

CHAPTER 3 |

Sustainability – environmental and social reporting

31.1 Introduction

The main purpose of this chapter is to provide an overview of the impact of sustainability on financial reporting.

Objectives

By the end of the chapter, you should be able to:

- discuss the evolution of sustainability reporting including:
 - triple bottom line reporting;
 - the connected framework;
 - IFAC Sustainability Framework;
 - the accountant's role in a capitalist society;
- discuss the evolution of environmental reporting in the annual report:
 - European Commission initiatives;
 - United Nations initiatives;
 - US initiatives;
 - Self-regulation schemes;
 - economic consequences;
 - environmental audit;
- discuss the evolution of social accounting in the annual report:
 - the corporate report;
 - corporate social reporting;
- need for comparative data:
 - Global Reporting Initiative;
 - benchmarking.

31.2 How financial reporting has evolved to embrace sustainability reporting

Primary stakeholders

When corporate bodies were first created the primary stakeholders were the shareholders who had invested the capital and it was seen as the directors' responsibility to maximise their return by way of dividends and capital growth. This view was promoted by Milton Friedman¹ writing that:

few trends would so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their shareholders as they possibly can.

It follows from this that directors were accountable to the shareholders who in turn should hold them to account. The Friedman approach offers protection for shareholders provided they actually do exercise their ability to hold directors accountable. However, it does not have regard to the interests of any other group affected by a company's decisions, such as consumers, employees or communities impacted upon by a company's operations unless there is a financial benefit to the company.

Other stakeholders

Since Friedman's writing in the 1960s companies have been under pressure to be accountable to a growing number of stakeholders. The pressure can be seen to come from

- Europe, e.g. the limiting and charging for landfill waste;
- national legislation, e.g. the Companies Act 2006 requirement that the business review in the Directors' Report must include information about:
 - environmental matters (including the impact of the company's business on the environment);
 - the company's employees; and
 - social and community issues.

Companies are now expected to act responsibly in their relationships with other stakeholders who have a legitimate interest in the business. Although there was a fear within companies that their financial performance would be damaged if public costs and other stakeholder interests were taken into account, societal pressure has grown since the 1990s. The following is a quote from the World Business Council for Sustainable Development:²

CSR is the continuing commitment by business to behave ethically and contribute to economic development while improving the quality of life of the workforce and their families as well as of the local community and society at large.

There are three interesting points to highlight in this quotation. The first is the reference to behave ethically, the second is the acknowledgement that a company has an economic objective and the third is the extension to improve the quality of life of other stakeholders which includes environmental and social impacts.

As far back as 1975 there have been various initiatives such as the corporate report proposing the disclosure of additional information, such as employment and value added reports. External corporate reporting has been evolving from the simple financial reporting of profits and losses, assets and liabilities to, for example, the inclusion of information on governance (e.g. disclosure of directors remuneration), as well as non-financial information such as environmental and social policies.

The concept of the triple bottom line was to integrate the reporting of economic, environmental and social impacts to recognise wider stakeholder interests.

31.3 The Triple Bottom Line (TBL)

TBL was a concept developed in the 1990s³ under which financial, social and environmental performance were to be reported within the annual report. Economic performance was already highly developed, e.g. return on investment, gearing and liquidity ratios. The fact

of reporting social and environmental impacts provided an incentive for a company to identify and establish performance indicators.

Environmental impacts were identified in relation, amongst other things, to waste, emissions and energy. Social impacts were identified in relation, amongst other things, to employment and human rights issues.

However, sustainability reporting is evolving and the author of TPL writes⁴ that:

In sum, the TBL agenda as most people would currently understand it is only the beginning. A much more comprehensive approach will be needed that involves a wide range of stakeholders and coordinates across many areas of government policy, including tax policy, technology policy, economic development policy, labour policy, security policy, corporate reporting policy and so on. Developing this comprehensive approach to sustainable development and environmental protection will be a central governance challenge – and, even more critically, a market challenge – in the 21st century.

31.4 The Connected Reporting Framework

The Accounting for Sustainability project⁵ has developed a Connected Reporting Framework which will:

help provide clearer, more consistent and comparable information for use both within an organisation and externally. The new Connected Reporting Framework developed by the Project explains how all areas of organisational performance can be presented in a connected way, reflecting the organisation's strategy and the way it is managed.

The principles which underlie the new Framework are:

- sustainability issues should be clearly linked to the organisation's overall strategy;
- sustainability and more conventional financial information should be presented together so that a more complete and balanced picture of the organisation's performance is given; and
- there should be consistency in presentation to aid comparability between years and organisations.

The Connected Reporting Framework has the following five key elements

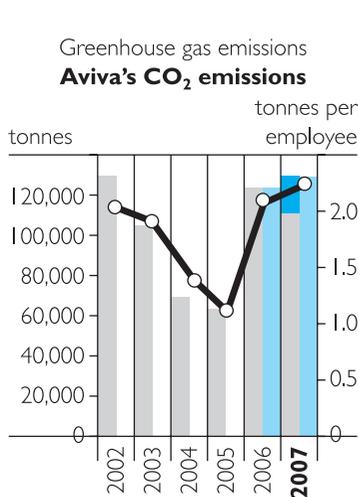
- 1 An explanation of how sustainability is connected to the overall operational strategy of the organisation and the provision of sustainability targets.
 - 2 Five key environmental indicators, which all organizations should consider reporting, being: polluting emissions, energy use, water use, waste and significant use of other finite resources
 - 3 Other key sustainability information should be given where the business or operation has material impacts.
 - 4 The inclusion of industry benchmarks, when available, for key performance indicators, to aid performance appraisal.
 - 5 The up-stream and down-stream impact of the organisation's products and services: the sustainability impacts of its suppliers and of the use of its products or services by customers and consumers.
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31.4.1 The Connected Reporting Framework illustrated

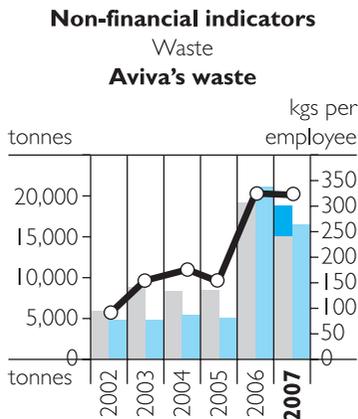
The following is an extract from the 2007 Aviva plc Annual Report:

Working with the Accounting for Sustainability project, Aviva is helping define a new reporting standard for sustainable business and a tool-kit to embed sustainable decision making. The table . . . (see below for extract) demonstrates some of the measures in the sustainability model. We continue to work towards internalising the cost of carbon and demonstrating how environmental impacts of the business can be brought into our reporting and accounting process:

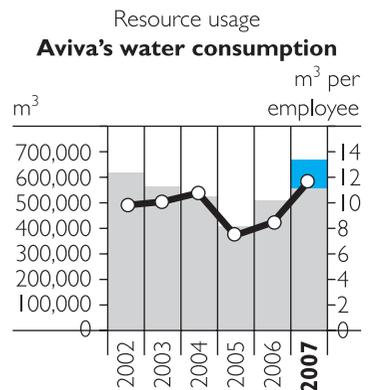
Key indicators		
Greenhouse gas Emissions	Waste	Resource usage
<i>CO₂ emissions</i> <i>Other significant emissions</i>	<i>Hazardous and non-hazardous waste</i> <i>Conservation investment</i>	<i>Water</i> <i>Energy intensity</i> <i>Paper usage</i>
	Direct company impacts Cash flow performance	
CO₂ emissions Total cost of offsetting 100% of our global CO ₂ emissions in 2007 is approximately £909,000. We incur up to a 2% premium for zero emission / renewable electricity compared to fossil fuels.	Total disposal cost for hazardous and non hazardous waste in the UK was £464,000 in 2007 (2006: £585,000) which includes UK landfill tax at circa £80 per tonne.	The operating cost of water usage was £938,000 in 2007 (2006: £670,000)



- CO₂ tonnes
- CO₂ offset
- CO₂ tonnes per employee
- New businesses



- Total waste (tonnes)
- Recycled (tonnes)
- Total waste per employee (kgs)
- New Businesses



- Water consumption m³
- Water consumption m³ per employee
- New Businesses

Commentary on our performance, strategy and targets

Greenhouse gas emissions	Waste	Resource usage
<p>In 2007, our total CO₂ emissions increased, mainly due to the inclusion of emissions data from our new business in Aviva USA, Aviva Global Services, Sri Lanka and Russia.</p> <p>From our existing businesses, emissions have shown an 11% decrease, by 13,555 tonnes reflecting significant focus on energy efficiency and resourcing renewable energy.</p>	<p>In 2007, the total volume of waste decreased and the total amount recycled increased.</p> <p>Plastic wrap from the Auto Windscreens operation is now being recycled – 70 tonnes per year with a value of £135 per tonne.</p>	<p>There is limited scope for the retro-fitting of latest technologies in water usage reduction in washrooms. However, where possible we take advantage of such technologies.</p>

	Industry Benchmark Information	
Greenhouse gas emissions	Waste	Resource usage
<ul style="list-style-type: none"> ● Carbon Disclosure Project CDP 5. 'Best in class' ● Innovest ranking 'AAA'. ● BREEAM minimum ranking 'Good' for new build and refurbishment. 	<p>200 kg of waste per employee per year.</p> <p>Recycling rate of 60–70% (BRE Office toolkit).</p>	<p>7.7 m³ per employee per year. (National Water Demand Management Centre).</p>

31.5 IFAC Sustainability Framework⁶

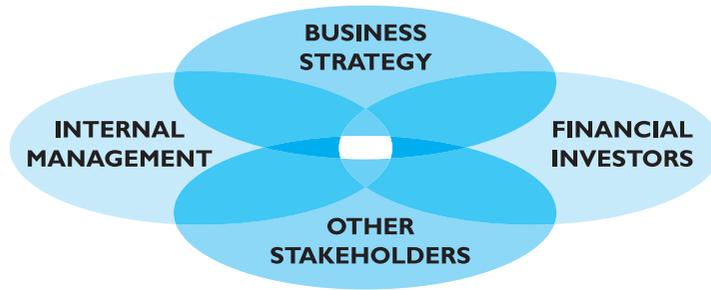
The Framework indicates that the successful management of a sustainable organisation requires attention to four perspectives. These perspectives are: business strategy, internal management, financial investors and other stakeholders.

As far as accountants are concerned, in an organisation a business strategy perspective would typically be taken by finance directors, an internal management perspective by management accountants and financial controllers, and a financial investors'/other stakeholders' perspective by accountants preparing and auditing the published financial statements.

31.5.1 The Framework's four perspectives

Taking a perspective means being aware of needs and concerns in relation to sustainability. For example, the importance attached to the control of carbon emissions by other stakeholders influences the priority given to it by management. This might also have to be reconciled with the business strategy perspective which could be that funds are being diverted away from productive capital investment. Taking a perspective means being aware, communicating effectively and influencing behaviour within an organisation.

Figure 31.1 is an extract from the Framework summarising the four perspectives.

Figure 31.1 The four perspectives

Part A: Business strategy perspective – taking a strategic approach

The Framework emphasises the importance of adopting a strategic approach, so that sustainable development is a part of strategic discussions, objectives, goals and targets, and is integrated with governance and accountability arrangements and risk management. Only by taking a business strategy approach can organisations make sustainable development a part of doing business.

