

SUSTAINABILITY AND INTEGRATED REPORTING: AN ANALYSIS OF THE AUDIT COMMITTEE'S OVERSIGHT ROLE

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ABSTRACT

Sustainability has been described as the primary moral and economic imperative of the twenty-first century and one of the most important sources of both opportunities and risks for businesses. Companies are also expected to behave, and be seen to behave, as responsible corporate citizens that is, as protecting, enhancing and investing in the wellbeing of the economy, society and the natural environment in which they do business. Accordingly the need exists for accurate, reliable and credible stakeholder reporting by organisations on their economic, social and environmental performances and achievements. An effectively functioning audit committee can play an important role in this regard to assist the board in providing accurate and credible sustainability reporting and disclosures that are integrated with the company's financial reporting.

The objective of the article is twofold: it aims, firstly, to provide a brief overview of the development of sustainability and sustainability reporting and the role that audit committees can fulfil in this regard; and, secondly, its intention is to provide evidence that the recommendations of the third Report on Corporate Governance for South Africa (King III) regarding sustainability reporting, assurance and the audit committee's oversight responsibility for this are justified. This is done through a literature review of current sustainability and audit committee developments and practices, and this is supported by empirical evidence obtained from assessing the annual reports and questionnaires sent to the audit committee chairs of the Top 40 listed companies in South Africa. The main findings of the study are that the majority of audit committees at the largest listed companies in South Africa are not taking oversight responsibility for sustainability reporting on their boards' behalf, although they are dealing with some ethical and social reporting aspects. It was also found that reporting by companies in their annual reports on their audit committee's corporate governance, social and sustainability oversight responsibilities was limited and does not reflect the true state of affairs. These findings are of significance, as they provide support for the recommendations of King III (effective from 1 March 2010) that companies should in future provide integrated reporting in terms of both their finances and sustainability, and that the audit committee should take oversight responsibility for this.

The study is of specific relevance for Africa with its rich mineral resources, as it is of vital importance that companies that do business on the continent behave as responsible corporate citizens, respect the environment and society, and provide accurate, reliable and credible reporting on their financial and sustainability performance to all of their stakeholders.

Keywords: Audit committee; corporate governance; sustainability; sustainability reporting; social responsibility

1. INTRODUCTION

The development of corporate governance over the years has given prominence to the need for organisations to do business in a responsible manner and respect the society and environment in which they function. There has also been a shift in emphasis from profits for shareholders only to the recognition that organisations have a responsibility to those who give them their licence to operate, namely their stakeholders (Ackers, 2009:2; King, 2006:21; Marx, 2008:334; Mitchell, Curtis & Davidson, 2008:6769; Naidoo, 2009:246250). The third King Report on Corporate Governance for South Africa (hereafter King III) is of the opinion that “Sustainability is the primary moral and economic imperative of the 21st century and one of the most important sources of both opportunities and risks for businesses”. It further states that it is expected that the company “will be and will be seen to be a responsible corporate citizen”. This is described as involving “social, environmental and economic issues the triple context in which companies in fact operate” (Institute of Directors (hereafter IoD), 2009:1112). Against this background the need exists for accurate, reliable and credible stakeholder reporting by organisations on their economic, social, environmental and governance performances.

Audit committees have been in existence for many years and have been widely accepted as a key component of the corporate governance structure of entities. Various factors have given rise to renewed emphasis being placed on audit committees and their composition, the most significant of these being major corporate collapses and business failures, and the issuing of various corporate governance codes and new or amended legislation (Brewer, 2001; Carcello, 2003; Ferreira, 2008; Klein, 2000; Kukabadse & Korac-Kukabadse, 2002; Liu, 2005; Marx, 2008; Rager, 2004; Spira, 2003; Wayne, 2003; Weiss, 2005; Wymeersch, 2006; Yang, 2002). Given the current financial crises companies all over the world are experiencing, and especially the financial sector, the oversight role of the audit committee has become even more important (Ernst & Young, 2008:12; 2009:14; Marx, 2009:).

Through its oversight role the audit committee assists the board of directors (hereafter referred to as the board) in meeting its financial reporting, risk management and control and audit-related responsibilities and dealing with emerging issues such as fostering an ethical culture of doing business and overseeing the company's integrated sustainability reporting (Blue Ribbon Commission, 1999:67; Deloitte, 2006:1; Dobie, 2006:54; Institute of Internal Auditors (hereafter IIA), 2006:2; IoD, 2009 principle 3.4 & 9.1.2; Marx, 2008:326334; PricewaterhouseCoopers, 2006:1; Van der Nest, 2006:v).

