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THE NEW RATIONAL PURPOSE REQUIREMENT

The purpose of this article is to inform sustainability assurance practitioners (SAPs) of the impact that the new rational purpose requirement could have on assurance practices in South Africa. It also explains the process that SAICA will follow to assist SAPs to prepare them for this impact

Words Pieter Conradie

Many researchers believe that sustainability reporting could have the potential to transform the role of business in society if it succeeds in making organisations more accountable for the negative social and environmental impacts. The unfortunate reality is that a lot of these reports tell a very one-sided story about the impacts of organisations. It is contended that this information could mislead stakeholders and that it could ultimately be counterproductive to sustainability development.

Researchers have also considered the role and impact of the practice of assuring information in sustainability reports. The general role of assurance (or audit) is to add credibility to reported information. The reality of sustainability

assurance practices is that the scope of assurance engagements is determined by management. Many academics lament the fact that, in their perception, assurance providers become complicit in the counterproductive momentum of the sustainability reporting practice as they add credibility to these reports that, in many cases, can be seen as being very 'one-sided'.

Assurance providers making use of ISAE 3000 were of course completely within their rights to accept assurance engagements where the scope was determined by management, as long as the scope was explicitly delineated in the assurance report. Even though assurance providers were acting within their rights when accepting these types of engagements, many assurance

practitioners were uncomfortable doing so as they believed they were not acting in the public interest in accepting these engagements.

Academic research has however indicated that assurance providers are very sensitive to encourage clients to broaden the assurance scope to a more representative scope of the phenomenon under investigation. The main reason for these concerns was of course the fact that clients may take their business to practitioners that are less scrupulous about accepting non-representative scopes of assurance.

It could be argued that the introduction of ISAE 3000 (revised) should have put an end to these practices. The revised standard has many new requirements,



and one of these requirements is that during the pre-engagement phase of the engagement the practitioner should determine whether an engagement has a rational purpose. The rational purpose itself has a number of requirements, but the most important requirement for the purpose of this article is the following: 'Whether aspects of the subject matter information are expected to be excluded from the assurance engagement, and the reason for their exclusion.'

In short, this means that the assurance provider cannot accept an assurance engagement if they suspect that relevant information is excluded from the assurance scope.

Given the fact that this standard became effective in December 2015, one

would have expected that practitioners around the world would have altered their practices to incorporate these requirements, but this has not been the case. The IAASB, in their recent discussion paper that considered Emerging Forms of External Reporting, does mention a rational purpose. It speaks about the fact that assurance providers may find it difficult to ascertain whether lesser scope assurance engagements have a rational purpose, but it does not elaborate any further.

The IRBA recognised the fact that practitioners might need assistance to operationalise the requirements of ISAE 3000 (revised) and hence embarked on the process of developing the South African Assurance Engagement Practice Statement 1, *Sustainability*

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THE UNFORTUNATE REALITY IS THAT A LOT OF THESE REPORTS TELL A VERY ONE-SIDED STORY ABOUT THE IMPACTS OF ORGANISATIONS. IT IS CONTENDED THAT THIS INFORMATION COULD MISLEAD STAKEHOLDERS AND THAT IT COULD ULTIMATELY BE COUNTERPRODUCTIVE TO SUSTAINABILITY DEVELOPMENT

Assurance Engagements: Rational Purpose, Appropriateness of Underlying Subject Matter and Suitability of Criteria (SAAEPS 1). The SAAEPS addresses a number of important issues that are raised in ISAE 3000 (revised), among others the rational purpose requirement. The IRBA also recognised that the requirements of the SAAEPS 1 may have a material impact on the assurance practices of South African assurance practitioners, and hence it provided a two-year period to allow practitioners to prepare themselves for a 31 December 2020 effective date.

SAICA was then approached to develop training interventions to assist practitioners to ready themselves for the impact of SAAEPS 1. SAICA then proceeded to assemble a project team to this effect. The team identified technical as well as conceptual areas that the training should focus on. It was thus decided to tackle the conceptual challenges first as an understanding of the conceptual thinking underlying SAAEPS 1 would facilitate an easier understanding of the technical issues.

Among others, a challenging aspect of implementing SAAEPS 1 will be that the consideration of the rational purpose requirement is a pre-engagement activity. The fact that the practitioner will most likely be able to commit only limited time and resources to this issue is a concern that will receive a lot of attention at the workshops. However, a potentially more challenging concern will lie with the fact that an assurance practitioner will be required to apply considerable professional judgement in an area where they may have no prior experience.

For the purposes of this article, I will reflect on some of the potential concerns that the assurance practitioner may experience during the consideration of the rational purpose requirement, and more specifically on whether the reported information (and by implication the assurance scope) meets the information needs of the intended users. ISAE 3000 (revised) specifically states that the intended users may be a broader group than those stakeholders to whom the assurance report is addressed.