Part B: Internal management perspective – making it happen

In many organisations, (a) enhancing performance evaluation and measurement, (b) changing behaviours, and (c) introducing sustainability and environmental accounting as an extension of existing accounting/information systems to accommodate organisational plans for sustainable development, can be a challenge for organisations, and can take time to achieve. Therefore, this perspective also includes advice on how organisations can achieve relatively simple quick wins to improve energy efficiency and reduce waste, that can help them improve environmental performance while reducing their costs, all in a relatively short time frame.

Part C: Financial investors' perspective – telling the story to investors

The Framework offers advice on both incorporating environmental and other sustainability issues into financial statements in a way that supports an organisation's stewardship role and enhanced reporting to investors in financial reporting, including narrative reporting using management commentary.

Part D: Other stakeholders' perspective – wider transparency

The final perspective considers an evolving part of sustainable development that builds on the development of stakeholder relationships (covered in the business strategy perspective) to improve transparency and non-financial reporting against a broader set of expectations. Such reporting commonly takes the form of separate sustainability or corporate social responsibility (CSR) reports that may be based on *de facto* standards, such as those from the Global Reporting Initiative (GRI). This perspective also includes sustainability assurance, to help to improve credibility and trust.

The proposals in the triple bottom line, the Connected Reporting Framework and the Sustainability Framework are voluntary proposals for best practice.

31.5.2 Why is the qualitative information voluntary?

It is voluntary in recognition of the fact that market and political pressures exist; that each company balances the perceived costs (e.g. competitive disadvantage) and the perceived

benefits of voluntary disclosure (e.g. improved investor appeal) in determining the extent of its voluntary disclosures.⁷

Companies have traditionally been ranked according to various criteria, e.g. their ability to maximise their shareholders' wealth or return on capital employed or EPS growth rates. However, there is a philosophical view that holds that a company:

possesses a role in society because society finds it useful that it should do so . . . [It] cannot expect to find itself fully acceptable to society if it single-mindedly pursues its major objective without regard for the range of consequences of its actions.⁸

This means that a company is permitted to seek its private objectives subject to legal, social and ethical boundaries. This takes accounting beyond the traditional framework of reporting monetary transactions that are of interest primarily to the shareholders.

31.6 The accountant's role in a capitalist industrial society

In a capitalist, industrial society, production requires the raising and efficient use of capital largely through joint stock companies. These operate within a legal framework which grants them limited liability subject to certain obligations. The obligations include **capital maintenance provisions** to protect creditors (e.g. restriction on distributable profits) and **disclosure provisions** to protect shareholders (e.g. the publication of annual reports).

The state issues statutes to ensure there is effective control of the capital market; the degree of intervention depends on the party in power. Accountants issue standards to ensure there is reliable information to the owners to support an orderly capital market. Both the state and the accountancy profession have directed their major efforts towards servicing the needs of capital. This has influenced the nature of the legislation, e.g. removing obligations that are perceived to make a company uncompetitive, and the nature of the accounting standards, e.g. concentrating on earnings and monetary values.

However, production and distribution involve complex social relationships between private ownership of property and wage labour⁹ and other stakeholders. This raises the question of the role of accountants. Should their primary concern be to serve the interests of the shareholders, or the interests of management, or to focus on equity issues and social welfare?¹⁰

Prior to the formation in the UK of the ASB, the profession identified with management and it was not unusual to allow information to be reported to suit management. If managers were unhappy with a standard, they were able to frustrate or delay its implementation, as with deferred tax. Often, reported results bore little resemblance to the commercial substance of the underlying transactions.

The ASB has concentrated on making reports reflect the substance of a transaction. It has developed a conceptual framework for financial reporting to underpin its reporting standards and criteria has been defined for the recognition of assets, liabilities, income and expense.

The ASB did not produce mandatory requirements for narrative or qualitative disclosures – the operating and financial review (OFR) was voluntary (now the business review in the directors' report). However, the fact that it proposed the publication of an OFR was an important in itself because it recognised that there was a need for narrative disclosure, even where this was not capable of audit verification.

31.7 The accountant's changing role

Accountants now make positive contributions to sustainability management by their responsible roles in systems and external reporting. They are responsible for the financial systems

which provide the raw data for strategic planning, the management of risk, the measurement and reporting of performance and the allocation. For example, they identify environmental costs to measure and report on the efficiency of energy costs and social costs such as the cost of staff turnover and absenteeism.

Sustainability information reported to investors and other stakeholders needs to be based on sound systems of accounting, internal control and be externally assured. Professional accountants provide the expertise for the design and operation of systems and external auditors are increasingly providing an assurance capability.

Accountants have a central role in finance from which they are able to encourage a sustainability culture within an organisation by raising sustainability as a consideration when making decisions. This can be at an operating level as when they identify environmental or social costs or at a strategic level when capital investment decisions are being made.

31.8 Sustainability – environmental reporting

There has been a growing concern since the early 1990s that insufficient attention has been given to the impact of current commercial activities on future generations. This has led to the need for sustainable development which meets the needs of the present without compromising the ability of future generations to meet their own needs.

Why have companies become sensitive to the environmental concerns of stakeholders other than their shareholders? This has been a reaction to pressure from a variety of stakeholders ranging from the government to local communities and from environmental groups to individual consumers and individual investors.

We will now look at the development of environmental reporting.

31.9 Environmental information in the annual accounts

Much of the environmental information falls outside the expertise of the accountant, so why was it included in the annual report? The annual report had already become the accepted vehicle for providing shareholders with information on matters of social interest such as charitable donations and this extended to present qualitative information such as a statement of company policy.

However, in addition to recognising the concerns of other stakeholder, companies also began to realise that there could be adverse financial implications for their capacity to raise funds.

Potential individual investors

The government in *This Common Inheritance*¹¹ indicated that shareholders could seek information about environmental practices from companies that they invest in and make their views known.

Potential corporate investors

Acquisitive companies needed to be aware of contingent liabilities,¹² which can be enormous. In the USA the potential cost of clearing up past industrially hazardous sites has been estimated at \$675 billion. Even in relation to individual companies the scale of the contingency can be large, as in the Love Canal case. In this case a housing project was built at Love Canal in upper New York State on a site that until the 1950s had been used by the Hooker Chemicals Corporation for dumping a chemical waste containing dioxin. Occidental,

which had acquired Hooker Chemicals, was judged liable for the costs of clean-up of more than \$260 million.¹³ Existing shareholders and the share price would also be affected by these increased costs.

There is recognition that there is a wider interest than short-term profits.

31.10 Background to companies' reporting practices

Some companies have independently instituted comprehensive environmental management systems but many have not. There has been a tendency initially for companies to target the area that they considered to be the most sensitive and to treat it rather as a PR exercise or damage limitation. There was a concern that resources devoted to achieving environmental benefits would merely increase costs and companies made a point of referring to cost benefits to justify their outlay as in the following extract from the Scottish Power 1994 Annual Report:

The company is committed to meeting or bettering increasingly stringent environmental controls for electricity generation and is developing new technologies and plant which can achieve significant benefits at realistic cost. At Longannet Power Station, more than £24 million is being invested in low Nox burners, which produce fewer nitrous oxides, and in renewing equipment to reduce dust from flue gases . . . This process is expected to be environmentally superior and lower in costs than alternative technologies.

This was quite understandable as it had been estimated that the enforcement of stringent environmental controls to reduce pollution could have substantial cost implications estimated at £15 billion for Britain in 1991.¹⁴

Companies were reactive and concentrated on satisfying statutory obligations or explaining their treatment of what they perceived to be the major environmental concern affecting their company. For example, in the case of Pearson, a major publishing company, a major concern was the use for printing of renewable resources and its 1993 Annual Report it included the following:

One aspect of our company's environmental responsibilities is to keep purchasing policies under review. Pearson's most significant purchase is paper. Our publishing companies between them buy some 180,000 tonnes of paper a year . . . Pearson makes certain that it buys paper only from responsibly managed forests and avoids paper bleached with chlorinated organic compounds where possible . . .

By 2007 Pearson published a CSR report, *Our Business and Society*, which included the following extract on the environment:

The environmental considerations relating to the purchase of paper continue to be a priority for us . . . Pearson has further developed its responsible paper sourcing practice. As part of an action plan on responsible paper sourcing agreed with the WWF UK Forest & Trade Network, we established a database on the environmental characteristics of the paper we purchase. We have also met a number of our key suppliers and manufacturers of paper and some NGOs to discuss and review environmental issues including certification and increasing the recycled content in the paper we use in our books.

Although this was an *ad hoc* approach to environmental reporting, it did not mean that significant benefits were not achieved. The following extract from the 2001 Annual Report of the Body Shop indicates the level of benefit:

At the Body Shop, we have made a significant commitment to reducing our CO₂ impact by switching electricity supply at both our Littlehampton sites and all UK company-owned shops to a renewable source. This initiative, together with our 15% investment in Bryn Titli wind farm, means that we offset an estimated 48% of electricity, gas and road freight used for all our UK operations including company-owned shops in the last financial year.

In some jurisdictions there have been mandatory requirements. In the USA, e.g. the Securities and Exchange Commission requires companies to disclose:

- (a) the material effects of complying or failing to comply with environmental requirements on the capital expenditures, earnings and competitive position of the registrant and its subsidiaries;
- (b) pending environmental legal proceedings or proceedings known to be contemplated, which meet any of three qualifying conditions: (1) materiality, (2) 10% of current assets, or (3) monetary sanctions; and
- (c) environmental contingencies that may reasonably have material impact on net sales, revenue, or income from continuing operations.

A typical disclosure of amounts appears in the following extract from the Bayer Schering Pharma AG 2006 Annual Report:

We have spent substantial amounts on environmental protection and safety measures up to now, and anticipate having to spend similar sums in 2007 and subsequent years. In 2006, our operating and maintenance costs in the field of environmental protection and safety totaled €59m (2005: €65m). Our capital expenditure on environmental protection projects and other ecologically beneficial projects totaled €4m (2005: €5m).

31.11 European Commission's recommendations for disclosures in annual accounts

In May 2001 the European Commission issued a *Recommendation on the Recognition, Measurement and Disclosure of Environmental Issues in the Annual Accounts and Annual Reports of Companies*.¹⁵

The Commission's view was that there were two problems. The first was that there was a lack of explicit rules, which meant that any one or all of the different stakeholder groups, e.g. investors, regulatory authorities, financial analysts and the public in general, could feel that the disclosures were insufficient or unreliable; the second was that there was a low level of voluntary disclosure, even in sectors where there was significant impact on the environment.

31.11.1 Lack of explicit rules

The lack of harmonised guidelines has meant that investors have been unable to compare companies or to adequately assess environmental risks affecting the financial position of the company. Whilst recognising that there are existing financial reporting standards on the disclosure of provisions and contingent liabilities and that companies in environmentally sensitive sectors are producing stand-alone environmental reports, the Commission was of the opinion that there is a justified need to facilitate further harmonisation on what to disclose in the annual accounts.

As mentioned above, the cost of collecting and reporting is frequently perceived to be a deterrent and the Recommendation intends to avoid unjustified burdensome obligations. It also proposes that Recommendations should be within existing European directives, e.g. the Fourth and Seventh Directives.

31.11.2 Stakeholder groups' information needs

All groups require relevant disclosures that are consistent and comparable – particularly disclosure in the notes to the accounts relating to environmental expenditures either charged to the profit and loss account or capitalised including fines and penalties for non-compliance and compensation payments.