As is evident from the above, it is imperative for companies to do business responsibly and ethically and to respect the rights of all the company's stakeholders, while still being accountable to the shareholders. In this regard an effectively functioning audit committee can play an important role in assisting the board in providing accurate and credible integrated reporting on its financial performance and its sustainability.

The remainder of the paper is organised as follows. The next section presents the objectives, scope and limitation of the study. The sections that then follow describe the theoretical background of the paper, the methodology applied and the empirical findings and deductions. Recommendations drawn from the study are then provided, and conclusions are presented in the last section.

2. OBJECTIVES, SCOPE AND LIMITATIONS

The objective of the paper is twofold: to provide a brief overview of the development of sustainability and sustainability reporting and the role that audit committees can fulfil in this regard; and secondly to provide evidence that the recommendations of King III regarding sustainability reporting, assurance thereon and the audit committee's oversight responsibility thereof, are justified. This is done by way of a literature review of current sustainability and audit committee developments and practices, which is supported by empirical evidence obtained from assessing the annual reports (content analysis) in March 2008 and from questionnaires sent in April 2008 to the audit committee chairs of the Top 40 listed companies in South Africa. The fact that 35 of the 40 companies in the population were listed on the Johannesburg Stock Exchange (hereafter JSE) Limited's Socially Responsible Index (hereafter SRI) at the time of the empirical study should provide added support to the findings and recommendations regarding sustainability reporting and the audit committee's role in this regard. The study has the specific limitation that the assessment is limited to the Top 40 JSE listed companies in South Africa, as defined by market capitalisation, and that they might not therefore necessarily be representative of the sustainability and audit committee practices of smaller listed companies, unlisted entities or public sector institutions.

3. THEORETICAL BACKGROUND

3.1 Stakeholder Concepts and Sustainability Reporting

Corporate governance issues became prominent in the nineteenth century when the first limited liability companies were formed in the United States and the United Kingdom, and as such separated the management and ownership of companies both formally and legally. This resulted in the directors being entrusted with management power, while still being accountable to the owners of the company. Consequently the shareholders needed to protect their investments against abuse of power by the directors, and as a result the agency concept was created and the concept of corporate governance was born (Pullinger, 1995:7; Reynecke, 1996:34; Rossouw, De Koker, Marx & Van der Watt, 2003:3). The debate surrounding corporate governance has intensified since the 1990s as a result of business failures and corporate collapses. It is also interesting to note that corporate governance practices have evolved from initial structural arrangements aligning the management of companies with the interests of their shareholders to being extended to the interests of other stakeholders and society at large. In this regard Jhaveri (1998) states that corporate governance covers three types of issues, namely “ethical issues, efficiency issues and accountability issues” to its shareholders and other stakeholders.

The various corporate governance codes issued over the years gave prominence to the need for businesses to behave in a responsible manner and to respect the society and the environment in which they do business (for corporate governance codes issued internationally, see the website of the European Corporate Governance Institute at http://www.ecgi.org/codes/_all_co_des.php). Sustainability issues, in South Africa as well as internationally, have gained in importance since the publication of King II (IoD, 2002:20, para. 41), which advocated a shift from the single bottom line of profits only, to a focus on corporate citizenship, sustainability and triple bottom line reporting. These principles have also gained momentum internationally through the publications, recommendations and guidelines issued by various institutes, professional bodies and other interested parties (such as inter alia the JSE's SRI index in South Africa; the United Nation's Global Compact and Principles for Responsible Investment; The Reform of United Kingdom Company Law, which requires directors to consider the impact of the company's operations on the community and the environment; the Norwegian government's White Paper on Corporate Social Responsibility (hereafter CSR); the Danish government's law on CSR reporting; the European Union's Directive on Transparency requiring companies to report relevant CSR information; and the sustainability guidelines of Organisations such as Account Ability, the International Standards Organisation (ISO) and the Global Reporting Initiative (GRI) (Ackers, 2009:17; IoD, nd:8; IoD 2009:1114; De Viiliers, 2004:2831; KPMG, 2010:23; Matutu, 2009; Wheeler & Elkington, 2002).

