Centre for Social and Environmental Accounting Research

Accountability Transparency Sustainability

Environmental and Social Accounting & Reporting

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PLEASE NOTE: The HTML version of this document is formatted rather differently compared to the original word processed version. In particular, footnotes now appear within the text. Sorry for the inconvenience.

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Environmental and Social Accounting & Reporting

1. Background

Introduction

In essence, there is nothing new about environmental and social issues. They have, of course, always been with us and no decent business has been able to ignore them. What *is* new is the place they occupy on business and political agendas. At no time in, at least, the last 20 years have matters relating to an organisation's interactions with the physical environment and society been so widely accepted as central, even crucial, to the future well-being of both the business *and* those who are affected by it. Whether for moral, economic, legal or pragmatic reasons, every organisation is having to make an increasingly explicit assessment of its environmental and social impact and to attempt to re-position itself as the terms of the social contract between business and society come under increasing scrutiny. It is now well-established that business success is drawn, in part at least, from the natural environment and society. That is hardly contentious. What *is* more contentious, is whether that business success is gained at the expense of environmental and social degradation - or whether, indeed, business success actually makes a net contribution to the well-being of society and the natural environment. As soon as we recognise that these trade-offs between (organisational) success and (societal/environmental) degradation or contribution are not trivial, we must accept that the business is not *just* an economic entity and its *overall* success or failure is *not* captured by the accounting numbers and the bottom line. There is a very real danger at this point that accounting and reporting are sending some seriously misleading signals. Environmental and social accounting are an attempt to try and balance - or, at least, to ameliorate the dangers arising from - those misleading signals.

No organisation in the UK can be unaware of the increasing emphasis on, for example, environmental management, environmental audits and stakeholders or the increasing importance of regulatory bodies such as the Environmental Agency (Scottish Environmental Protection Agency north of the border). Voluntary initiatives, market and social pressures, strategic opportunities, opportunities for cost savings, reduction of environmental and social risks, moral decency and the slow, but inexorable, growth in regulation are all ensuring that more and more organisations are having to address the 'externalities' arising from their economic mission. And yet, to look at most companies' financial statements or annual reports, you would hardly be aware that anything important was happening. Companies and accountants playing at ostriches might have seemed a reasonable, even responsible, attitude ten years ago. Now it looks increasingly professionally indefensible.

Accounting, auditing and reporting are showing the first signs of response to the increased demands for environmental and social responsibility and accountability. The question of 'if' we should develop environmental and social accounting has been replaced by the questions of 'how?' and 'when?'. Whether these developments will arise through legal, market, professional or industry initiatives is not yet clear, but as the following pages illustrate, there is both an inexorability *and* an inevitable desirability about these new accounting developments. No well-managed business or self-respecting professional accountant can afford to ignore them.

In this short chapter we will introduce some of the principal elements of environmental and social accounting, outline current requirements, illustrate current best practice and try to point to the most likely directions for the near future. We will consider the emerging practice of environmental and social accounting & reporting as comprising the following strands:

- the environmental impact on financial statements and auditing;
- environmental reporting;
- social accounting and reporting;
- accounting and sustainability.

We deal with each of these in separate sections below.

2. Financial Statements and Auditing

Current UK Requirements and Proposals

Currently no accounting or auditing standards are devoted to environmental issues, although explicit references are made to them in a number of auditing standards and in SSAP 13 (Accounting for research and development) where environmental legislation is cited as an important consideration in assessing the commercial viability of deferred development expenditure. Current disclosure requirements, thus, have little noticeable impact on financial statements. What little there is, appears in the form of (infrequent) explicit mentions of environmental issues within the statement of accounting policies or in relation to provisions and contingencies. No requirements exist for the separate disclosure of environmental expenditure *per se*. Most (of the few) references to environmental issues in annual reports tend to be outside the audited financial statements, (see below).

Auditors, of course, have a (limited) responsibility for any information published with financial statements (especially, but not only, in the Directors' Report) and must check *inter alia* that any references to environmental issues in the annual report and possibly in free standing environmental reports are consistent with the financial statements. Also environmental impacts on financial statements may be very significant without being explicit. The research report *The Financial Auditor and the Environment* (ICAEW, 1996) provides strong evidence that there is a need for increased expertise and awareness of the significance of environmental issues for the financial statement audit, particularly among smaller firms. Specific guidance for auditors is starting to appear: the Canadian Institute of Chartered Accountants (CICA) issued a set of guidelines (*Audit of Financial Statements Affected by Environmental Matters*) in January 1994 and The International Auditing Practices Committee drew heavily on this work and on work done by the Limperg Institute in the Netherlands for their May 1995 Discussion Paper (*The Audit Profession and the Environment*).