31.11.3 Key points relating to recognition, measurement and disclosure

The approach to recognition and measurement is a restatement of current financial reporting requirements with some additional illustrations and explanations. The disclosures are fuller than currently met within annual accounts.

Recognition and measurement

For the recognition of environmental liabilities the criteria are the same as for IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* e.g. requirement for probable outflow of resources, reliable estimate of costs and recognition of liability at the date operations commence if relating to site restoration.

For the capitalisation of environmental expenditure the criteria to recognise as an asset apply, e.g. it produces future economic benefits. There are also detailed proposals relating to environmental expenditure which improves the future benefits from another asset and to asset impairment.

Disclosures

Disclosure is recommended if the issues are material to either the financial performance or financial position. Detailed proposals in relation to environmental protection are for the disclosure of:

- the policies that have been adopted and reference to any certification such as EMAS (see section 31.12.2 below);
- the improvements made in key areas with physical data if possible, e.g. on emissions;
- progress implementing mandatory requirements;
- environmental performance measures, e.g. trends for percentage of recycled packaging;
- reference to any separate environmental report produced.

There are, in addition, detailed cross-references to the requirements of the Fourth and Seventh Directives, e.g. description of valuation methods applied and additional disclosures, e.g. if there are long-term dismantling costs, the accounting policy and, if the company gradually builds up a provision, the amount of the full provision required.

31.12 Evolution of stand-alone environmental reports

There is a steady growth in the rate at which environmental reports are being produced. The rate is faster where there are clear risks such as paper, chemicals, oil and gas, and pharmaceuticals.

In some jurisdictions such as Denmark, the Netherlands, Norway and Sweden, there is legislation requiring environmental statements from environmentally sensitive industries either in their financial statements or in a stand-alone report; in other countries, voluntary disclosures are proposed.

The following is an extract relating to a Danish experience where most companies now produce separate CSR reports (www.sustainabilityreporting.eu/denmark/index.htm):

Most Danish companies now publish separate CSR reports, independent of their statutory annual reporting. In recent years, more companies have started integrating their financial and non-financial data into the same report, for instance by adding a section on non-financial data at the end of the report. The companies preparing the best reports, however, are those which grasp the connection between the non-financial data and their business. As a result, these companies have fully integrated non-financial data with financial data in the report. In doing this, the companies clearly demonstrate their full understanding of the value of reporting on non-financial data. *They demonstrate that the data are being used as a serious management and communication tool and that they are able to link CSR to business strategy.* However, as statutory reports do not necessarily reach all stakeholders. These companies also make use of a number of other communication channels to report on their CSR work. When we consider the future focus on climate change, the companies' desire to adapt their reporting to their future stakeholders, the Danish Government's pressure on Danish companies to integrate CSR in their business strategy, and the need for cost cuts owing to the current crisis, we are convinced that the trend will be that more Danish companies begin to employ completely integrated reporting.

When considering inclusion of CSR reporting in the annual report, one of the problems has been the volume of data. Companies are overcoming this by issuing summary CSR reports in hard copy and uploading the full CSR report onto their websites. The following is an extract relating to experience in the Netherlands (www.sustainabilityreporting.eu/netherlands/index.htm):

In the Netherlands, various companies are aiming for further integration of the CSR information into their annual reports. Companies are increasingly using the Internet in order to reduce the size of their CSR reports. They publish hard copy summary reports, with the full versions available on the Internet.

Attention is also being given to the increasing use of non-financial information:

In the Netherlands, from 2006, health insurance became an entirely private activity. As a result, health insurance companies have certain responsibilities towards their clients. To monitor this process, these companies have to publish mandatory CSR reports to the health insurance authority. CSR reporting by health insurance companies to their stakeholders has consequently increased. Government departments (ministry, province, municipality) also have to provide information on their performance in relation to their policy plans.

This includes both financial and non-financial performance indicators and will also lead to an increase in reporting. Amsterdam has already published its first CSR report.

CSR is also being progressively introduced into academic programmes. For example, the Erasmus University Rotterdam has started a one-year postgraduate course on CSR Management and CSR Auditing, which includes one module on CSR Reporting.

In Chapter 30 we discussed the development of corporate governance and the concentration was on the accountability of the board to the shareholders for its strategic control

of the assets and its responsibility to act in the best interest of the shareholders. The effectiveness of its control would be assessed in financial terms by reference to ratios such as ROCE, ROI, growth rate of EPS, earnings and dividend yield.

In the early stages of environmental, social and now sustainability reporting the emphasis was on reporting to other stakeholders. This was extended by the concept of the triple bottom line and it is interesting to see that sustainability and corporate governance are potentially merging as companies see that the two do not have separate audiences. Shareholders and stakeholders are both beginning to look at both aspects. The following is an extract relating to Swedish experience (www.sustainabilityreporting.eu/sweden/index.htm):

During the last year newspapers, television and other media have reported more than ever before on climate change and supply chain related issues. The media interest in corporate responsibility and the need for change and transparency has an even longer tradition. The manner in which these trends will have an impact on the further development of sustainability reporting is, of course, an interesting question. We are at a turning point in reporting on sustainability. The Accounting Modernisation Directive implemented in the Swedish Annual Accounts Act may help companies to focus their reporting on non-financial risks. Some companies are already integrating their efforts on sustainability and corporate social responsibility with their work on corporate governance. Interesting to note is the fact that some companies' governance reports include information on sustainability. There is a call for transparent non-financial reporting from the financial community. Last but not least, the Swedish Government's requirements on reporting sustainability will pave the way for GRI reporting also in the public sector.

There has been a growing pressure for CSR information to be subject to assurance reports to give stakeholders the same confidence as they have obtained from the audit reports on financial statements. The following is an extract relating to a UK experience (www.sustainabilityreporting.eu/uk/index.htm):

The challenges facing companies are:

- starting assurance engagements using the updated, 2008 version of the AA1000AS;
- improving the standards of assurance statements (as in previous years), including: more detailed commentary on methodology and recommendations in the statement; and focusing more on the materiality, completeness and responsiveness principles rather than just simply checking accuracy of information;
- providing an organisational response to the assurance engagement in the report, including how any recommendations will be put into place; and
- dealing with the mandatory reporting on carbon emissions according to the requirements of the Climate Change Bill.

There is progress being made at varying rates around the world. One of the stimuli has been the environmental, social and sustainability award schemes. One of the earliest of the award schemes was that of the ACCA.

31.12.1 The ACCA award schemes

In 2000 the ACCA commemorated ten years of progress in environmental reporting. After these ten years the ACCA established in 2002 a new structure for the UK awards to reflect the ever-increasing public awareness of the environmental, social and economic impacts of business. The ACCA Award scheme was restructured in 2001 under the title 'The ACCA

Awards for Sustainability Reporting'. There are three different award categories: the ACCA UK Environmental Reporting Awards, the ACCA Social Reporting Awards and a new category, the ACCA Sustainability Reporting Awards. Details of Award winners can be found on the ACCA website.

These schemes have given environmental reporting a high profile and contributed greatly to the present quality of reports. The schemes now take place in a number of countries and regions. These include Hong Kong, Malaysia, Singapore, South Africa, Sri Lanka, Europe and North America.

The following is an extract relating to the Singapore awards (www.accaglobal.com/singapore/publicinterest/sustainability/sustainability).

Singapore Awards for Sustainability Reporting

ACCA is pleased to announce the launch of the ACCA Singapore Awards for Sustainability Reporting 2008. Formerly known as the Singapore Environmental and Social Reporting Awards (SESRA), the awards which are now into its seventh year are endorsed by the National Environment Agency and supported by the Singapore Environment Council and TÜV SÜD PSB. Joining the list of supporting organisations this year is Singapore Compact for CSR.

ACCA Singapore invites organisations of all sizes and sectors to submit their application into the awards. The closing date for entries is 31 March 2009. The Awards ceremony will be held in June 2009.

The aim of the awards is to promote transparency and give recognition to those organisations which report and disclose environmental, social and full sustainability information. The awards also provide a platform to raise awareness of corporate transparency issues.

ACCA has promoted sustainability reporting for more than a decade since the introduction of the environmental reporting awards in 1991 in the United Kingdom. ACCA is involved in reporting awards around the world in Europe, Africa, North America and the Asia Pacific region.

Any organisation of any size or industry sector; be it private or public with operations in Singapore can enter into the awards.

The entries are reviewed by a judging panel comprising of experts within the field of environmental and sustainability reporting. At the core of the judging criteria are completeness, credibility and communication.

This year ACCA will be giving out awards in the following categories; Environmental Reporting, Social Reporting and the newly added category of Sustainability reporting. In addition to the main awards and commendations, ACCA Singapore will also be introducing new awards for 'First Time Reporter'. The introduction of the new awards is to encourage greater participation and to acknowledge a wider range of efforts that organisations have taken towards enhancing sustainability and transparency.

The criteria that each scheme sets can vary and reflect local interests. For example, the Hong Kong awards for 2008 were in the following categories:

Best Sustainability Report	CLP Holdings Limited
Runner Up – Best Sustainability Report	Swire Pacific Limited
Commendation For Excellent Communication Using The Internet	MTR Corporation
Commendation For Demonstration Of Integrity In Reporting	Gammon Construction Limited
Commendation For Addressing Sectoral Issues	The China Navigation Company Limited

Encouragement has been actively given to SME reporting. For example, in 2000, at the Europe-wide level, the European Environmental Reporting Awards (EERA), in which entries are selected from the winners of national schemes organised by EU member states, selected four winners:

- Overall winner: Shell International (UK),
- Best first-time reporter: Acquedotto Pugliese (Italy),
- Best SME reporter: Obermurtaler Brauereigenossenschaft (Austria),
- Best sustainability report: Novo Nordisk (Denmark).

The judges commented on strengths, and in respect of the best SME reporter listed:

- its comprehensive reporting on corporate performance including five-year trend data for various indicators and quantified targets;
- an analysis of the environmental impact arising from the product development activity;
- detailed description of supplier audits;
- disclosure of internal audit procedures and results; and
- evidence of environmental interest including obtaining EMAS registration (the first site to do this in Austria).

SMEs continue to be encouraged to develop CSR reporting.

In the UK the ACCA awards again looked carefully at assurance and reported (www.accaglobal.com/uk/publicinterest/sustainability/):

- All the shortlisted companies for the 2008 ACCA UK Sustainability Reporting Awards have some form of external assurance of their reports, including the small and medium-sized enterprises (SMEs), but the scope and approach varies widely between reports.
- Many assurance statements continue to lack concrete recommendations from the assurance provider, meaning that they do not provide the reader with a clear account of the outcomes of the engagement. Assurance was picked up by the 2008 judges as being a general weakness, both in terms of the assurance statement itself and the organisational response to the assurance engagement's outcomes.
- As in previous years, non-accounting assurance providers tend to use the AccountAbility AA1000 Assurance Standard (sometimes in combination with the ISAE300) and Big 4 accounting firms are encouraged to use the ISAE3000.
- UK organisations (as well as those elsewhere in Europe) will have to start using the new version of AA1000AS, launched in October 2008, from 2009 onwards.
- There continues to be a wider scope of assurance processes than the traditional assurance statement approach. For example, the inclusion of an external stakeholder assurance panel (as demonstrated by Shell's report) and different 'niche' assurance providers for different areas of the business/reporting (as demonstrated by De Beers' sustainability report).