The implication is that the assurance practitioner will (1) have to identify all the potential users and then (2) view

the reported information (and assurance scope) from the perspective of these groups to determine whether it meets their information needs. At this point, it becomes relevant to consider the notion of rationality.

According to the 'reason', or rationality of a specific user group, certain pieces of subject matter information (and a certain assurance scope) may appear reasonable. However, the reason (or rationality) of the assurance practitioner may be different to that of the user group and to hence come to the conclusion that the reported information (and assurance scope) meets a user group's information needs may become very challenging.

What further complicates this challenge for the assurance provider is the concept of bounded rationality. A Wikipedia search of the concept reveals the following: 'Bounded rationality is the idea that when individuals make decisions, their rationality is limited by the tractability of the decision problem, the cognitive limitations of their minds, and the time available to make the decision.'

In simpler terms, this means that what an individual thinks is rational depends on (or is limited by):

- The complexity of the thing they are thinking about
- Their intellectual capability
- The time they have to think about it

I will not dwell on the intellectual capability of specific user groups nor the time that they have to think about a specific problem. What concerns me most is the complexity of the thing that they are thinking about.

Even though many organisations have been practising sustainability reporting for many years, it is of concern to academic researchers that there is no consensus around the meaning of the concept of sustainability nor about what the underlying phenomenon is that sustainability reporting is supposed to represent. Hence, for an assurance provider to be able to use their professional judgement on whether a sustainability report (and an assurance scope) fulfils the information needs of the intended users, the assurance provider would first have to understand how the user groups understand the concept of sustainability, how this concept should be represented in a sustainability report, and what they wish to know about it.



EVEN THOUGH MANY ORGANISATIONS HAVE BEEN PRACTISING SUSTAINABILITY REPORTING FOR MANY YEARS, IT IS OF CONCERN TO ACADEMIC RESEARCHERS THAT THERE IS NO CONSENSUS AROUND THE MEANING OF THE CONCEPT OF SUSTAINABILITY NOR ABOUT WHAT THE UNDERLYING PHENOMENON IS THAT SUSTAINABILITY REPORTING IS SUPPOSED TO REPRESENT

The SAICA training programme will thus firstly aim to provide assurance providers with views around the way that the different user groups' views sustainability, and the way that this should be represented in the sustainability report. This will be the primary focus of the first workshop in May and will be of fundamental importance for any assurance provider who wishes to apply their professional judgement effectively in an ISAE 3000 (revised) assurance engagement.

The second workshop will be specifically for assurance practitioners and will focus on the technical intricacies of applying the SAAEPS 1. This workshop will be repeated to enable practitioners to attend that may have missed the first workshop. (Iteration 1 of the workshop will be in August and iteration 2 in October.)

SAICA will document the outcomes of the different workshops in a report that will be in the public domain. The dates and venues will be communicated to relevant stakeholders in due course. Contact Loshni Naidoo at loshnin@saica.co.za in case of any queries.

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BEFORE ACCEPTING YOUR SUSTAINABILITY ASSURANCE ENGAGEMENT ...

ASSURANCE

Are you aware that the Independent Regulatory Board for Auditors (IRBA) has developed and issued South African Assurance Engagements Practice Statement (SAAEPS) 1, *Sustainability Assurance Engagements: Rational Purpose, Appropriateness of Underlying Subject Matter and Suitability of Criteria*? The IRBA seeks to elicit feedback on implementing SAAEPS 1 by 15 December 2019

Words Nicolette Bester

International Standard on Assurance Engagements (ISAE) 3000 (Revised), *Assurance Engagements Other than Audits or Reviews of Historical Financial Information*, is an 'umbrella standard' that covers assurance engagements other than audits or reviews of historical financial information. The International Auditing and Assurance Standards Board (IAASB) has issued several subject matter-specific ISAEs but has not developed a subject matter-specific ISAE on sustainability assurance engagements.

Are you aware that ISAE 3000 (Revised) requires a practitioner who is requested to accept a sustainability assurance engagement to establish

whether all the preconditions for an assurance engagement are present, before accepting the engagement? Based on feedback received from practitioners through members of the Sustainability Standing Committee,¹ the *Acceptance and Continuance – Preconditions for the Assurance Engagement* phase of the assurance engagement is challenging and applied inconsistently in practice for certain types of engagements.

SAAEPS 1

SAAEPS 1 is aimed at providing practical assistance to practitioners on certain preconditions that need to be present when requested to

accept a sustainability assurance engagement in accordance with the requirements of ISAE 3000 (Revised). SAAEPS 1 deals with the practitioner determining, on the basis of a preliminary knowledge of the engagement circumstances and discussion with the appropriate parties, whether the engagement exhibits the following characteristics:

- A rational purpose
- The underlying subject matter is appropriate, and
- The criteria that the practitioner expects to be applied in the preparation of the subject matter information are suitable for the engagement circumstances



The preparation of appropriate engagement documentation is emphasised.