Although SSAP 13 is the only current standard which mentions environmental issues explicitly, the subject is addressed elsewhere in UK GAAP. For example, the Operating and Financial Review (OFR) enjoins preparers of accounts to 'discuss the main factors and influences that may have a major effect on future results'. Examples of matters that may be relevant include environmental protection costs and potential environmental liabilities. *Company Reporting* (December 1996) reviewed experience with the (non-mandatory) OFR and concluded that it was failing to deliver the original goals of the ASB and that when given a free rein companies could be expected to disclose only items that show them in a positive light. Exceptions to this generalisation can certainly be found: **Zeneca PLC** made reference to '3 minor prosecutions involving small fines' in the Safety, Health and Environment section of their 1996 annual report and **BG plc** admitted to failure 'to meet our objective of a year free from prosecution or enforcement notices relating to health, safety or environmental legislation' in their annual report for the year to 31 December 1996. But the general point made in *Company Reporting* is surely valid. A statutory framework for the OFR is one of a number of suggestions for strengthening corporate governance made in a recent ICAEW study (*Accountancy*, May 1997, p.16).

The most significant initiative so far by the ASB in this area was the issue in 1995 of the discussion paper "Provisions" and at the time of writing a FRED on the subject is imminent. As well as addressing the general principles of their treatment the paper dealt with certain specific applications of the principles and included a chapter on environmental liabilities. In brief the paper recommends:

- that a provision for the costs of remedying past contamination should be recognised when an entity is legally or constructively obliged to rectify the damage;
- that expenditure that is provided for is capitalised only when it provides access to future economic benefits (the question of whether there should be *increased* future benefits to warrant capitalisation - and how these might be measured - has been the subject of some debate but not within this discussion paper);
- that in the case of abandonment costs, full provision (discounted where material) for the total costs should be made when the environmental damage is inflicted. (This represents a change from current practice which is to build up the liability gradually.) Such costs would be capitalised as part of the cost of the facility. This last recommendation has been challenged by, amongst others, the ICAEW.

There are passing references to environmental issues in a number of other ASB publications which, for completeness, will be very briefly outlined. The Exposure Draft of the *Financial Reporting Standard for Smaller Entities* makes equivalent references to those made in

SSAP 13 regarding development expenditure. In the Exposure Draft of the *Statement of Principles*, Chapter 5 (Measurement in financial statements) refers to environmental liabilities (along with pension provisions - but see below) in the context of the difficulties of making estimates. The Discussion Paper *Impairment of Tangible Fixed Assets* exemplifies impairment by reference to environmental legislation terminating a manufacturing process. The *Measurement of Tangible Fixed Assets* Discussion Paper cites environmental factors as a relevant issue in the calculation of the "Depreciated Replacement Cost" (DRC) of "Specialised properties". Finally, and most recently, the working paper *Discounting in Financial Reporting* gives fairly detailed consideration to environmental liabilities (amongst other topics) and their ultimate cost is described as "much more uncertain" than pension provisions.

Financial Reporting Initiatives

Amongst the increasing number of recent (and often related) reports concerning environmental matters in financial accounting from the professional bodies in Europe and North America, two recent UK reports by the ICAEW (*Environmental Issues in Financial Reporting*, 1996) and the Advisory Committee on Business and the Environment (ACBE, *Environmental Reporting and the Financial Sector*, 1997) are especially worthy of mention. However, neither report contains suggestions for extending disclosure requirements on environmental items beyond what is currently needed under conventional materiality grounds. We feel that environmental issues are qualitatively, and potentially quantitatively, different from all other issues with financial impacts. They do not just have financial impacts, they are a constant reminder of the limitations of the term itself. The difficulties of quantifying the full external costs of environmental impacts are indeed profound, (see below in the **Sustainability** section of this chapter). The urgent reality is that these costs are still accumulating, whether we attribute a number to them or not. And therefore, in our view, the profession should take whatever limited measures it can to at least systematically remind readers of accounts of our great communal environmental gamble (and thereby at least not help conceal it). In more prosaic terms that means disclosing whatever we currently can in terms of conventionally measured environmental costs. CICA's *Statement of Principles on Environmental Costs and Liabilities* makes the case for the special nature of environmental costs and recommends their separate disclosure. Illustrations 1 and 2 which appear below are good examples of what can be achieved.

Two special examples of disclosure that we would like to see (preferably in audited accounts) are, firstly, details of fines and penalties for non compliance with environmental regulations. This is a recommendation of the ACBE report although it sees the OFR or an Environmental Report as the appropriate location. The ICAEW report does recognise the importance of reporting significant non-compliance but the point is not highlighted as one of its conclusions. The report also cautions against the possibility that expenditure on penalties and fines which contribute to a high or increasing figure for disclosed environmental costs could be misinterpreted as a favourable signal. In our view this is easily avoided by appropriate disclosure. Precedents for separate disclosure in particularly significant or sensitive areas already exist (for example R&D expenditure and transactions with directors) and environmental issues arguably warrant similar treatment. In the case of fines the key notion is what has been called "inductance" i.e. the potential of what is reported to influence behaviour *within* the reporting entity. Thus disclosure requirements that may not necessarily be material in influencing the judgement of a user of accounts may have a dramatic effect in concentrating the minds of those who are responsible for environmental rectitude. Secondly we feel that the debate over whether the ultimate cost of abandonment/decommissioning costs should be recognised in full as a liability (with or without discounting) should not obscure the more vital issue of *disclosing* the information, whatever the outcome of that debate. The example of Scottish Nuclear in Illustration 2 below shows the feasibility of such disclosure as a note.