31.13 International charters and guidelines

There have been a number of international and national summits, charters and recommendations issued. In some jurisdictions such as Denmark, the Netherlands, Norway and

Sweden, there is now legislation requiring environmental statements from environmentally sensitive industries either in their financial statements or in a stand-alone report; in other countries, voluntary disclosures are proposed. Below are brief descriptions of just some of the voluntary disclosures proposed by the United Nations, Europe and the USA, and of some self-regulation schemes in which companies can elect to participate.

31.13.1 United Nations

At the United Nations we can see that the United Nations Environment Programme (UNEP)¹⁶ has made major impacts, e.g. it was the driving force behind the 1987 Montreal Protocol on Substances that Deplete the Ozone Layer whereby industrialised countries ceased production and consumption of a significant proportion of all ozone-depleting substances in 1996. It is estimated that 1.5 million cases of melanoma skin cancer due to the sun's UV-B radiation will be averted by the year 2060 as a result of the Protocol. It has had similar success as the leading force for the sound global management of hazardous chemicals and the protection of the world's biological diversity by forging the Convention on Biological Diversity. It is innovative in its approach, e.g. entering into a partnership agreement with the International Olympic Committee (IOC) in 1995 as a result of which the environment now figures as the third pillar of Olympism, along with sport and culture, in the IOC's Charter. UNEP has initiated the development of environmental guidelines for sports federations and countries bidding for the Olympic Games.

UNEP is actively concerned with climate change. As a science-based organisation it is able to make available better and more relevant scientific information on climate change impacts to developing country decision-makers. UNEP states that 'it will help improve capacity to use this information for policy purposes, as well as providing scientific, legal and institutional support to developing country negotiators and their institutions so that they can meaningfully contribute to a strengthened international regime on climate change'.

31.13.2 Europe

In Europe the Eco-Management and Audit Scheme (EMAS)¹⁷ was adopted by the European Council on 29 June 1993, allowing voluntary participation in an environmental management scheme. Its aim is to promote continuous environmental performance improvements of activities by committing organisations to evaluating and improving their own environmental performance.

The main elements of the current EMAS regulations include:

- making environmental statements more transparent;
- the involvement of employees in the implementation of EMAS; and
- a more thorough consideration of indirect effects including capital investments, administrative and planning decisions and procurement procedures.

Companies that participate in the scheme are required to adopt an environmental policy containing the following key commitments:

- compliance with all relevant environmental legislation;
- prevention of pollution; and
- achieving continuous improvements in environmental performance.

The procedure is for an initial environmental review to be undertaken and an environmental programme and environmental management system established for the organisation.

Verification is seen as an important element and environmental audits, covering all activities at the organisation concerned, must be conducted within an audit cycle of no longer than three years. On completion of the initial environmental review and subsequent audits or audit cycles a public environmental statement is produced.

An organisation's environmental statement will include the following key elements:

- a clear description of the organisation, and its activities, products and services;
- the organisation's environmental policy and a brief description of the environmental management system;
- a description of all the significant direct and indirect environmental aspects of the organisation and an explanation of the nature of the impacts as related to these aspects;
- a description of the environmental objectives and targets in relation to the significant environmental aspects and impacts;
- a summary of the organisation's year-by-year environmental performance data which may include pollution emissions, waste generation, consumption of raw materials, energy use, water management and noise;
- other factors regarding environmental performance including performance against legal provisions; and
- the name and accreditation number of the environmental verifier, the date of validation and deadline for submission of the next statement.

The following extract from the Schering 2000 Annual Report indicates the persuasive influence of schemes such as EMAS:

We aim at achieving the ISO 14001 certification or the Eco Management and Audit Scheme (EMAS) validation for all production sites. We have begun to integrate the existing management systems for quality, safety and environmental protection, and to organise throughout the Group. This Integrated Management System (IMS) is based on International Standard ISO 9000 (for quality) as well as ISO 14001 and EMAS (for environmental protection).

31.13.3 The USA

In the USA the Environmental Accounting Project began in 1992 to encourage companies to adopt environmental accounting techniques which would make environmental costs more apparent to managers and, therefore, make them more controllable. It was thought that this could result in three positive outcomes namely, the significant reduction of environmental costs, the gaining of competitive advantage and the improvement of environmental performance with the initial concern being to reduce pollution.

31.14 Self-regulation schemes

There are a number of examples of self-regulatory codes of conduct from institutions, e.g. the International Chamber of Commerce (ICC),¹⁸ the International Organization for Standardization (ISO), and bodies representing particular industries, e.g. the European Chemical Industry Council (CEFIC).¹⁹ We will describe briefly the ICC Charter and ISO standards.

31.14.1 The International Chamber of Commerce (ICC)

The ICC launched the **Business Charter for Sustainable Development** in 1991 to help business around the world improve its environmental performance relating to health, safety and product stewardship. The charter set out sixteen principles which include:

- *Policy statements* – such as giving environmental management high corporate priority; aiming to integrate environmental policies and practices as an essential element of management; continuing to improve corporate policies performance; advising customers, distributors and the public in the safe use, transportation, storage and disposal of products provided; promoting the adoption of these principles by contractors acting on behalf of the enterprise; developing products that have no undue environmental impact and are efficient in their consumption of energy and natural resources, and that can be recycled, reused, or disposed of safely; fostering openness and dialogue with employees and the public, anticipating and responding to their concerns about the potential hazards and impacts of operations, products, wastes or services; and measuring environmental performance.
- *Financially quantifiable practices* – such as employee education; assessment of environmental impacts before starting a new activity or decommissioning; conduct or support of research on the environmental impacts of raw materials, products, processes, emissions and wastes associated with the enterprise and on the means of minimising such adverse impacts; modification of the manufacture, marketing or use of products or services to prevent serious or irreversible environmental degradation.

The following extract from the Nestlé 2000 Environment Progress Report is a good example of a company that has applied the ICC approach and is proactive in seeking improvements:

Message from CEO

I am pleased about the clear progress in a number of key areas, including a significant decline in the amounts of water and energy used to bring each kilo of Nestlé product into your home, and a similar reduction in factors which potentially affect global warming. However, we are never completely satisfied with our current performance, and are committed to further environmental improvements.

We try to remain sensitive to the environmental concerns of our consumers and the public as a whole. . . . we have pledged our allegiance to *The Business Charter for Sustainable Development* of the International Chamber of Commerce, and we are committed to being a leader in environmental performance.

In 2007 Nestlé published its *Creating Shared Value Report* (see <http://www.nestle.com/csv>). This profiles Nestlé's global efforts to increase the delivery of high-quality, nutritious food products that add to consumers' health and well-being. The report also profiles Nestlé's ongoing commitment to develop nutritious, popularly positioned products that are affordable and accessible to consumers at the base of the global economic pyramid.

The following is an extract from the Nestlé CSV Report:

Nestlé is committed to reporting its performance openly. In 2008, we published our first global report on Creating Shared Value. It is a first step towards providing evidence that the successful creation of long-term shareholder value is dependent also on the creation of value for society.

We first explored the concept of Creating Shared Value in our 2005 report, 'The Nestlé concept of corporate social responsibility', which focused on our Latin American operations . . . Since then, in conjunction with our business areas and advisers including SustainAbility and AccountAbility, we have identified and assessed critical issues, developed global performance indicators and engaged stakeholders in debate.

In order to provide assurance to stakeholders over Nestlé Creating Shared Value reporting, an external auditor Bureau Veritas has been engaged. For more information, read the full Bureau Veritas Assurance Statement.

Nestlé is also among the first food companies to join the Global Reporting Initiative multi-stakeholder programme to develop global reporting standards and indicators on sustainability in the food industry.

31.14.2 The International Organization for Standardization (ISO)

The ISO is a non-governmental organisation established in 1947, and comprises a world-wide federation of national standards with the aim of establishing international standards to reduce barriers to international trade. Its standards, including environmental standards, are voluntary and companies may elect to join in order to obtain ISO certification.

One group of standards, the ISO 14000 series, is intended to encourage organisations to systematically assess the environmental impacts of their activities through a common approach to environmental management systems. Within the group, the ISO 14001 standard states the requirements for establishing an EMS and companies must satisfy its requirements in order to qualify for ISO certification.

What benefits arise from implementation of ISO 14001?

Those who support the ISO approach consider that there are a number of positive advantages, such as:

- **Top-level management become involved** – they are required to define an overall policy and, in addition, they recognise significant financial considerations from certification, e.g. customers might in the future prefer to deal with ISO compliant companies, insurance premiums might be lower and there is the potential to reduce costs by greater production efficiency.
- **Environmental management** – ISO 14001 establishes a framework for a systematic approach to environmental management which can identify inefficiencies that were not apparent beforehand resulting in operational cost savings and reduced environmental liabilities. We have seen above, for example, that Nestlé reduced its energy consumption by 20%.
- **A framework for continual improvements is established** – there is a requirement for continual improvement of the management system.

What criticisms are there of a compliance approach?

Compliance approaches which set out criteria such as a commitment to minimise environmental impact can allow companies to set low objectives for improvement and report these as achievements with little confidence that there has been significant environmental benefit.

31.15 Economic consequences of environmental reporting

There can be internal and external favourable economic consequences for companies. They can achieve cost reductions and become more attractive to potential investors.

31.15.1 Cost reductions

It has been reported that the discipline of measuring these risks can yield valuable management information with DuPont, for example, reporting that since it began measuring and

reporting on the environmental impact of its activities, its annual environmental costs dropped from a high of US\$1 billion in 1993 to \$560 million in 1999.

31.15.2 Investors

Investors are gradually beginning to require information on a company's policy and programmes for environmental compliance and performance in order to assess the risk to earnings and statement of financial position. One would expect that the more transparent these are the less volatile the share prices will be which could be beneficial for both the investor and the company. This will be a fruitful field for research as environmental reporting evolves with more consistent, comparable, relevant and reliable numbers and narrative disclosures.

This has also given rise to Socially Responsible Investing (SRI) which considers both the investor's financial needs and the investee company's impact on society to an extent that in 1999 over US\$2,000 billion in assets were invested in 'ethical' investment funds. In the UK there is pressure from bodies such as the Association of British Insurers for institutional investors to take SRI principles into account. Investors are also able to refer to indices such as the Dow Jones Sustainability Indices and the FTSE4Good Index.

Dow Jones Sustainability Indices

The Dow Jones Sustainability Indices were begun in 1999 and were the first global indices tracking the financial performance of the leading sustainability-driven companies worldwide.

FTSE4Good Index Series

The FTSE4Good Index Series provides potential investors with a measure of the performance of companies that meet globally recognised corporate responsibility standards. FTSE4Good is helpful as a basis for socially responsible investment and as a benchmark for tracking the performance of socially responsible investment portfolios.

However, research carried out by Trucost and commissioned by the Environment Agency (www.environment-agency.gov.uk/business) into quantitative disclosures found that direct links between management of environmental risks and shareholder value are almost non-existent, with only 11% of FTSE 350 making a link between the environment and some aspect of their financial performance and only 5% explicitly linking it to shareholder value.

31.16 Summary on environmental reporting

Environmental reporting is in a state of evolution ranging from *ad hoc* comments in the annual report to a more systematic approach in the annual report to stand-alone environmental reports.

Environmental investment is no longer seen as an additional cost but as an essential part of being a good corporate citizen and environmental reports are seen as necessary in communicating with stakeholders to address their environmental concerns.

