   |

|  |  |  |
|--|--|--|
| Royal Dutch/<br>Shell Group            | The Shell report (2001, 2002 , 2003)                       | KPMG, PricewaterhouseCoopers                                       |
| RWE                                    | Corporate responsibility: report 2003                      | PricewaterhouseCoopers   |
| SAS Group                              | Annual & Environmental Report (2001, 2002, 2003)           | Deloitte   |
| Sony<br>Corporation                    | Social & Environmental Report (2001, 2002)                 | PricewaterhouseCoopers   |
|  | Corporate social responsibility report 2003                |  |
| SAB                                    | Corporate accountability report (2001, 2002, 2003)         | The Corporate Citizenship Company                                  |
| Suez                                   | Activities and sustainable development report (2002, 2003) | Ernst & Young, Deloitte & Touche                                   |
| Suncor Energy                          | Report on sustainability (2001, 2003)                      | PricewaterhouseCoopers   |
| The Tokyo<br>Electric Power<br>Company | Sustainability Report (2003)                               | Shin Nihon Environmental Management and Quality Research Institute |
| The Co-<br>operative Bank              | The partnership report (2000, 2001,2002):                  | Ethics etc.. Assessment from three NGOs                            |
| Toyota Motor<br>Corporation            | Environmental report (2000, 2001, 2002, 2003)              | Tohmatsu Environmental Research Institute                          |
| Unilever                               | Environmental performance report 2002, 2003                | URS Verification Ltd   |
| United Utilities                       | Social and Environmental Performance Report (2001,2002)    | CSR network Ltd.   |
|  | Corporate sustainability report 2003                       |  |
| Volkswagen<br>Group                    | Environmental report 2001/2002                             | KPMG   |
| WMC                                    | Sustainability reporting (2001, 2003)                      | PricewaterhouseCoopers   |

## Appendix 2. The interview guideline-Reporting organisations

### ▪ Section 1: Experience in environment/sustainability reporting

1. When did your organisation start publishing the environment/sustainability report (hereafter, the report)?
2. What would be the major changes made in the report during the years?
3. Who is the target audience of the report?
4. What would be the critical development in need, in order to increase the quality of reporting in your organisation?

### ▪ Section 2: Experience in third-party assurance

5. Did your organization get third-party assurance on the latest report?  
(If not, please go to question 6)
  - Background information
    - 5a) When did your organisation start commissioning third-party assurance?
    - 5b) What was the motivation for seeking third-party assurance?
    - 5c) Who provided the assurance? Why were they chosen as assurance provider(s)?
    - 5d) What was the scope of the assignment given to the assurance provider?
  - Opinions
    - 5e) Can you describe the third-party assurance process?
    - 5f) In this process, what is the most difficult part for your organisation?
    - 5g) Can you tell us how much resources your organisation spent in third-party assurance engagement (in terms of time and expense)?
    - 5h) Did assurance result in any changes in the reporting activities or environmental /sustainability management of your organisation?
  - Future perspective
    - 5i) Will your organisation continue to seek the third-party assurance?
    - 5j) Do you think third-party assurance will be the common practice in the near future?
    - 5k) Do you think regulation will require mandatory third-party assurance in the near future?
6. If your organisation did not get any third-party assurance on the latest report, please answer following questions.
  - Past experience
    - 6a) Has your organisation commissioned third-party assurance before?  
If yes, why did you stop seeking third-party assurance?  
If not, what prevented your organisation from seeking third-party assurance?
  - Opinions
    - 6b) Can you describe the third-party assurance process?
    - 6c) In this process, what would be the most difficult part for your organisation?
    - 6d) Can you estimate time and expenses required for third-party assurance on the report?
    - 6e) What measures are being taken by your organisation to assure the credibility of the report and to be sure material information is not missing?
  - Future perspective
    - 6f) Does your organisation have a future plan to seek the third-party assurance?
    - 6g) Do you think third-party assurance will be the common practice in the near future?
    - 6h) Do you think regulation will require mandatory third-party assurance in the near future?



### Section 3: Stakeholder involvement in third-party assurance

7. Who are the key stakeholders of your organisation?
8. Does your organisation communicate with stakeholders regularly to seek their opinion regarding the corporate social and environmental management?
9. What would be the competence necessary for providing assurance on the environmental/sustainability report?
10. Suppose you have to select the assurance provider of your organisation, who will you prefer as an assurance provider? Please list following entities in order of your preference.
  - *Big name accountants*
  - *Consultants*
  - *Independent panel*
  - *Independent experts in specific subject*
  - *NGOs.*
11. Some organisations involve stakeholders in the third-party assurance in several ways. Examples are as follows:

|               |   |
|---------------|---|
| <b>Type 1</b> | <b>Traditional assurance providers actively listening to stakeholder opinions</b><br>→ Accountants and environmental consultants play their role as an assurance provider. Also, they actively seek stakeholder opinions outside the company by interviewing external experts or reviewing the external media.                        |
| <b>Type 2</b> | <b>Traditional assurance providers and stakeholders together</b> → Typically traditional assurance provider verifies the data. Independent experts in specific subject (e.g. strategic environmental management, corporate social responsibility, etc.) give strategic commentary or assess certain performance of the company.       |
| <b>Type 3</b> | <b>Independent panel as an assurance provider</b> → The panel consist of external experts plays a significant role as an assurance provider, typically together with traditional assurance provider. The panel tends to influence the reporting process by identifying hot issues to report, standards to be used for reporting, etc. |
| <b>Type 4</b> | <b>NGO as an assurance provider</b> → The company appoints a non-profit organisation as an assurance provider.  |

- 11a) What type of stakeholder involvement in assurance would describe your organisation best?
  - 11b) Please suggest the reason why you selected that type.
  - 11c) Can you foresee any benefits and difficulties in carrying out the selected type of stakeholder involvement in third-party assurance?
  - 11d) Can you think of another type of stakeholder involvement in assurance suitable for your organisation?
12. Do you think stakeholder involvement would increase the value of assurance for your organisation?

## **Appendix 3. The interview guideline- Assurance providers**

### **Experiences with the third-party assurance engagement**

1. Could you describe your experience with third-party assurance engagement on environment/sustainability report?
2. What arguments do you use to persuade the reporting organisations to commission third-party assurance?

### **Process attributes**

3. Could you describe how the typical assurance process would look like?
4. Along the process, what would be the most difficult part for you as an assurance provider?
5. Key elements of assurance can be identified as follows:
  - standards, principles or guidelines governing the actual assurance work,
  - subject matter,
  - criteria for assessment,
  - audit objective,
  - level of assurance,
  - evidence, and
  - assurance statement prepared for reporting.

Among those (including others), what would be subject to the negotiation with reporting organisation?

6. How do you manage the third-party relationship with the reporting organisation?
7. Do you refer to any *established* standards (such as AA 1000 AS, ISAE 3000, etc.) to describe your work?
8. How do you assemble the assurance team?
9. What would be the competencies necessary for providing assurance on the environment/sustainability report?
10. In your view, what would be the critical development in need, to enhance the quality of third-party assurance?

### **Stakeholder involvement in third-party assurance**

11. How do you elicit stakeholder concerns during the assurance process?
12. Do you see any need of having direct contacts with external stakeholders in the assurance process?

### **Future perspective**

13. Do you think third-party assurance will be the common practice in the near future?
14. Do you think regulation will require third-party assurance mandatory in the near future?