UK Company Practice

In this section we shall give some examples of explicit references to environmental issues in companies' financial statements and to financially relevant information that they have published elsewhere. As a forthcoming ICAS monograph (*The Valuation of Assets and Liabilities: Environmental Law and the impact of the environmental agenda for business*) reports, environmental issues may significantly influence the size of the numbers in financial statements and yet not be mentioned explicitly. Similarly the recent ICAEW report *(The Financial Auditor and the Environment)* found that auditors had widespread experience of environmental issues having both actual and potential material impacts on clients' financial statements. The auditors' responses showed contingent liabilities to be the most widely experienced type of financial statement impact, and, anecdotally, it is often the first example that accountants would cite as typical. This may be because the relevant disclosure requirements would often make the environmental link explicit. However other widely experienced impacts (which would often not require the degree of disclosure that would make the environmental issues apparent) include depreciation, valuation of fixed assets especially land, stock valuation and the cost of compliance with environmental standards. Thus, whilst the examples cited in this chapter are chosen because of their explicit treatment of environmental issues, it is worth remembering that the financial significance of these issues is very often unrecorded.

General Financial Disclosures

While companies in industries with the more obvious environmental exposures (e.g. chemicals) often provide the most clear examples of financial statement impacts, environmentally-motivated financial reporting is not limited to these. **Thorn EMI**, for example, claims in its 1995 Annual Report and Accounts to have relatively small environmental impacts. The company has, however, taken to environmental reporting with both enthusiasm and distinction. Its Annual Report and Accounts has an environmental section in which the company discloses financial information. (See Illustration 1).

ILLUSTRATION 1 ABOUT HERE

Thorn EMI's audited financial statements make no mention of environmental costs and while the outlays described in Illustration 1 are, in one sense, hardly material in the context of a £4billion plus turnover and over £300million operating profit they are nearly twice as large as the Research and Development Costs which, of course, are required to be separately disclosed.

Even this limited disclosure is unusual, most companies make no mention of, let alone attempt, financial quantification of these costs. One company which at least makes reference to the disclosure of environmental costs is **Allied Domecq PLC**. Its 1996 Annual Report contains a 'Citizen' section in which the main features of environmental policy are described in some detail. Although the company does give an example of relevant expenditure:

> *For example, the Maker's Mark distillery in Kentucky spent nearly $1 million last year on a water treatment plant which allows all the distillery waste to be processed to give water purer than required by local regulations*

it goes on

.....It is not possible to give a comprehensive figure for the amount spent across the group. Effluent control or emission reductions, for example, are considered part of the ordinary process of running the business and are not accounted for separately.

US disclosure requirements have generally forced the pace of development in financial reporting of environmental issues. For example the 1993 Annual Report of **Shell Transport and Trading PLC** acknowledged that

... on going expenditures associated with managing hazardous substances and pollution abatement are considered as an ordinary part of carrying on business and are only separately identified in the case of the USA.

Specific Financial Disclosures

Illustration 2, which contains extracts from **Scottish Nuclear Limited's** 1995 financial statements exemplifies an extreme case of the potentially long term nature of environmental liabilities.

ILLUSTRATION 2 (Scottish Nuclear) ABOUT HERE

In Illustration 2 we have omitted for reasons of space the detail of the provisions for liabilities and charges showing opening and closing balances, increases and utilisations, broken down by major categories. This also allows us to focus attention on the rare disclosure of totals payable (both discounted and undiscounted) and their comparison with the provisions already made. The discussion which concludes the extract is highly pertinent to the ASB's 1995 Discussion Paper on Provisions and also, in our view, demonstrates that disclosure rather than recognition is the primary issue. In addition to their financial statements, **Scottish Nuclear** produced a separate report, *Managing Waste and Decommissioning 1994/95,* which included a restatement of the financial information concerning their provisions. This separate report restated in a slightly more accessible style, and expanded on, the information contained in the financial statements as follows:

Decommissioning Provisions (extract)

Expenditure on decommissioning and waste management is spread over a long timescale, much of the cost not falling due until many years after the generation of electricity - and hence income - has ceased. Therefore it is important that adequate financial provisions, based on these cost estimates, are made during the productive lives of the power stations.

Provisions are made by estimating the current cash costs of decommissioning and discounting them at a rate of interest which represents a real increase in provisions. The rate used by Scottish Nuclear is 2% above inflation per annum and provisions must therefore be maintained from profits at this rate. Provided Scottish Nuclear earns at least this rate of return, the provisions will be adequate to pay for the decommissioning of the stations.

At present, provisions set aside are reinvested in the business and not held as cash. This effectively reduces the need to borrow externally and hence reduces the cost of finance.