Companies are realising that it is their corporate responsibility to achieve sustainable development whereby they meet the needs of the present without compromising the ability of future generations to meet their own needs. Economic growth is important for shareholders and other stakeholders alike in that it provides the conditions in which protection of the environment can best be achieved, and environmental protection, in balance with other human goals, is necessary to achieve growth that is sustainable.

However, there is still a long way to go and the EU's Sixth Action Programme 'Environment 2010: Our Future, Our Choice'²⁰ recognises that effective steps have not been taken by all member states to implement EC environmental directives and there is weak ownership of environmental objectives by stakeholders. The programme focuses on four major areas for action – climate change, health and the environment, nature and biodiversity, and natural resource management – and emphasises how important it is that all stakeholders should be involved to achieve more environmentally friendly forms of production and consumption as well as integration into all aspects of our life such as transport, energy and agriculture.

As with the other environmental reporting initiatives discussed above and the corporate governance approach we have seen with the Hampel Report and the OFR, the programme concentrates on setting general objectives rather than quantified targets apart from the targets relating to climate change where there is the EU's 8% emission reduction target for 2008–12 under the Kyoto Protocol. This is a sensible way to progress with an opportunity for best practice to evolve.

However, significant improvements are still required, with research indicating that although the majority of FTSE All Share companies discuss their interaction with the environment in their annual report and accounts, the vast majority lack depth, rigour or quantification.

31.17 Environmental auditing: international initiatives

The need for environmental auditors has grown side by side with the growth of environmental reporting. This is prompted by the need for investors to be confident that the information is reliable and relevant. There have been various initiatives around the world and we will briefly refer to examples from Canada, the USA and Europe.

Canada

The Canadian Environmental Auditing Association (CEAA) was founded in 1991 to encourage the development of environmental auditing and the improvement of environmental management through environmental auditor certification and the application of environmental auditing ethics, principles and standards. It is a multidisciplinary organisation whose international membership base now includes environmental managers, ISO 14001 registration auditors, EMS consultants, corporate environmental auditors, engineers, chemists, government employees, accountants and lawyers. The CEAA is now accredited by the Standards Council of Canada as a certifying body for EMS Auditors.²¹

USA

The Registrar Accreditation Board (RAB)²² was established in 1989 by the American Society for Quality to provide accreditation services for ISO 9000 Quality Management Systems (QMS) registrars.

In 1991, the American National Standards Institute (ANSI) and RAB joined forces to establish the American National Accreditation Program for Registrars of Quality Systems.

In 1996, with the release of new ISO 14000 Environmental Management Systems (EMS) standards, the ANSI-RAB National Accreditation Program (NAP) was formed covering the accreditation of QMS and EMS registrars as well as accreditation of course providers offering QMS and EMS auditor training courses. Certification programmes for both EMS and QMS auditors are now operated solely by RAB.

RAB exists to serve the conformity assessment needs of business and industry, registrars, course providers and individual auditors.

Europe

Since 1999 the European Federation of Accountants (FEE) Sustainability Working Party (formerly Environmental) has been active in the project Providing Assurance on Environmental Reports²³ and is actively participating with other organisations and collaborating on projects such as GRI Sustainability Guidelines which are discussed further in section 31.23 below.

31.18 The activities involved in an environmental audit

There are many activities commonly seen in practice. These can be grouped into those assessing the *current position* and those evaluating decisions affecting the *future*.

31.18.1 Assessing the current position

The assessment embraces physical, systems and staff appraisal.

- Physical appraisal is carried out by means of:
 - **site inspections**;
 - **scientific testing** to sample and test substances including air samples;
 - **off-site testing and inspections** to examine the organisation's impact on its immediate surroundings; after all, the company's responsibility does not stop at the boundary fence.
- Systems appraisal is carried out by means of:
 - **systems inspections** to review the stated systems of management and control in respect of environmental issues;
 - **operational reviews** to review actual practices when compared to the stated systems;
 - **compliance audits for certification schemes**.
- Staff appraisal is carried out by means of:
 - **awareness tests for staff** to test, by questionnaire, the basic knowledge of all levels of staff of the systems and practices currently used by the organisation. This will highlight any areas of weakness.

31.18.2 Assessing the future

The assessment embraces planning and design processes and preparedness for emergencies.

- Planning and design appraisal is carried out by means of:
 - **review of planning procedures** to ensure that environmental factors are considered in the planning processes adopted by the organisation;
 - **design reviews** to examine the basic design processes of the organisation (if applicable) to ensure that environmental issues are addressed at the design stage so the organisation can avoid problems rather than have to solve them when they happen.
- Preparedness for emergencies is appraised by means of:
 - **review of emergency procedures** to assess the organisation's preparedness for specific, predictable emergencies;
 - **review of crisis plans** to review the organisation's general approach to crisis management with the audit covering such topics as the formation of **crisis management teams** and resource availability.

31.18.3 The environmental audit report

We can see from the above that an environmental audit may be wide-ranging in its scope and time-consuming, particularly when auditing a major organisation. A typical report could include:

- Current practice
 - a comprehensive review and comment on current operational practices.
- List of action required
 - areas of **immediate concern** which the organisation needs to address as a matter of urgency;
 - areas for improvement over a set period of time.
- Qualitative assessment
 - a **statement of risk** as seen by the audit team based on an overview of the whole situation with a qualitative assessment of the level of environmental risk being faced by the organisation.
- An action plan
 - a **schedule of improvement** may also be produced which gives a timetable and series of stages for the organisation to follow in improving its environmental performance.
- Encouraging good practice
 - a positive statement of ‘good practice’ may be included. This has a dual value in that it is a motivational tool for management and an educational tool to foster staff awareness of what constitutes ‘good practice’.

31.18.4 What is the status of an environmental audit report?

Legal position

There is no legal obligation to carry out an environmental audit or to inform outside parties of any critical findings when such an audit is carried out. The reports are usually regarded as ‘confidential’ even when carried out by external auditors who provide the service as an ‘optional extra’ which is offered to the organisation for an additional fee.

Public interest

There is a strong case for requiring both environmental audits and the publication of the resultant reports. Requiring reports to be put into the public domain would encourage transparency in the process and avoid accusations of secrecy. However, this ‘public interest’ argument has been heard before in accounting and has met with some resistance in the guise of commercial sensitivity.

Mandatory position

The lack of legal obligation could be regarded as a crucial weakness of the environmental audit process as there could be a major danger to the environment which remains ‘secret’ until after the crisis when it is then too late. The responsible organisation will of course inform all appropriate parties of any revealed risk but it would be foolhardy to assume that all organisations are responsible. The ASB has become involved with potential liability for the company in its consideration of provisions. Whilst this is only viewing it from the viewpoint of the shareholder, it may well be the only pragmatic way forward at present.

31.18.5 Experience in the USA

The increasing importance of environmental accounting can be seen in the USA in the work of the United States Environmental Protection Agency (EPA) and its Environmental Accounting Project (EAP) which has been operating since 1992.

In this large project the EPA attempts to identify the currently ‘hidden’ societal costs faced by organisations. These costs are those which an organisation incurs in its interaction with the environment and which in theory are totally avoidable. By identifying these costs, the organisation is motivated to address them and by implication make every attempt to reduce them, thus improving the environment.

The EPA has a very impressive website, which can be found at the following address: www.epa.gov/epahome/aboutepa/htm. Here the basic ideas and concepts governing the EPA’s study of environmental accounting are set out.

The work of the EPA has also been of a more practical nature in helping organisations address environmental issues from an environmental viewpoint. A brief review of three such cases may help explain the proactive approach to environmental accounting, which goes beyond traditional reporting.

A. The Chrysler Corporation (a major vehicle manufacturer) was faced with a problem with the use of mercury switches in its electrical systems on vehicles. Mercury is dangerous to use and is very dangerous as a waste product when the vehicle is scrapped. The company had always resisted the use of non-mercury switches on pure cost terms.

However, during the EPA project, by looking at the environmental cost it was seen that non-mercury switches actually made a saving of \$0.11 per unit. The company on an annual basis would make an \$18,000 annual saving on one plant alone by this component change.

B. Amoco Corporation (a major oil company) needed to identify the cost of complying with environmental protection regulations and used one of its refineries in Yorktown, Virginia, as an experimental site. From an analysis of the financial accounts it was found that environmental costs represented 21.9% of the non-crude cost of the product (crude oil being the major cost).

This figure was six times the level previously assumed to be the environmental cost of production. The realisation of the scale of the cost led to changes in managerial policies and practices.

C. Majestic Metals Inc. of Denver, Colorado, had a problem with pollution caused by its paint-spraying machinery and practices. Through an environmental accounting exercise, the company decided to use high-volume, low-pressure (HVLP) sprayers and this reduced the cost of environmental damage (as shown by fines and rectification costs) by \$40,000 per year. From a capital investment appraisal viewpoint the project gave a positive NPV over eight years of \$140,000, an internal rate of return (IRR) of 906% and a discounted payback of 0.12 years – an impressive range of results in any terms.

The EPA’s website has many more cases showing the impact of an environmental accounting approach.

31.19 Concept of social accounting

This is a difficult place to start because there are so many definitions of social accounting²⁴ – the main points are that it includes non-financial as well as financial information and addresses the needs of stakeholders other than the shareholders. Stakeholders can be broken down into three categories:

- **internal stakeholders** – managers and workers;
- **external stakeholders** – shareholders, creditors, banks and debtors;
- **related stakeholders** – society as represented by national and local government and the increasing role of pressure groups such as Amnesty International and Greenpeace.

31.19.1 Reporting at corporate level

Prior to 1975, social accounting was viewed as being in the domain of the **economist** and concerned with national income and related issues. In 1975, *The Corporate Report* gave a different definition:

the reporting of those costs and benefits, which may or may not be quantifiable in money terms, arising from economic activities and subsequently borne or received by the community at large or particular groups not holding a direct relationship with the reporting entity.²⁵

This is probably the best working definition of the topic and it establishes the first element of the social accounting concept, namely **reporting at a corporate level** and interpreting corporate in its widest sense as including all organisations of economic significance regardless of the type of organisation or the nature of ownership.

31.19.2 Accountability

The effect of the redefinition by *The Corporate Report* was to introduce the second element of our social accounting concept: accountability. The national income view was only of interest to economists and could not be related to individual company performance – *The Corporate Report* changed that. Social accounting moved into the accountants' domain and it should be the aim of accountants to learn how accountability might be achieved and to define a model against which to judge their own efforts and the efforts of others.²⁶

31.19.3 Comprehensive coverage

The annual report is concerned mainly with monetary amounts or clarifying monetary issues. Despite the ASB identifying employees and the public within the user groups,²⁷ no standards have been issued that deal specifically with reporting to employees or the public.

Instead, the ASB prefers to assume that financial statements that meet the needs of investors will meet most of the needs of other users.²⁸ For all practical purposes, it disassociates itself from the needs of non-investor users by assuming that there will be more specific information that they may obtain in their dealings with the enterprise.²⁹

The information needs of different categories, e.g. employees and the public, need not be identical. The provision of information of particular interest to the public has been referred to as **public interest accounting**,³⁰ but there is a danger that, whilst valid as an approach, it could act as a constraint on matters that might be of legitimate interest to the employee user group. For example, safety issues at a particular location might be of little interest to the public at large but of immense concern to an employee exposed to work-related radiation or asbestos. The term 'social accounting' as defined by *The Corporate Report* is seen as embracing all interests, even those of a small group.