In concluding on whether the preconditions for a sustainability assurance engagement are present, the practitioner considers all the preconditions set out in paragraph 24 of ISAE 3000 (Revised) (those considered in terms of SAAEPS 1 and those beyond its scope).

SAAEPS 1 introduces guidance on the following matters under the heading 'Concepts relevant to the guidance provided in this SAAEPS':

- Sustainability information
- Reporting infrastructure, and

- The underlying subject matter, subject matter information and criteria

The guidance is supplemented by a series of questions that the practitioner may ask. After receiving feedback from the reporting entity, the practitioner may consider the responses collectively to determine whether the sustainability assurance engagement exhibits the characteristics referred to above.

EFFECTIVE DATE

SAAEPS 1 is effective for the Acceptance and Continuance – Preconditions for the Assurance Engagement phase of the sustainability assurance engagement for reporting periods beginning on or after 15 December 2020. Early adoption is permitted.

The effective date of SAAEPS 1 has been deferred by two years since its issue in August 2018 to give practitioners time to prepare for and implement the guidance, receive training and provide feedback to the IRBA on any implementation lessons. The effective date also gives preparers of sustainability reports time to receive training on the content of SAAEPS 1, as it relates to them.

QUESTIONS TO ASSIST YOU IN PROVIDING FEEDBACK TO THE IRBA

- 1 Have you / has your firm raised awareness and developed/ presented training to assurance practitioners on the South African Assurance Engagements Practice Statement (SAAEPS) 1, *Sustainability Assurance Engagements: Rational Purpose, Appropriateness of Underlying Subject Matter and Suitability of Criteria* so that the guidance contained in SAAEPS 1 can be readily implemented by assurance practitioners? If not, what other initiative have you/your firm taken? And/or, how do you/your firm propose to raise awareness amongst assurance practitioners about SAAEPS 1?

- 2 In your/your firm's preparations to implement SAAEPS 1, what initiatives have you taken so as to be able to provide feedback to the IRBA on lessons learnt regarding any specific aspects of SAAEPS 1? If not, what initiatives do you/ your firm plan to take in order to be able to provide feedback to the IRBA on lessons learnt regarding any specific aspects of SAAEPS 1?

- 3 Are there specific aspects of SAAEPS 1 that you have found helpful? If so, please provide a description thereof and why.

- 4 Are there any specific aspects of SAAEPS 1 that create challenges to you/ your firm/ your client(s) for implementation in practice? If so, are there particular enhancements to SAAEPS 1 or support materials that would assist in addressing these challenges?

Should you have any feedback on implementing SAAEPS 1, contact the IRBA by email at standards@irba.co.za. Please provide your feedback by 15 December 2019.

SAAEPS 1 may be downloaded from the IRBA website (www.irba.co.za).

CONCLUSION

The IRBA encourages practitioners to early adopt SAAEPS 1 or to execute a 'dry run' using it on at least one client so as to be able to provide feedback to the IRBA on any lessons learnt. Preparers are also encouraged to familiarise themselves with those aspects of SAAEPS 1 that relate to them. Attendance of relevant training is also encouraged.

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NOTE

¹ The Sustainability Standing Committee is a standing committee of the IRBA's Committee for Auditing Standards.

SAAEPS 1

A practitioner's perspective

SAAEPS 1 provides guidance to a practitioner that will enable him or her to assess the value of a sustainability report to the user

The growth of assurance being provided on sustainability and integrated reports has required the auditing profession, through the Independent Regulatory Board for Auditors (IRBA) Sustainability Standing Committee, to consider the value to be achieved through the provision of assurance on those non-financial indicators that have been identified by the client. The Sustainability Assurance Engagement Practice Statement SAAEPS 1 (*Sustainability Assurance Engagements: Rational Purpose, Appropriateness of Underlying Subject Matter and Suitability of Criteria*) is aimed at providing practitioners with practical guidance on whether or not the preconditions for an assurance of this type of engagement exist. This is referred to as the rational purpose. Basically, it requires that the practitioner considers whether or not there is any value or benefit to a reader of a sustainability report in having assurance provided on a particular financial or non-financial indicator.

The objective of this article is to explain what the responsibilities of the practitioner are in determining whether or not to provide assurance on an identified indicator – in other words whether there is a rational purpose that makes it worthwhile for assurance to be undertaken on a particular indicator. There are two key considerations when determining if there is a rational purpose:

- What aspects of the subject matter information are to be excluded from the assurance engagement and the reason for their exclusion?
- Who selected the criteria to be applied to measure or evaluate the underlying subject matter, what degree of judgement was used, and is there any evidence of bias? It is expected that an engagement would be more likely to have a rational purpose if the intended users selected or were involved in selecting the criteria.