Scottish Nuclear Ltd, Managing Waste and Decommissioning 1994/95

In 1996 both **Scottish Nuclear** and **Nuclear Electric** were privatised as subsidiaries of **British Energy plc** and a significant change was made to the provisioning process (following on from a significant change in the discount rate from 2% to 3% in the year to 31 March 1996). There now exists a "Segregated fund" for the long term costs of decommissioning into which **British Energy** makes quarterly payments. The fund is managed by an independent Board of Trustees. Therefore, even if **British Energy** were to go into receivership, money would be available, subject to realistic provisions having been made, to meet its long term liabilities. It is arguable that all organisations with long term environmental cleanup liabilities should be required to set up such funds given the reality that such liabilities would have to be met ultimately by the community (ie the taxpayer) and provisions do not, of course, guarantee that any resources will be available.

A further example of environmental liabilities, and of contingencies which derive from the US "Superfund" legislation is provided by **Zeneca Group PLC's** 1996 accounts. In this case the level of environmental provisions has been obscured by their aggregation with other categories.

illustration 3 (Zeneca) ABOUT HERE

Future Developments

There is an inexorability to the increased attention being paid to environmental issues in financial accounting and reporting. The accounting profession has, so far, generally sought to contain such attention to the confines of existing GAAP. It is likely that it will continue to be "successful" in this restriction for the immediate future. Environmental degradation is, however, a fundamental problem to which systematic attention is increasingly demanded from companies - not least by shareholders, financial markets and other stakeholders. In the face of such degradation, it is quite apparent that the financial statements will become increasingly misleading. If something as crucial as protection of the environment will not "fit" into current GAAP, then the inescapable conclusion is that there is something amiss with current GAAP. It is, hopefully, only a matter of time before this conclusion is apparent to the profession and to those responsible for future Companies Acts.

3. Environmental Reporting

Whilst there was a steady growth in companies touching upon environmental issues in their annual reports during the 1980s, it was not until the publication of the first UK Environmental Report by **Norsk Hydro** in 1990 that environmental reporting hit the headlines. Since then environmental reporting has become an accepted part of the business reporting landscape.

Current Reporting Requirements

Environmental reporting in the UK is still a voluntary activity. This contrasts starkly with the situation in Denmark and the Netherlands which countries passed legislation in 1996 making environmental disclosure in the Annual Report mandatory for larger companies.

Whilst it would be good to see imaginative and sensible legislation along the lines of the Danish requirements introduced throughout Europe, there are no immediate signs of this happening. Europe did attempt to bring in an environmental disclosure requirement via the Environmental Management and Audit Scheme (EMAS). Registration under EMAS requires organisations to produce a significant - and 'verified' - environmental statement. However a combination of business lobbying (which apparently encouraged the EU to make EMAS voluntary rather than compulsory) and the increasing popularity of the less demanding International Standard on environmental management systems (ISO 14001) suggests that universal environmental reporting is unlikely to arrive by this mechanism.

Codes of Practice and Guidelines

In place of legislation on environmental reporting there has been a significant number of attempts, especially in the UK, to encourage business to take up environmental reporting on a voluntary basis. This encouragement has come in the form of systems to encourage voluntary environmental disclosure as well as codes of practice and environmental reporting guidelines. For example, companies signing up to EMAS or codes of practice such as the *CERES Principles* or the *CBI Environment Business Forum* commit to undertaking systematic and regular environmental reporting. Encouragement has also come from business groups such as the *100 Group of Finance Directors, Business in the Environment, The Chemical Industries Association* and *The Advisory Committee on Business and the Environment*. Such cajolery has had some success but what seems to have kept the voluntary ball rolling has been the (unexpected) discovery by companies that environmental reporting - if undertaken seriously - is actually a very valuable business exercise. As most of the environmental information necessary for a report (see below) should already be known to the company, the only costs are those of collation, design and distribution. All of these can be minimised through, for example, publication on the Internet. The advantages to the company can be considerable and include keeping employees informed, changing the emphasis on environmental stewardship, encouraging personal values to be manifest in the organisation, communication and dialogue with stakeholders, annual progress monitoring and so on. The only major downside seems to arise from woolly or misleading reports when the external critics *do* pounce. In other cases, the external pressure groups have proved to be highly supportive of companies undertaking serious environmental accountability.

The first global environmental reporting guidelines were issued by the United Nations, (see Figure 1), with the intention to encourage sovereign governments to incorporate such guidelines into their national laws. Further guidance on what an environmental report should cover has proliferated. The cores of these guidelines are very similar. They wish to encourage organisations to disclose:

- information on the organisation and its environmental interactions;
- environmental policy and steps taken to implement that policy;
- environmental targets on such matters as emissions, resource use and waste plus data on progress in meeting those targets;
- plans for the future; and
- some analysis of the relationship between the financial and environmental performance of the entity.

Additionally, guidelines are beginning to address such matters as environmental risk, communication with stakeholders, educating the financial markets on environmental matters and the longer term demands of sustainability.

Although such guidelines have clearly influenced the developments in environmental reporting, few companies fully comply in detail with them. A more significant influence appears to have been the emergence of best practice set by organisations at the leading edge of environmental reporting.