Equally, the information needs within a category – say, employees – can differ according to the level of the employees. One study identified that different levels of employee ranked the information provided about the employer differently, e.g. lower-level employees rated safety information highest, whereas higher-level employees rated organisation information highest.³¹ There were also differences in opinion about the need for additional information, with the majority of lower-level but minority of higher-level employees agreeing that the social report should also contain information on corporate environmental effects.³²

The need for social accounting to cope with both inter-group and intra-group differences was also identified in a Swedish study.³³

31.19.4 Independent review

The degree of credibility accorded a particular piece of information is influenced by factors such as whether it is historical or deals with the future; whether appropriate techniques exist for obtaining it; whether its source causes particular concern about deliberate or unintentional bias towards a company view; whether past experience has been that the information was reasonably complete and balanced; and, finally, the extent of independent verification.³⁴

Given that social accounting is complex and technically underdeveloped, that it deals with subjective areas or future events, and that it is reported on a selective basis within a report prepared by the management, it is understandable that its credibility will be called into question. Questions will be raised as to why particular items were included or omitted – after all, it is not that unusual for companies to want to hide unfavourable developments.

31.20 Background to social accounting

A brief consideration of the history of social accounting in the UK could be helpful in putting the subject into context. *The Corporate Report* (1975) was the starting point for the whole issue. This was at a time when there was the general dissatisfaction with the quality of financial reporting which had resulted in the creation of a standard-setting regulatory body (the Accounting Standards Steering Committee) and additional statutory provisions, e.g. Companies Act provisions relating to directors.

The Corporate Report was a discussion paper issued by the ASSC which represented the first UK conceptual framework. Its approach was to identify users and their information needs. It identified seven groups of user, which included employees and the public, and their information needs. However, although it identified that there were common areas of interest among the seven groups, such as assessing liquidity and evaluating management performance, it concluded that a single set of general-purpose accounts would not satisfy each group – a different conclusion from that stated by the ASB in 1991, as discussed above.³⁵ The conclusions reached in *The Corporate Report* were influenced by the findings of a survey of the chairmen of the 300 largest UK listed companies. They indicated a trend towards acceptance of multiple responsibilities towards groups affected by corporate decision-making and their interest as stakeholders.³⁶

It was proposed in *The Corporate Report* that there should be additional reports to satisfy the needs of the other stakeholders. These included a statement of corporate objectives, a statement of future prospects, an employment report and a value added statement.

Statement of corporate objectives

Would this be the place for social accounting to start? Would this be the place for vested interests to be represented so that agreed objectives take account of the views of all stakeholders and not merely the management and, indirectly, the shareholders? At present, social accounting appears as a series of add-ons, e.g. a little on charity donations, a little on disabled recruitment policy. Corporate objectives or the mission statement are often seen as something to be handed down; could they assume a different role?

The employment report

The need for an employment report was founded on the belief that there is a trust relationship between employers and employees and an economic relationship between employment prospects and the welfare of the community. The intention was that such a report should contain statistical information relating to such matters as numbers, reasons for change, training time and costs, age and sex distribution, and health and safety.

Statement of future prospects

There has always been resistance to publishing information focusing on the future. The arguments raised against it have included competitive disadvantage and the possibility of misinterpretation because the data relate to the future and are therefore uncertain.

The writers of *The Corporate Report* nevertheless considered it appropriate to publish information on future employment and capital investment levels that could have a direct impact on employees and the local community.

Value added reports

A value added report was intended to give a different focus from the profit and loss account with its emphasis on the bottom line earnings figure. It was intended to demonstrate the interdependence of profits and payments to employees, shareholders, the government and the company via inward investment. It reflected the mood picked up from the survey of chairmen that distributable profit could no longer be regarded as the sole or prime indicator of company performance.³⁷

The value added statement became a well-known reporting mechanism to measure how effectively an organisation utilised its resources and added value to its raw materials to turn them into saleable goods. Figure 31.2 is an example of a value added statement.

Several advantages have been claimed for these reports, including improving employee attitudes by reflecting a broader view of companies' objectives and responsibilities.³⁸

There have also been criticisms, e.g. they are merely a restatement of information that appears in the annual report; they only report data capable of being reported in monetary terms; and the individual elements of societal benefit are limited to the traditional ones of shareholders, employees and the government, with others such as society and the consumers ignored.

There was also criticism that there was no standard so that expenditures could be aggregated or calculated to disclose a misleading picture, e.g. the inclusion of PAYE tax and welfare payments made to the government in the employee classification so that wages were shown gross, whereas distributions to shareholders were shown net of tax. The effect of both was to overstate the apparent employee share and understate the government and shareholders' share.³⁹

In the years immediately following the publication of *The Corporate Report*, companies published value added statements on a voluntary basis but their importance has declined. There was a move away from industrial democracy and the standard-setting regulators did not make the publication of value added statements mandatory.

Figure 31.2 Barloworld Limited value added statement for year ended 30 September 2004

<i>R million</i>	2004	%	2003	%
Revenue	36,673		34,603	
Paid to suppliers for materials and services	26,184		25,486	
Value added	10,489		9,117	
Income from investments*	287		274	
Total wealth created	<u>10,776</u>		<u>9,391</u>	
Wealth distribution				
Salaries, wages and other benefits (note 1)	5,993	56	5,450	58
Providers of capital	1,298	12	1,512	16
Finance cost	468		531	
Dividends paid to Barloworld Ltd shareholders	626		736	
Dividends paid to outside shareholders in subsidiaries	204		245	
Government (note 2)	1,059	10	809	9
Reinvested in group to maintain and develop operations	2,426	22	1,620	17
Depreciation	1,535		1,226	
Retained profit	814		415	
Deferred taxation	77		(21)	
	<u>10,776</u>	100	<u>9,391</u>	100
Value added ratios				
Number of employees (30 September)	25,233		22,749	
Turnover per employee (Rand)#	1,528,615		1,506,410	
Wealth created per employee (Rand)#	449,168		406,086	
Notes:				
1. Salaries, wages and other benefits				
Salaries, wages, overtime payments, commissions, bonuses and allowances	4,483		4,385	
Employer contributions ⁺	1,150		1,065	
	<u>5,593</u>		<u>5,450</u>	
2. Central and local government				
Current taxation	828		637	
Regional Services Council levels	39		33	
Rates and taxes paid to local authorities	62		54	
Customs duties, import surcharges and excise taxes	122		76	
Skills development levy	13		11	
South African withholding taxation			2	
Cash grants and cash subsidies granted by the government	(5)		(4)	
Gross contribution to central and local government	<u>1,059</u>		<u>809</u>	

* Includes interest received, dividend income and share of associate companies and joint ventures retained profit.

Based on average number of employees.

⁺ In respect of pension funds, retirement annuities, provident funds, medical aid and insurance.

31.20.1 Why *The Corporate Report* was not implemented

The Corporate Report's proposals for additional reports have not been implemented. There are a number of views as to why this was so. There is a view that the business community, despite the results of the chairmen survey, were concerned about the possibility of their reporting responsibility being extended through the report's concept of public accountability and welcomed the release of the Sandilands Report on inflation accounting which overshadowed *The Corporate Report*. There is a view that *The Corporate Report* fell short of making a significant contribution 'by virtue of its failure to select the accounting models appropriate to the informational needs of the individual user groups which it had identified'.⁴⁰

However, the most likely reason for it not being fully implemented was the change of government. The Labour government produced a Green Paper in 1976, *Aims and Scope of Company Reports*, which endorsed much of *The Corporate Report* concept. The reaction from the business community and the Stock Exchange was hostile to any move away from the traditional stewardship concept with its obligations only to shareholders. The CBI view was that other users could ask for information, but that was no reason for companies to be required to provide it.⁴¹ In the event, there was a change of government and the Green Paper sank without trace.

The new government supported the view of Milton Friedman, who wrote in 1962 that 'few trends could so . . . undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money . . . as possible'.

Many responsible members of the business community pressed for change,⁴² but the mid 1980s saw a decline in the commercial support for social accounting, as profit, dividends and growth superseded all other social goals in business. The movement continued but advocates were regarded at best as well-meaning radicals and at worst as dangerous politicised activists devoted to the destruction of the capitalist system.

By the early 1990s, interest was appearing in the commercial sector but from a free market rather than regulatory viewpoint. The thought was that socially responsible policies need not mean lower profits – in fact, quite the opposite. Given this change in perception, companies began to embrace social accounting concepts – suddenly accountants were able to make a contribution, e.g. evaluating the profit implication of crèche facilities for working mothers being provided by the employer rather than the state. There was also a growth within society in general of a socially responsible point of view which even extended to share investment decisions with the marketing of ethically sound investments.

31.21 Corporate social responsibility

Companies are increasingly recognising the importance of adopting a social, ethical and environmentally responsible approach to business activity and entering into dialogue with all groups of stakeholders. We have discussed the environmentally responsible approach above – the socially responsible approach includes a wide range of activities including the companies' dealings in the marketplace, the workplace, and the community, and in the field of human rights.

Reporting is slowly evolving from simply reporting the amount of charitable donations in the annual report to including additional activities which the company considers to be of key interest. The reporting might be brief but it gives an attractive picture of a company's social responsibility. For example, the 2001 Kingfisher Annual Report has a brief two-page section for social responsibility in which it gives information on:

- environmental issues, e.g. a commitment to sustainable forestry, winning the Business in the Environment award for energy saving; and
- social issues, e.g. from training young unemployed people to recycling electrical goods; making charitable donations that supported the Woolworth Kids First, You Can Do It and Green Grants schemes; and winning a Business in the Community award for Innovation relating to its work forming partnerships with local disability organisations.

We can see from this that community involvement can take many forms, e.g. charitable donations, gifts in kind, employee volunteering initiatives, staff secondments, and sustainable and mutually beneficial partnerships with community and voluntary organisations active in a variety of fields including education, training, regeneration, employment and homelessness.

The approach to CSR is becoming increasingly formalised with the setting up of committees reporting to the Board and more comprehensive CSR Reports.

Committees reporting to the board

The 2004 Kingfisher Annual Report described the role of the Social Responsibility Committee whose purpose is to review progress in fulfilling the Social Responsibility Plan, including monitoring the resources required to support the plan and ensuring that actions taken maximise the opportunity to meet the expectations of key group stakeholders and emerging corporate governance standards (e.g. investor surveys, Turnbull, Business in the Community Survey). The seniority of the committee members is an indication that it has significant influence in advising the board and ensuring the plan is delivered.

CSR Reports

The following is an extract from the CSR Report accompanying the Marks & Spencer 2004 Annual Report:

What Corporate Social Responsibility means to us

Marks & Spencer has a strong tradition of CSR . . . Our founders believed that building good relationships with employees, suppliers and wider society was the best guarantee of long-term success . . . Managing CSR well will allow us to identify potential risks to the Company and respond to areas of performance where we fall behind . . . it also means we can identify opportunities to differentiate ourselves from our competitors. CSR can help us to draw shoppers to our stores, attract and retain the best staff, make us a partner of choice with suppliers and create value for our shareholders.

Their approach is built around three principles, namely **products, people and places**, and a framework developed by their board-level CSR Committee during 2002 with a detailed statement for each principle. For example, the **principle for places** reads as follows:

Help make our communities good places in which to live and work

We recognise our obligations to the communities in which we trade. We were founding members of Business in the Community . . . Our relationship with communities is interdependent. Successful retailing requires economically healthy and sustainable communities . . . we provide employment and products and services and often become an important part of the fabric of the high street. We place much emphasis on our stores, their location, design, construction and activities. A ‘Store of the Future’ project has helped to improve the environmental standards we use to locate, build and refurbish them. Day-to-day operations are managed

within an overall compliance system that includes emergency planning, energy and water usage, health and safety, waste disposal, recycling, recovery of shopping trolleys and donations of unsold food to charities . . . We are also active in a wider sense . . .