The stakeholder concept has also been widely researched and defined over the years. One of the first definitions of the term was that of Freeman (as quoted by Breckenridge, 2004:27), who defined stakeholders as “any group or individual who can affect or is affected by the achievement of the organisation's objectives.” This definition was slightly refined by Rossouw (2003:3) and Rossouw, et al. (2007:243), who defined a stakeholder as “a person or party who is affected by a business or who has the potential to affect the performance of a business”. Mervyn King, who chaired the King Committee, has a totally different definition of stakeholders: he defines them as “the licensors of the business of the company” and states that “today, the licensor of a business is not only the regulator who grants the company the licence to operate its business. There are always other licensors for example, standard-setting or industry bodies; the media; the individual stakeholders linked to the company through its business such as its customers, employees, suppliers, pressure groups, public opinion makers, politicians etc. Any one of these licensors could impact positively or negatively on a business and will definitely be needed when the inevitable downturn is being corrected” (King, 2006:21). King III defines stakeholders as “any group affected by and affecting the company's operations” (IoD, 2009:127).

Stakeholders are interested in both financial and non-financial information regarding the company and its operations. Financial information was traditionally provided through the annual report, while non-financial reporting, which focuses on environmental, social, transformation, ethical, safety and health information, was provided as part of the annual report, or in a separate sustainability report. King II (IoD, 2002: 91, section 4) defined the concept of sustainability as follows: “each enterprise must balance the need for long-term viability and prosperity of the enterprise itself and the societies and environment upon which it relies for its ability to generate economic value with the requirement for short-term competitiveness and financial gain”. This was refined in King III, which now defines sustainability as: “conducting operations in a manner that meets existing needs without compromising the ability of future generations to meet their needs. It means having regard to the impact that the business operations have on the economic life of the community in which it operates. Sustainability includes environmental, social and governance issues” (IoD, 2009:126). King III also requires that sustainability reporting and disclosure be integrated with the company's financial reporting (principle 9.2) and defines integrated reporting as: “the holistic and integrated representation of the company's performance in terms of both its finances and its sustainability” (IoD, 2009: 121).

3.2 The audit committee and sustainability reporting oversight

With the increase in focus and importance of corporate citizenship and sustainability reporting, the role of the modern audit committee has also evolved accordingly.

The audit committee's role now includes taking oversight responsibility on the board's behalf for ensuring that the company provides accurate, reliable and credible financial and non-financial information to the various stakeholder groups to ensure not only the short-term profitability of the company, but also its long-term sustainability. An effectively functioning audit committee can fulfil a critical role in this regard, as Williams (2007:14) remarks: "Anyone who supports the idea of corporate governance as holding companies accountable both to shareholders and other stakeholders has to see audit committees as a cornerstone of the structure".

An overview of the literature indicates that the term 'audit committee' is not always formally defined, but is quite often informally described as being part of corporate governance reports and legislative requirements. From the various audit committee definitions and descriptions, ranging from the earliest to the most recent, Marx (2008:41) concluded that: "the audit committee should function as a subcommittee of the board of directors of which the members should be independent non-executive directors. Although the audit committee is tasked with many and diverse responsibilities, the most important task of the committee remains its oversight role to ensure accurate and reliable financial reporting. Accordingly, it is imperative that the members are financially literate and have the necessary financial experience and expertise to perform this oversight function effectively". From this description (and supported by King, 2006: 7172) it is obvious that the modern audit committee, consisting of independent non-executive directors who are financially literate and who have the necessary financial expertise among themselves, is ideally suited to oversee the company's sustainability reporting. This is mainly attributed to the fact that the status and seniority of the audit committee, and the fact that it is generally regarded as being the most important subcommittee of the board, will further strengthen the importance of sustainability reporting if the oversight responsibility for this falls under its remit (Marx, 2008: 338339). By assuming oversight responsibility for stakeholder reporting the audit committee can ensure that the non-financial reporting information that the stakeholders use to base their decisions on is accurate, reliable and credible. This will in turn contribute to the protection and advancement of the individual stakeholder interests.

A review of audit committee and environmental, social and governance literature, however, indicates that there is very limited research into, reference to, or guidance material on the audit committee's responsibility for sustainability reporting (Blue Ribbon, 1999; Brewer, 2001, Ferreira, 2009; KPMG, 2005, 2007, 2010; Liu, 2005; Marx, 2008; Mitchell, Curtis & Davidson, 2008; Park, 1998; PricewaterhouseCoopers, 2005, 2006; Van der Nest, 2006; Rea, 2009; Van Altena,2009:42; Weiss, 2005). King III, however, addressed this shortcoming and now provides that the audit committee should oversee the company's integrated reporting, which consists of performance in terms of both its finance and its sustainability.

It also tasks the audit committee with oversight responsibility for the sustainability issues in the integrated report, and requires that the audit committee recommend to the board that the board engage an external assurance provider to provide assurance on sustainability aspects included in the integrated report. As part of this oversight responsibility the audit committee should also evaluate the independence and credentials of the external assurance provider (IoD, 2009: 60, Para. 3436).