UK Company Practice

There are four broad ways in which companies choose to reflect the growing environmental agenda in their reporting. *First*, they may choose to ignore it altogether. This is still the chosen path for most, especially smaller, companies. *Second*, companies may give some partial attention to environmental issues within their annual report. The majority of the UK's largest companies - and virtually all of the largest 100 - have reached at least this stage. *Third*, companies may produce a systematic environmental review in the annual report itself. This practice is not yet that widespread. However, **Inveresk plc**, a medium sized paper company, is a particularly good example, (see Illustration 4). *Fourth*, a company may produce a stand alone environmental report (perhaps producing just a summary of this in the annual report - see, for example, past reports from **Thorn EMI)**. This is where most attention on environmental disclosure is directed - although this still remains something of a minority activity. *Company Reporting* identified 42 such environmental reports produced by UK companies in 1996 - 32 of which were from FTSE 100 companies.

ILLUSTRATION 4 (Inveresk) ABOUT HERE

Keeping abreast of environmental reporting practice and developments is now relatively simple. In addition to research reports from, *inter alia*, the professional accountancy bodies and the United Nations and one-off reports from organisations such as the Big Six and other consultancies and NGOs with an active interest in the field, regular updates are published in a variety of forms. KPMG, for example, produces an annual survey of environmental reporting and the excellent *Environmental Accounting and Auditing Reporter* provides analyses and discussions of notable environmental reporting (and other accounting and auditing) developments. More illustrative detail is contained in *Company Reporting*'s periodic coverage of environmental disclosures whilst the *ACCA's Environmental Reporting Award Scheme (ERAS)* provides a window onto the UK and mainland European state-of the-art.

The issue of reporting quality is of increasing concern. The clarity of the report, its communication of the central environmental factors in the business and, most particularly, the completeness of the report are essential characteristics. Completeness here concerns providing the reader with a confidence that they have a comprehensive picture of the important aspects of the organisation and that performance data has not been selectively reported. A water company which ignores its management of reservoirs or the quality of drinking water, an oil company which ignores its more contentious activities overseas or a bank which ignores its lending activities are all past examples of incomplete reports. The mainland European companies have shown us the way in this area through their development of the *eco-balance*. Pioneered in Germany and Austria, the eco-balance involves measuring all inputs to the organisation and matching them (for example via weight) to all outputs, emissions and leakages from the organisation. (Particularly helpful published examples of this approach are given by **Danish Steel Works** and **Kunert AG**). The approach has been adapted by a number of UK companies to provide a flow chart of the inputs and outputs of the organisation. The following extract from **BT plc**'s *A Report on BT's Environmental Performance 1995/96* illustrates both clarity in reporting and the use of an input/output flowchart.

ILLUSTRATION 5 (BT plc) ABOUT HERE

A further characteristic of quality relates to the setting of targets and reporting quantitative data against those targets, the integration of the company's environmental and financial data and an honesty in recognition of limitations in the reporting and/or in the environmental performance itself. Environmental Reports from companies such as **BT**, **Thorn EMI** and **London Electricity** all provide examples of these characteristics. Illustration 6 is drawn, however, from **J Sainsbury plc** which was a first-time environmental reporter in 1996

ILLUSTRATION 6 (Extract from J Sainsbury plc) ABOUT HERE

A new approach to assessing reporting quality has recently been undertaken by *Company Reporting* (February 1997). The company's approach has been to devise an *Environmental Reporting Scoreboard* of reporting quality - based on 21 separate elements of environmental disclosure - divided by a factor that accounts for the 'environmental significance' of the company and its sector. **Body Shop** comes out as the clear leader with **BT, British Airways** and three of the water companies (**Severn Trent, Nothumbrian** and **Yorkshire**) leading the rest of the 42 companies assessed. 1997 is the first year in which the *Scoreboard* has been compiled but it seems likely to continue.

Two further attributes that commentators are beginning to look for in environmental reports are the careful examination of the implications of sustainability for the business (see later section) and the independent attestation of the environmental report.

Independent Attestation of Environmental Reports

Just as it is accepted practice that financial statements - if they are to be at all reliable - must be subject to the scrutiny of an independent third party so there is a growing view that environmental reports must be attested to in the same way and for the same reasons. Indeed, registration under EMAS not only requires the publication of an environmental report but that report must be attested to by an independent third party - the 'independent verifier'. In Germany, where EMAS registration is much more widespread, this independent attestation is becoming a commonplace. In the UK, attestation is only performed on a minority of environmental reports. *Company Reporting* identifies eight of the 42 reports analysed as carrying attestation statements. A similar proportion (in the region of 15-20%) of all submissions to the ACCA ERAS has carried an independent attestation statement. More interestingly, however, over 60% of ERAS *shortlisted* reports have carried an independent audit report - although this is only one of many criteria for shortlisting. The attestations are supplied by consultancies and, on occasions, by the larger accountancy firms.