A recent development is our growing co-operation with suppliers and business partners in community programmes.

31.22 Need for comparative data

There is evidence⁴³ that environmental performance could be given a higher priority when analysts assess a company if there were comparable data by sector on a company's level of corporate responsibility.

We will consider two approaches that have taken place to satisfy this need for comparable data: benchmarking and comprehensive guidelines.

31.22.1 Benchmarking

There are a number of benchmarking schemes and we will consider two by way of illustration – these are the London Benchmarking Group, established in 1994, and the Impact on Society, established in December 2001.

The London Benchmarking Group⁴⁴

The Group started in 1994 and consists of companies which join in order to measure and report their involvement in the community, which is a key part of any corporate social responsibility programme, and which have a tool to assist them effectively to assess and target their community programmes. Organisations such as Deloitte & Touche, British Airways and Lloyds TSB are members.

The scheme is concerned with corporate community involvement. It identifies three categories into which different forms of community involvement can be classified, namely, charity donations, social or community investment and commercial initiatives, and includes only contributions made over and above those that result from the basic business operations.

It uses an input/output model, putting a monetary value on the 'input' costs which include contributions made in cash, in time or in kind, together with full cost of staff involved; and collecting 'output' data on the community benefit, e.g. number who benefited, leveraged resources and benefit accruing to the business.

Impact on Society⁴⁵

This is a website created in 2001 which provides free access to corporate social responsibility information from leading companies. It is the first time a common set of indicators against which companies can be measured has been provided, offering insight into areas such as the environment, the workplace, the community in which the company operates, the marketplace and human rights. The information ranges from relatively easy-to-measure numeric data, such as water usage, through to more complex, often perception-based information, e.g. from employee surveys. The information is then summarised into clear company profiles and can be compared and contrasted according to a range of parameters, such as specific indicators or industry sectors.

The site provides **qualitative** information for each company with key indicators as shown in Figure 31.3. It also provides quantitative information as a percentage, absolute cash value or physical volume.

Figure 31.3 Impact on Society key indicators

<i>Indicator area</i>	<i>Indicators reported against</i>
Marketplace	Advertising complaints upheld; upheld cases of anti-competitive behaviour; customer satisfaction levels; average time to pay bills to suppliers; customer retention; customer complaints about products and services; provision for customers with special needs.
Environment	Overall energy consumption; water usage; quantity of waste produced by weight; upheld cases of prosecution for environmental offences; CO ₂ /greenhouse gas emissions; percentage of waste recycled; environmental impact; benefits or costs of company's core products and services; environmental impact over the supply chain.
Workplace	Workforce profile by race, gender, disability and age; number of legal non-compliances with health and safety and equal opportunities legislation; upheld cases of corrupt or unprofessional behaviour; staff turnover; value of staff training; perception measures of the company by its employees; absenteeism rates; pay and conditions compared to local equivalent average; work profile compared to local community profile.
Community	Cash value of support as percentage of pre-tax profits; estimated combined value of staff company time; gifts in kind and management time; leverage of other resources; perception measure of company as a good neighbour.
Human rights	Existence of confidential grievance procedures for staff; proportion of suppliers or partners screened for human rights compliance; proportion of suppliers or partners meeting company's own standards on human rights; perception by staff and local community of company's performance on human rights; wage rates.

An illustration of the scheme applied to Marks & Spencer for human rights and the environment is as follows:

Human rights

Particularly applicable to countries with operations or suppliers in developing countries.

The issues measured under human rights largely apply to companies who operate in, or buy from suppliers in, developing countries. What does or does not constitute a human right is always under some debate. However, the Universal Declaration of Human Rights is a main reference point. Before they can report that they definitely fall outside the scope of this section, companies need to answer a 'gatekeeper' question. Unless they can answer that they are definitely not exposed to human rights issues, they need to do more research and report against this indicator area.

The human rights indicators are being developed further: in consultation with non-governmental organisations and businesses engaged in human rights issues. While some companies have chosen to report, others await more fully developed indicators in this area.

Environment

Use of recycled material

Percentage of material used from recycled sources

Non-weight bearing food product cardboard packaging

<i>Recycled cardboard</i>	
2000	60%
1999	50%
1998	25%

Many types of packaging use recycled materials as a matter of course, e.g. glass bottles, tin cans and transport boxes. Where we believe that the use of recycled materials is the best environmental option and that we are able to achieve improvements we set targets. We have been working to increase our use of recycled cardboard (made from at least 50% post-consumer waste) for all our non-weight bearing food product packaging.

31.23 International initiatives towards triple bottom line reporting

There are no mandatory standards for sustainability reporting but there are Sustainability Reporting Guidelines which were issued in 2000 by the Global Reporting Initiative Steering Committee on which a number of international organisations are represented including ACCA, the Institute of Social and Ethical Accountability, the New Economics Foundation and SustainAbility Ltd from the UK.

31.23.1 The Global Reporting Initiative (GRI)

The GRI has a mission to develop global sustainability reporting guidelines for voluntary use by organisations reporting on the three linked elements of sustainability, namely, the economic, environmental and social dimensions of their activities, products and services.

Economic dimension

This includes financial and non-financial information on R&D expenditure, investment in the workforce, current staff expenditure and outputs in terms of labour productivity.

Environmental dimension

This includes any adverse impact on air, water, land, biodiversity and human health by an organisation's production processes, products and services.

Social dimension

This includes information on health and safety and recognition of rights, e.g. human rights for both employees and outsourced employees.

31.23.2 How will the guidelines assist organisations?

The aim is to assist organisations to report information that complements existing reporting standards and is consistent, comparable and easy to understand so that:

- Parties contemplating a relationship such as assessing investment risk, obtaining goods or services or entering into any other commercial partnership arrangement will have available to them a clear picture of the human and ecological impact of the business so that they can make an informed decision.
- Management has the means to develop information systems to provide the basis for monitoring performance, making inter-company comparisons and reporting to stakeholders.

31.23.3 What information should appear in an ideal GRI report?

There are six parts to the ideal GRI report:

- 1 CEO statement – describing key elements of the report.
- 2 A profile – providing an overview of the organisation and the scope of the report (it could, for example, be dealing only with environmental information) which sets the context for the next four parts.
- 3 Executive summary and key indicators – to assist stakeholders to assess trends and make inter-company comparisons.
- 4 Vision and strategy – a statement of the vision for the future and how that integrates economic, environmental and social performance.
- 5 Policies, organisation and systems – an overview of the governance and management systems to implement this vision with a discussion of how stakeholders have been engaged. This reflects the GRI view that the report should not be made in isolation but there should have been appropriate inputs from stakeholders.
- 6 Performance review.

The GRI issued Draft Sustainability Reporting Guidelines in 2006 (www.grig3.org/guide-lines/overviewg.html). The guidelines consist of principles for defining report content and ensuring the quality of reported information as well as standard disclosures comprising performance indicators and other disclosure items. There is also detailed guidance to assist users in applying the guidelines in the form of technical protocols that are being developed on indicator measurement, e.g. specific indicators for energy use, child labour and health and safety.

31.23.4 How are GRI reports to be verified?

CSR Reports are now able to be verified by independent, competent and impartial external assurance providers. The assurance providers now have a standard – the AA1000 Assurance Standard (www.accountability.org.uk) to provide a framework for their work. This standard was launched in 2003 to address the need for a single approach to deal effectively with the qualitative as well as quantitative data that makes up sustainability performance plus the systems that underpin the data and performance. It is designed to complement the GRI Reporting Guidelines and other standardised or company-specific approaches to disclosure. It requires reports against three Assurance Principles which are Materiality, Completeness and Responsiveness, as well as statements as to how conclusions were reached and on the independence of the assurance providers.

As an example, in the 2004 Annual Report of O₂ Ernst & Young, who were the assurance providers, stated that they were forming a conclusion on matters such as (a) *materiality* – whether O₂ had provided a balanced representation of material issues concerning O₂'s corporate responsibility performance, (b) *completeness* – whether O₂ had complete information on which to base a judgement of what was material for inclusion in the Report, and (c) *responsiveness* – whether O₂ had responded to stakeholder concerns. They also explained what they did to form their conclusions:

What we did to form our conclusions

There are currently no statutory requirements in the UK in relation to the independent review of corporate responsibility reports. The AA1000 Assurance Standard sets out principles for social and environmental report assurance. We have been asked by O₂ to set out our conclusions by reference to the assurance principles described in the AA1000 Assurance Standard.

31.23.5 Will there be any impact on matters that are currently disclosed?

There may be an overlap with existing disclosures in the OFR and there is also a pressure for additional information to permit a greater understanding of future risks, e.g. the GRI acknowledges that in financial reporting terms a going concern is one that is considered to be financially viable for at least the next financial year but seeks additional information such as:

- The extent to which significant internal and external operational, financial, compliance, and other risks are identified and assessed on an ongoing basis. Significant risks may, for example, include those related to market, credit, liquidity, technological, legal, health, safety, environmental and reputation issues.
- The likely impact of prospective legislation, e.g. product, environmental, fiscal or employee-related.

31.23.6 The nature of the accountant's involvement

There will be inputs from accountants in each of the three elements with a greater degree of quantification at present for the economic and environmental dimensions. For example:

The economic dimension may require economic indicators such as:

- profit: segmental gross margin, net profit, EBIT, return on average capital employed;
- intangible assets: ratio of market valuation to book value;
- investments: human capital, R&D, debt/equity ratio;
- wages and benefits: totals by country;
- labour productivity: levels and changes by job category;
- community development: jobs by type and country showing absolute figures and net change;
- suppliers: value of goods and services outsourced, performance in meeting credit terms.

The environmental dimension may require environmental indicators such as:

- products and services: major issues, e.g. disposal of waste, packaging practices, percentage of product reclaimed after use;
- suppliers: supplier issues identified through stakeholder consultation, e.g. forest stewardship;
- travel: objectives and targets, e.g. product distribution, fleet operation, quantitative estimates of miles travelled by transport type.

Social dimensions may require social indicators such as:

- quality of management: employee retention rates, ratio of jobs offered to jobs accepted, ranking as an employer in surveys;
- health and safety: reportable cases, lost days, absentee rate, investment per worker in injury prevention;
- wages and benefits: ratio of lowest wage to local cost of living, health and pension benefits provided;
- training and education: ratio of training budget to annual operating cost, programmes to encourage worker participation in decision making;
- freedom of association: grievance procedures in place, number and types of legal action concerning anti-union practices.

Summary

Sustainability is now recognised as having three elements. These are the economic, environmental and social. It is recognised that advances in environmental and social improvement are dependent on the existence of an economically viable organisation.

As environmental and social reporting evolves, there are proposals being made to harmonise the content and disclosure. This can be seen with the publication of the triple bottom line, the Connected Framework and the IFAC Sustainability Framework.

In addition there are benchmark schemes which allow stakeholders to compare corporate social reports and evaluate an individual company's performance. The management systems that are being developed within companies should result in data that are consistent and reliable and capable of external verification. The benchmarking systems should assist in both identifying best practice and establishing relevant performance indicators.