The guidance is quite clear in that the practitioner has to determine whether or not there is a rational

purpose. This requires the practitioner to consider a range of factors, including the maturity of sustainability reporting by the reporting entity, the use of a recognised reporting framework and how this has been applied by the reporting entity, whether the indicators are commonly reported on by the industry, and whether there is a common understanding of how the indicators are reported on.

Key concepts to the saaeps 1 guidance provided

A key requirement to understanding the SAAEPS is the key concepts that provide the basis for the assurance engagement on the sustainability report. The sustainability information provides the basis for the subject matter information that is critical to determining that the sustainability assurance engagement exhibits a rational purpose, that the underlying subject matter is appropriate, and that the criteria that will be applied are suitable for the engagement circumstances.

- **Sustainability information** This typically includes information related to the reporting of social, environmental, governance and economic performance, targets and outcomes. This information may be financial, such as a key performance indicator on training or rehabilitation costs, or non-financial, such as litres of water consumed, tons of paper recycled and any narrative disclosures, such as a policy on stakeholder community engagement.
- **Reporting infrastructure** This allows for the production of relevant and reliable sustainability information and is central to the considerations of whether or not the sustainability assurance engagement demonstrates a rational purpose. It includes a combination of the application of a relevant reporting framework, the use of appropriate policies and procedures, ensuring that there are effective systems and controls, and essentially, governance and oversight.

- **Underlying subject matter, subject matter information and criteria** This requires that the concepts that underly the subject matter, subject matter information and criteria used are well understood as they are also key in determining whether or not a sustainability assurance engagement demonstrates a rational purpose. The determination of the subject matter and the subject matter information is achieved through the identification of the criteria to be applied. There are two types of criteria, namely scoping criteria and measurement or evaluation criteria. So, for example:
 - The first level of understanding is the need to report on sustainability performance (this could be the sustainability report).
 - The second level is to determine what is to be reported (subject matter). This would typically include environmental, social, governance and economic performance.
 - The third level is to then determine what to specifically report on (subject matter information). In the area of social performance, this may be customer satisfaction.
 - Finally, what is actually to be measured and reported on (the criteria) in the area of customer satisfaction. This may be the number of customer complaints received.

Concluding on rational purpose

This SAAEPS has as its primary objective to provide practical guidance to a practitioner to evaluate, prior to accepting a sustainability assurance engagement, as to whether or not there is a rational purpose, that is, whether there would be value to the user of the assurance report relating to the assurance opinion provided. The guidance provided requires the practitioner to consider a number of specific areas. These include:

- Whether aspects of the subject matter information are expected to be excluded from the assurance engagement and the reasons for their exclusion.
- Who selected the criteria to be applied to measure or evaluate the underlying subject matter, and to what degree of judgement did this affect the assurance opinion provided. The engagement is more likely to have a rational purpose if the intended users selected or were involved in selecting the criteria.

This requires the practitioner to determine the need for the entity to report on sustainable performance, and if this is necessary, to determine what needs

to be reported. There is an expectation that the responsible executives, with oversight by the governance structures, will agree to the reporting of those indicators that will provide the intended user with the necessary insight to make a decision. Hence, understanding the criteria used to determine what subject matter needs to be included is a critical decision point. The practitioner needs to have a good understanding of how management determined what to include or exclude to ensure that the intended users have the necessary information to base their decisions on.

Second, the practitioner needs to understand the context in which the information is to be gathered and reported on. It is essential that the practitioner obtains the necessary understanding of the macroeconomic factors, laws, regulations and industry practices within which the entity operates and how this can impact on the indicators to be reported on.

Third, the practitioner needs to assess the underlying subject matter, being the information that needs to be measured or evaluated. This information may include well-defined information that is widely used in the market, or it may be assumptions or an assertion made by management. If this information is not capable of consistent measurement or evaluation, it may not be possible for the practitioner to form an opinion on it.

Finally, the practitioner needs to consider what reporting framework, related reporting systems and internal controls are being used by the reporting entity to develop the reporting content. The variability of the various reporting frameworks, systems and internal controls currently in use in reporting sustainability reporting requires the practitioner to assess the ability of that framework to be able to ensure the recognition, measurement, presentation and disclosure that will cater for the majority of the areas where the reporting entity may apply judgement.

Conclusion

SAAEPS 1 provides guidance to a practitioner that will enable him or her to assess the value of a sustainability report to the user. While this guidance is focused on understanding the decision-making processes that the practitioner will use, it is worthwhile for executive and governing bodies to be aware of the need to ensure that what is reported in a sustainability report is relevant to the achievement of the strategic goals of their businesses.

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