In the voluntaristic climate in which UK environmental reporting has developed, there are mixed views on the value of such attestation. Whilst the need for attestation might seem, from an accountability viewpoint, to be self-evident, opposition to the concept is fairly widespread. Whilst some reporting organisations probably dislike the disruption, the cost and, indeed, the being called to account inherent in the audit process, other reasons for the avoidance of attestation have been offered. It can be argued that: *first*, the need for experimentation in environmental reporting may be stifled by the potential of an independent attestation; *second,* the greater certainty of 'environmental facts' makes the nature of the thing being attested to less open to question; and *third,* the audit opinions themselves, being only about management systems (rather than environmental impact) and largely determined by the client (as opposed to an independent authority), may actually offer little additional comfort to the reader. Whilst the first two of these arguments are of little real substance in practice, the third *is* a matter of concern and will, in due course, need to be subject to independent regulation.

Conclusions and the Future for Environmental Reporting

Environmental reporting is continuing to expand and evolve. Whilst current best practice is relatively easy to identify - and an increasing minority of companies can be seen to be operating at this level - some important issues remain. Probably the most important of these are: ensuring the widespread practice of environmental reporting - a virtual impossibility in the absence of regulation; developing standards for the completeness of environmental disclosures; establishing best practice in attestation of the reports; and looking forward to the more demanding challenges of reporting about sustainability (see below). One thing seems certain, however: environmental reporting is no passing fad. It is here to stay. The only questions are what form it will eventually take and how its adoption by *all* organisations will be achieved.

4. Social Accounting and Reporting

Whilst social accounting and reporting enjoyed a fairly wide currency in the 1970s (featuring, for example, quite prominently in *The Corporate Report* in 1975), it had largely disappeared as a systematic matter of significant concern by 1980. In much the same way as environmental reporting has re-emerged, so social accounting and reporting has recently burst back to prominence with renewed vigour. Little illustrates this better than the public commitments in 1996 by **Shell** and **BT** to the development of their own social reporting processes. There are many reasons for this renewal of interest. The increasing concern with stakeholders, growing anxiety about business ethics and corporate social responsibilities, the Royal Society of Arts' *Inquiry into Tomorrow's Company* and the increasing importance of ethical investment have all raised the need for new accounting and accountability methods through which organisations and their participants can address such matters. But probably the most important of all the influences has been the dawning realisation that environmental issues - especially when examined within the framework of sustainability (see below) - cannot be separated from *social* issues and the accompanying questions of justice, distribution, poverty and so forth. Social accounting, in all its guises, is designed to deal with exactly these issues.

What is it?

Social accounting and reporting is a rapidly developing and diverse field of practice. At its simplest, it relates to the collation and communication of data - financial, quantitative and/or qualitative - about an organisation's interactions with society. This collation may be undertaken by the organisation to which the social account relates (as is typically the case with financial statements and environmental reports) or it may be the work of a body external to - and often independent of - the organisation. The communication of the social account might be limited to internal, management use in the form of *social bookkeeping and information systems* or it may be for external consumption as a published *social account*. We will restrict ourselves to internally generated, externally reported accounts here.

The backbone of social accounting is the explicit recognition that every organisation has a wide range of stakeholders - those who are influenced by and/or, in turn, influence the organisation. In addition to shareholders and other financial participants, the most important of the other stakeholders are usually taken to be the employees, the local community(ies), customers, suppliers, the environment and government(s). From society's point of view, each of these stakeholders have rights to, amongst other things, information about the activities of the organisation - whether or not the organisation chooses to recognise those rights. From the organisation's point of view, it has a range of stakeholders that it must manage and whose interests it must balance if it is to remain a successful enterprise. These two points of view, not surprisingly, lead to different - though overlapping - specifications of what a social account should comprise. For this reason, if no other, social accounting is likely to remain an evolving and widely debated practice for the foreseeable future.

Current Reporting Requirements

UK companies - especially the larger companies - already produce a significant amount of social data in their annual reporting. Companies are currently expected to disclose, for example, information about:

- numbers and pay of employees;
- arrangements for consultation with employees;
- arrangements for disabled employees;
- pension arrangements and share ownership schemes;
- corporate governance;
- charitable and political donations;
- directors' involvements, remuneration and options.

To this, most larger companies voluntarily add - with varying degrees of detail and thoroughness - information about: health and safety at work; equal opportunities; community, arts and schools involvements; and (of course) the environment. All of this data can be thought of as a form of social reporting. For many companies this information is further enhanced by special reports, additional employee or community reports and other forms of social disclosure. So current social reporting is, already, common practice - albeit variable and scattered around the annual report and other documents. In fact, were organisations to collate all this information - what has been termed a *silent social account* - they would have data which could form the backbone of a reasonably substantial social report which could be so separately identified within the annual report.

On a more prosaic level, whilst there is every likelihood that the social data which companies are required to disclose will continue to rise, there seems only a remote likelihood of a requirement for a full social account becoming law in the next year or two.