4. METHODOLOGY

The role of the audit committee in overseeing sustainability reporting was empirically tested (as part of a bigger study) through content analysis. This took the form of an inspection of companies' annual reports and through questionnaires that were sent to audit committee chairs for completion. The empirical study was descriptive in nature: it focused on the quality of information obtained rather than the quantitative nature of data. This approach is supported by Henning et al. (2004), who stress the importance of capturing the views of the subjects in the population. Holsti (1969) offers a broad definition of content analysis as "any technique for making inferences by objectively and systematically identifying specified characteristics of messages." Content analysis has limitations (as noted by Unerman, 2000:66), but it is also widely recognised and accepted as a research instrument (Ackers, 2009:3; Barack & Moloi, 2010:45; Brennan & Solomon, 2008:893; Dawkins & Ngunjiri, 2008: 291292). When used in conjunction with well-designed and controlled questionnaires it can add to an understanding of the characteristics of the population.

4.1 Population

The study focused on audit committees at the large listed companies in South Africa and accordingly the population for the empirical study was selected as the largest 40 companies ranked by market capitalisation on the JSE's All-Share Index (referred to as the FTSE/JSE Top 40 Index) (JSE 2008a). At the date of the study these companies represented 87.64% of the total market value of the JSE's All-Share Index (JSE, 2008b) and as such would represent a wide spectrum of stakeholders' interests in South Africa.

4.2 Content analysis of annual reports

In this section of the study the most recently available annual reports of the 40 companies were inspected between 25 and 28 March 2008. This was done at the offices of the JSE in Johannesburg, or on the companies' websites in cases where the latest annual reports had not yet been received by the JSE (companies have six months to submit hard copies of their financial statements to the JSE).

All the annual reports of the companies in the population were inspected (100% coverage).

4.3 Questionnaire

The second part of the empirical study consisted of questionnaires (available upon request) that were sent to the audit committee chairs for completion on 4 April 2008. The questionnaires were also tested by a selected group of highly experienced people, consisting of academics, corporate governance experts, and audit committee chairs who were not in the population. They all provided valuable input into the questionnaire design and content, contributing to the relevance thereof. A response rate of 34 completed and usable questionnaires (85%) was achieved, while two questionnaires were returned, as it is the policy of these companies not to complete questionnaires (5%).

5. RESEARCH FINDINGS AND INTERPRETATION

This section presents detail about the audit committee's oversight responsibility for sustainability reporting specifically and other corporate governance and social responsibility aspects in general.

Table 1: Audit committee responsibilities disclosed in the annual report

	Number			%	
	Total	Yes	No	Yes	No
Sustainability reporting	Total	Yes	No	Yes	No
Review of sustainability reporting	40	3	37	7.5	92.5
Corporate governance and social responsibility	Total	Yes	No	Yes	No
Review compliance with the company's code of ethics	40	10	30	25.0	75.0
Review/provide a channel for safe reporting (whistle-blowing)	40	8	32	20.0	80.0
Review of compliance with laws and regulations	40	28	12	70.0	30.0
Review compliance with corporate governance codes	40	8	32	20.0	80.0
Review the accuracy of information on BBBEE statistics	40	0	40	0	100
Review the compliance with BBBEE codes	40	0	40	0	100
<i>Other corporate governance and business ethics-related responsibilities disclosed include reviewing compliance with the JSE listing requirements and Sarbanes-Oxley requirements, as well as reviewing of unethical conduct and fraud by employees.</i>					

Source: Annual report disclosure (own analysis)

Key interpretations based on the above findings:

The above findings indicate that only three companies (7.5%) disclosed specific information that their audit committees review their company's sustainability reporting, while 70% indicated that their audit committees review compliance with laws and regulations.

The above findings further indicate that few companies are disclosing information on audit committee responsibilities regarding ethics compliance (25%), whistle-blowing (20%), and corporate governance compliance (20%), while none disclose their responsibilities vis-à-vis BBEE (broad-based black economic empowerment).

An assessment of the annual reports for the period under review revealed that 37 of the companies (92.5%) provided sustainability reporting in one form or another, and that 13 of the companies in the population (32.5%) obtained external assurance on their sustainability reports. As noted above, however, this information is not mirrored in the audit committee's oversight responsibility for sustainability and social reporting. Thus it can be concluded that the audit committees are not assuming oversight responsibility for their company's sustainability and social responsibility-related disclosure or that, in cases where they do, such responsibilities are not disclosed.

These disclosure findings are further analysed and discussed in Table 3.