Codes of Practice and Guidelines

From time to time, business and industry bodies have produced codes and guidelines on aspects of social reporting. Some of the most prominent in the past have been on such matters as reporting to employees, development of the value-added statement and the disclosure of information about employment in Southern Africa. More recently the possibilities of guidance on social reporting have been, albeit briefly, considered by organisations as diverse as Business in the Community, the Royal Society of Arts and the New Economics Foundation. But the primary source of formal guidance is most likely to emerge as the newly formed *Institute for Social and Ethical AccountAbility (ISEA)*. ISEA was founded as a cooperative venture between NGOs, universities, businesses and consultancies to encourage and codify best practice in social accounting. Most of the current examples of best practice of social accounting have the hand of ISEA - or one of its founder members - in there somewhere.

UK Company Practice

Whilst UK company social reporting is still dominated by the 'silent social account', a small, but growing, number of organisations has published social accounts. The most prominent of these is, undoubtedly, **The Body Shop** but important innovations are also being made by less well-known organisations such as **Traidcraft plc, Traidcraft Exchange** (a charity)**, Cooperative Retail Services, Shared Earth, Allied Dunbar Staff Charity Fund** and the **New Economics Foundation**.

Probably the best way to envisage the emerging best practice represented by organisations like these, is to think of the social account as comprising three layers of information. These three are:

- Descriptive data about the organisation's stakeholder relationships: this would include information on such things as employee numbers and pay by category of employee; community involvement initiatives; and provision of facilities for customers. Such data is much the sort of thing found in existing annual reports.
- Information relating to the accountability of the organisation: this relates to reporting the extent to which the company is meeting current legal, ethical and industry standards, for example. It might well include, accident rates and sickness leave, numbers of disabled employees, noise levels, fair trade conditions and assessments of compliance with the company's own mission statement. An obvious element of this is the sort of data currently being produced in the better environmental reports.
- Stakeholder dialogue information provides the third layer of information. This data relates to the processes undertaken by the organisation to consult - and listen to - *all* its stakeholders and provides public feedback on what the stakeholders had to say about the company, its ethical positioning, its community responsibility and its provision of reliable information about its activities.

We can see each of these strands in current social reports.

Single illustrations can give no more than a flavour of the more innovative social reports. Illustration 7 is taken from the **Traidcraft Exchange** *Social Accounts 1995/1996*. The Traidcraft Exchange social accounts were built around six broad groups of stakeholders and, for each group, 'descriptive', accountability and 'stakeholder voice' data was reported. The extract relates to the descriptive data for the staff and volunteers stakeholder group.

ILLUSTRATION 7 (Traidcraft Exchange) ABOUT HERE

The development of reporting the 'voices' of the stakeholders is a new and important development. The **Body Shop** *Social Statement 1995* is perhaps the most detailed example of this approach. The extract shown here, from a 134 page report, reports one aspect of the shareholders' views about the company.

ILLUSTRATION 8 (Body Shop) ABOUT HERE

The Future of Social Accounting and Reporting

Consideration of social accounting and reporting by companies would have been unthinkable only a very few years ago. It is now rapidly taking its place as an essential element of well-run and accountable company. Social accounting and reporting was not implemented in the 1970s - ostensibly because there were no well-developed and defensible means of undertaking such an activity. This is no longer the case. Whilst experimentation in the field continues - and is extremely important - there is an emerging 'best practice' that shows every sign of being increasingly widely practised, which will be codified into guidelines and standards in the coming years (by the Institute of Social and Ethical AccountAbility) and which will, in all probability, find its way into organisational regulation in the foreseeable future.

5. Accounting for Sustainable Development

The growing importance of environmental and social accounting needs to be seen against the much wider - and more demanding - implications of sustainable development. Sustainability (or sustainable development - the terms can often be used interchangeably) will almost certainly prove to be the most important policy issue with which governments, business entities and society will have to grapple in the near future.

Sustainable development is usually taken to mean development activity:

> *... which meets the needs of the present without compromising the ability of future generations to meet their own needs.*
>
> *{**WCED (The Brundtland Report) 1987 p8**}*

Few would argue with such an apparently desirable goal. However, such a policy goal needs to be explicitly stated because, on a global scale, conditions for sustainable development are not being met. Current development, normally expressed in terms of economic activity, is not meeting the needs of all people alive today (one need only consider the starvation in many countries of the globe) and current levels of activity are having a significantly adverse impact on the natural environment (on which all present and future development rests). The question, therefore, becomes 'how can business respond to calls for it to play its part in pursuing sustainability?' Further, what potential role exists for the accounting profession in this context given national and European Governments have urged that business and accounting take on the challenge which sustainability presents?

Sustainability is usefully thought of as comprising two elements: one of which concerns environmental issues (eco-efficiency) and one of which deals with social elements (eco-justice), (see Figure 2).

While exploring these elements in the context of business and accountancy is in its fledgling stage it seems likely that social accounting and reporting may assist in shedding light on the eco-justice elements of sustainability, while environmental accounting and reporting should provide insight to the eco-efficiency elements of sustainability. While this broad alignment is evident it is also clear that accounting for sustainable development is likely to push the debate beyond the sum of social and environmental accounting and reporting. That is, it is increasingly apparent that current economic and business practices are not sustainable. This in turn raises very serious questions about how we organise our economic activity, how we measure organisational success and accounting's role in that measurement.

Current Reporting Requirements and Guidelines

There are no current requirements that companies should report on the extent to which their activities are in harmony with the demands of sustainable development. Current environmental reporting and management practices have only the most tenuous connection with sustainability. Best practice in environmental management and environmental reporting *does not* ensure that a company is moving towards sustainability. Even current guidelines which appear to deal with the issues - notably the International Chamber of Commerce's *Charter for Sustainable Development* and the pronouncements from the World Business Council for Sustainable Development - fail to address the deeper questions about total resource use, let alone consider eco-justice issues.

And yet, national governments are increasingly emphasising the exigencies of sustainable development in their institutional frameworks. The UK government reports periodically on progress towards attempts to incorporate the requirements of sustainability into the economic life of the nation. This, in turn, is bound to influence the corporate environment in due course. More pertinently for accounting and reporting, both the European Union and the United Nations have explicitly addressed the role that accounting will have to play if corporations are to rise to the sustainability challenge. The EU *Fifth Action Programme on the Environment*, (*Towards Sustainability*) has signalled its desire for accounting to redefine its concepts, rules, conventions and methods so that the full cost of consuming and using environmental resources are calculated and included in product costs and ultimately prices. It is believed that this will lead to changed use of resources and hence will assist the pursuit of sustainability. The United Nations Conference on Trade and Development has instigated a range of research projects intended to explore how accounting might contribute to a move towards sustainability. The most recent of these are summarised in *International and Accounting Reporting Issues: 1995 Review* which outlines the (lack of) progress towards accountability for sustainability and offers a number of "blue sky" explorations of potential future directions for this most difficult of challenges. We have some way to go before detailed and systematic accounting and reporting for sustainable development can become common practice.

UK Company Practice

A sub-set of the environmental reports produced by companies now indicate perceptions of sustainable development and what the pursuit of this goal will imply for business. Responses to the sustainability agenda mirror those found in the environmental reporting arena ranging from no analysis of the concept, mere repetition of the definition of sustainable development adopted by Government, to well thought-out expositions of the likely future shape of more sustainable business organisations. By and large, the corporate disclosures in this area emphasise the environmental elements of sustainable development and neglect the social aspects of the concept. The pursuit of sustainability appears to be equated with sound environmental management, which it undoubtedly is not. Further, many of the disclosures on this concept seem to assume that sustainable development will be achieved with no real change to business activities. Despite this evidence of poorly informed business conceptions of sustainability, there are a number of companies that are recognizing the more radical characteristic of sustainability. Illustration 9 quotes from three environmental reports where sustainable development is discussed.

Full(er) Cost Accounting

The area of full(er) cost accounting is the area where the sustainable development agenda is most likely to impact upon accountants in the shorter term. A number of company experiments - some prompted by, some unrelated to, the EU's Fifth Action Programme - are underway to develop a methodology which would amend the present narrow base of accounting. We can see attempts to try and understand what the cost of sustainability might mean for business in the experiments in North America (**Ontario Hydro**, **Baxter Health Care** and the **Tellus Institute**), Europe (**BSO/Origin**) and New Zealand (**Landcare Research Ltd**). It is too early to tell how these initiatives will develop and what impact they will have on accounting practice in the UK in the medium term. What is clear, however, is that this is likely to be an area of considerable debate and importance to the accounting profession in the future.

Likely Future Developments

Of all the areas covered in this chapter, accounting for sustainable development is the one which is least developed but which has, potentially, the most profound implications for business activities. In addition, via the exploration of what full(er) cost accounting may entail, the accounting profession (potentially, if they seize the initiative) is likely to be involved intimately in re-examining accounting fundamentals in the light of the challenge of sustainable development. Several proposals for accounting for sustainable development are in their very early experimental stages and it is these ideas which are likely to lead the profession forward in this area. While there is much uncertainty as to how this agenda will develop in the future, it is certain that current human (and hence business) activities are not sustainable. Thus, the pursuit of this goal will affect the way business in conducted in the future. Social and environmental accounting have a crucial role to play in accounting for sustainable development.

6. Conclusions

Environmental and social accounting and reporting are growing and increasingly important activities. Whilst not always popular with companies, the increasing importance of environmental issues, the re-emerging awareness of the social dimensions of organisations, the growing importance of stakeholding as a concept and the absolutely essential imperatives of sustainability are all ensuring that we must embrace these new forms of accounting. Recent years have seen, not only an increasing acceptance - even enthusiasm - for these new reporting approaches, but also energetic and innovative experimentation by far-sighted organisations that has brought us to the point where environmental and social accounting and reporting are not only crucially important but feasible and practicable as well. Environmental and social accounting and reporting were quietly ushered off the accounting and business agenda 20 years ago - it is most unlikely that they will suffer the same fate this time around.

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Social accounting is the process of communicating the social and environmental effects of organizations' economic actions to particular interest groups within society and to society at large. Social Accounting is different from public interest accounting as well as from critical accounting. Social accounting is commonly used in the context of business, or corporate social responsibility (CSR), although any organisation, including NGOs, charities, and government agencies may engage in social accounting