Table 2: Audit committee responsibilities performed as per the audit committee chair questionnaire

Sustainability reporting	Number	%
Review the fair presentation of the sustainability report?	16	47.1
Corporate governance and social responsibility	Number	%
Review compliance with the company's code of ethics?	22	64.7
Review/provide a channel for safe reporting (whistle-blowing)?	30	88.2
Review compliance with laws and regulations?	29	85.3
Review compliance with corporate governance codes?	30	88.2
Review the accuracy of BBEE information/statistics?	8	23.5
Review compliance with BBEE codes?	7	20.6

Source: Audit committee chair questionnaire (own calculation)

Key interpretations based on the above findings:

The above findings indicate that the majority of audit committees are assuming oversight responsibility for whistle-blowing (88.2%), corporate governance compliance (88.2%), and review of compliance with laws and regulations (85.3%) and the company's code of ethics (64.7%). Only 47.1% of the audit committees, however, review the fair presentation of the company's sustainability reporting, while only a small number review the accuracy of BBEE information disclosed (23.5%) and compliance with BBEE codes (20.6%).

As stated above, an assessment of the annual reports for the period under review revealed that 37 of the companies (92.5%) provided sustainability reporting in one form or another, and that 13 of the companies in the population (32.5%) obtained external assurance on their sustainability reports. However, the fact that so few audit committees are taking oversight responsibility for sustainability reporting (47.1%), as is evident from the audit committee questionnaires, is alarming and could also affect the accuracy, reliability and credibility of the company's sustainability reporting. The research was undertaken before the recommendations of King III became effective (1 March 2010) and the findings serve as justification for the requirement that the audit committee should take oversight responsibility for sustainability issues in the integrated report, and that sustainability reporting and disclosure should be externally assured.

Table 3: Comparison of audit committee responsibilities and functions performed as disclosed in the annual report and those actually performed as per the audit committee chair questionnaire

	Annual report analysis %	Audit committee chair questionnaire %
Sustainability reporting		
Review the fair presentation of the sustainability report	7.5	47.1
Corporate governance and social responsibility		
Review compliance with the company's code of ethics	25.0	64.7
Review/provide a channel for safe reporting (whistle-blowing)	20.0	88.2
Review compliance with laws and regulations	70.0	85.3
Review compliance with corporate governance codes	20.0	88.2
Review the accuracy of BBBEE information/statistics	0	23.5
Review compliance with BBBEE codes	0	20.6

Source: Annual report analysis and audit committee chair questionnaire

Key interpretations based on the above findings:

When the audit committee's responsibilities regarding sustainability and social reporting as disclosed in the annual report are compared with those actually performed by the audit committees, it is evident that more audit committees are in fact performing these functions than is actually reported. The reporting does not, in other words, adequately convey the important role that audit committees fulfil in providing accurate, reliable and transparent reporting to stakeholders.

6. RECOMMENDATIONS

Following from the findings of the study it is recommended that audit committees adhere to the recommendations of King III and take oversight responsibility for both financial and sustainability issues in the integrated report.

It is also recommended that companies' sustainability reporting and disclosure be independently assured and that audit committees assume responsibility for recommending the appointment of the assurance providers to their boards, as well as for evaluating the independence and credentials of the assurance providers. Audit committees should also ensure that sufficient information is disclosed in the integrated report on their oversight responsibilities regarding sustainability aspects so as to enhance the report's credibility and reliability.

7. CONCLUSION

In conclusion, the article found that the majority of audit committees at the largest listed companies in South Africa are not taking oversight responsibility for sustainability reporting on their boards' behalf, although they are dealing with some ethical and social reporting aspects. It was also found that reporting by audit committees in the annual report on their corporate governance, social and sustainability oversight responsibilities was limited and did not reflect the true state of affairs. These findings are of significance as they provide support for the recommendations of King III (effective from 1 March 2010) that companies should provide integrated reporting on their finance and sustainability performance, and that the audit committee should take oversight responsibility for this. The study is of specific relevance for Africa with its rich mineral resources, as it is of vital importance that companies that do business on the continent behave as responsible corporate citizens, respect the environment and society, and provide accurate, reliable and credible reporting on their financial and sustainability performance to all stakeholders.

The study was performed prior to the implementation of King III, and it is recommended that an analysis similar to the one undertaken here should be performed for financial reporting periods beginning after 1 March 2010, the date that King III becomes effective. This should be done to assess the impact of King III on the sustainability reporting of companies and their audit committees' responsibilities in this regard. It is also recommended that future research should focus on sustainability reporting and the responsibilities of audit committees in this regard at smaller companies and public sector entities.

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