Corporate social reporting is coming of age. Initially there were fears that it would add to costs and there are present concerns that it is diverting too much of a finance director's attention away from commercial and strategic planning. However, it is becoming generally recognised that a company's reputation and its attractiveness to potential investors are influenced by a company's behaviour and attitude to corporate governance and sustainability.

Companies are reacting positively to the need to be good corporate citizens and it is interesting to see the developments around the world where sustainability, good corporate governance and strategic planning are merging into an integrated system. This will take time but companies are taking up the challenge to be transparent and innovative in their financial reporting. Award schemes are encouraging the spread of best practice. Companies are integrating their non-financial narrative and using the Internet to get their message out to a wider public.

The time has passed since corporate governance, sustainability, environmental and social reporting were seen purely as a PR exercise.

REVIEW QUESTIONS

- 1 Discuss the relevance of corporate social reports to an existing and potential investor.
- 2 Obtain a copy of the environmental report of a company that has taken part in the ACCA Awards for Sustainability Reporting and critically discuss from an investor's and public interest viewpoint.
- 3 'Charters and guidelines help make reports reliable but inhibit innovation and reduce their relevance.' Discuss.
- 4 Discuss the implications of the Global Reporting Initiative for the accountancy profession.
- 5 Discuss *The Corporate Report's* relevance to modern business; identify changes that would improve current reporting practice and the conditions necessary for such changes to become mandatory.
- 6 (a) Explain the term 'stakeholders' in a corporate context.
(b) 'Social accounting recognises all *Corporate Report* users as stakeholders.' Discuss.

- 7** Discuss the value added concept, giving examples, and ways to improve the statement.
- 8** Outline the arguments for and against a greater role for the audit function in corporate social reporting.
- 9** (a) 'Human assets are incapable of being valued.' Discuss.
- (b) Football clubs have followed various policies in the way in which they include players within their accounts. For example, some clubs capitalise players, as shown by a 1992 Touche Ross survey:⁴⁶

<i>Club</i>	<i>Value £m</i>	<i>Basis</i>	<i>Which players</i>
Tottenham Hotspur	9.8	Cost	Those purchased
Sheffield United	8.7	Manager's valuation	Whole squad
Portsmouth	7.0	Directors' valuation	Whole squad
Derby County	6.5	Cost	Those purchased

Other clubs disclose squad value in notes to the accounts or in the directors' report:

Manchester United	24.0	Independent valuation
Charlton Athletic	4.1	Directors' valuation
Millwall	11.0	Manager's valuation

Discuss arguments for and against capitalising players as assets. Explain the effect on the profit and loss account if players are not capitalised.

- 10** (a) Examine the recent financial press to identify examples of a failure to meet information needs in respect of an area of public interest.
- (b) Obtain a set of accounts from a public listed company and assess the success in meeting the needs of the traditional users. Repeat the process for non-traditional users and discuss how you could improve the situation (i) marginally, (ii) significantly.
- 11** Discuss the impact of the following groups on the accounting profession:
- (a) Environmental groups;
- (b) Customers;
- (c) Workforce;
- (d) Ethical investors.
- 12** Nissan, the Japanese car company, decided that 'any environmentalism should pay for itself and for every penny you spend you must save a penny. You can spend as many pennies as you like as long as other environmental actions save an equal number.'⁴⁷ Discuss the significance of this for each of the stakeholders.
- 13** (a) 'Accounting should contribute to the protection of the environment.' Discuss whether this is a proper role for accounting and outline ways in which it could.
- (b) Outline, with reasons, your ideas for an environmental report for a company of your choice.
- (c) Discuss the arguments against the adoption of environmental accounting.
- 14** (a) Obtain the annual reports of companies that claim to be environmentally aware and assess whether these reports and accounts reflect the claim. The various oil, chemical and pharmaceutical companies are useful for this.
- (b) Look at your own organisation/institution, outline the possible environmental issues and discuss how these could or should be disclosed in the annual report.

EXERCISES

An extract from the solution is provided on the Companion Website (www.pearsoned.co.uk/elliott-elliott) for exercises marked with an asterisk (*).

* Question 1

The following information relates to the Plus Factors Group plc for the years to 30 September 20X8 and 20X9:

	Notes	20X9 £000	20X8 £000
Associated company share of profit		10.9	10.7
Auditors' remuneration		12.2	11.9
<i>Payables for materials</i>			
At beginning of year		1,109.1	987.2
At end of year		1,244.2	1,109.1
<i>Receivables</i>			
At beginning of year		1,422.0	1,305.0
At end of year		1,601.0	1,422.0
11% debentures	1	500.0	600.0
Depreciation		113.7	98.4
Employee benefits paid		109.9	68.4
Hire of plant, machinery and vehicles	2	66.5	367.3
Materials paid for in year		3,622.9	2,971.4
Minority interest in profit of the year		167.2	144.1
Other overheads incurred		1,012.4	738.3
Pensions and pension contributions paid		319.8	222.2
Profit before taxation		1,437.4	1,156.4
Provision for corporation tax		464.7	527.9
Salaries and wages		1,763.8	1,863.0
Sales	3	9,905.6	8,694.1
<i>Shares at nominal value</i>			
Ordinary at 25p each fully paid	4	2,500.0	2,000.0
7% preference at £1 each fully paid	4	500.0	200.0
<i>Inventories of materials</i>			
Beginning of year		804.1	689.7
End of year		<u>837.8</u>	<u>804.1</u>

Ordinary dividends were declared as follows:

Interim	1.12 pence per share (20X8, 1.67p)
Final	3.57 pence per share (20X8, 2.61p)
Average number of employees was 196 (20X8, 201)	

Notes:

- 1 £300,000 of debentures were redeemed at par on 31 March 20X9 and £200,000 new debentures at the same rate of interest were issued at £98 for each £100 nominal value on the same date. The new debentures are due to be redeemed in five years' time.
- 2 This is the amount for inclusion in the statement of comprehensive income.
- 3 All the groups' sales are subject to value added tax at 15% and the figures given include such tax. All other figures are exclusive of value added tax. This VAT rate has been increased to 17.5% and may be subject to future changes, but for the purposes of this question the theory and workings remain the same irrespective of the rate.
- 4 All shares have been in issue throughout the year.

The statement of value added is available for 20X8 and the 20X9 statement needs to be completed.

	<i>Workings</i>	<i>£000</i>	
Turnover	1	7,560.1	
Less: Bought-in materials and services	2	<u>4,096.4</u>	
Value added by group		3,463.7	
Share of profits of associated company		<u>10.7</u>	
		<u><u>3,474.4</u></u>	
<i>Applied in the following ways</i>			
To pay employees	3	2,153.6	62.0%
To pay providers of capital	4	566.5	16.3%
To pay government		527.9	15.2%
To provide for maintenance and expansion of assets	5	<u>226.4</u>	<u>6.50%</u>
		<u><u>3,474.4</u></u>	<u><u>100.0%</u></u>
<i>Workings</i>			
1 <i>Turnover</i>			
Sales inclusive of VAT		8,694.1	
VAT at 15%		<u>1,134.0</u>	
		<u><u>7,560.1</u></u>	
2 <i>Bought-in materials and services</i>			
<i>Cost of materials</i>			
Creditors at end of year		1,109.1	
Add: Payments in year		<u>2,971.4</u>	
		4,080.5	
Less: Payables at beginning of year		<u>987.2</u>	
Materials purchased in year		3,093.3	
Add: Opening inventory		689.7	
Less: Closing inventory		<u>(804.1)</u>	
Materials used		2,978.9	
Add: Cost of bought-in services			
Auditors' remuneration		11.9	
Hire of plant, machinery and vehicles		367.3	
Other overheads		<u>738.3</u>	
		<u><u>4,096.4</u></u>	

	£000
3 To pay employees	
Benefits paid	68.4
Pensions and pension contributions	222.2
Salaries and wages	<u>1,863.0</u>
	<u>2,153.6</u>
4 To pay providers of capital	
Debenture interest	
11% of £600,000	66.0
Dividends	
Preference 20X8 7% of £200,000	14.0
Ordinary 20X8 8 million shares at 4.28p	342.4
Minority interest	<u>144.1</u>
	<u>566.5</u>
5 To provide for maintenance and expansion of assets	
Profit before tax	1,156.4
Less:	
tax	<u>(527.9)</u>
minority interest	<u>(144.1)</u>
dividends	<u>(356.4)</u>
Retained profits	128.0
Depreciation	<u>98.4</u>
	<u>226.4</u>

Required:

- (a) Prepare a statement of value added for the year to 30 September 20X9. Include a percentage breakdown of the distribution of value added.
- (b) Produce ratios related to employees' interests based on the statement in (a) and explain how they might be of use.
- (c) Explain briefly what the difficulties are of measuring and reporting financial information in the form of a statement of value added.

Question 2

David Mark is a sole trader who owns and operates supermarkets in each of three villages near Ousby. He has drafted his own accounts for the year ended 31 May 20X4 for each of the branches. They are as follows:

	Arton		Blendale		Clifearn	
	£	£	£	£	£	£
Sales		910,800		673,200		382,800
Cost of sales		<u>633,100</u>		<u>504,900</u>		<u>287,100</u>
Gross profit		277,700		168,300		95,700
Less: Expenses:						
David Mark's salary	10,560		10,560		10,560	
Other salaries and wages	143,220		97,020		78,540	
Rent			19,800			
Rates	8,920		5,780		2,865	
Advertising	2,640		2,640		2,640	
Delivery van expenses	5,280		5,280		5,280	
General expenses	11,220		3,300		1,188	
Telephone	2,640		1,980		1,584	
Wrapping materials	7,920		3,960		2,640	
Depreciation:						
Fixtures	8,220		4,260		2,940	
Vehicle	<u>3,000</u>	<u>203,620</u>	<u>3,000</u>	<u>157,580</u>	<u>3,000</u>	<u>111,237</u>
Net profit/(loss)		<u>74,080</u>		<u>10,720</u>		<u>(15,537)</u>

The figures for the year ended 31 May 20X4 follow the pattern of recent years. Because of this, David Mark is proposing to close the Clifearn supermarket immediately.

David Mark employs 12 full-time and 20 part-time staff. His recruitment policy is based on employing one extra part-time assistant for every £30,000 increase in branch sales. His staff deployment at the moment is as follows:

	Arton	Blendale	Clifearn
Full-time staff (including managers)	6	4	2
Part-time staff	8	6	6

Peter Gaskin, the manager of the Clifearn supermarket, asks David to give him another year to make the supermarket profitable. Peter has calculated that he must cover £125,500 expenses out of his gross profit in the year ended 31 May 20X5 in order to move into profitability. His calculations include extra staff costs and all other extra costs.

Additional information:

- 1 General advertising for the business as a whole is controlled by David Mark. This costs £3,960 per annum. Each manager spends a further £1,320 advertising his own supermarket locally.
- 2 The delivery vehicle is used for deliveries from the Arton supermarket only.
- 3 David Mark has a central telephone switchboard which costs £1,584 rental per annum. Each supermarket is charged for all calls actually made. For the year ended 31 May 20X4 these amounted to:

Arton	£2,112
Blendale	£1,452
Clifearn	£1,056

Required:

- (a) A report addressed to David Mark advising him whether to close Clifearn supermarket. Your report should include a detailed financial statement based on the results for the year ended 31 May 20X4 relating to the Clifearn branch.
- (b) Calculate the increased turnover and extra staff needed if Peter's suggestion is implemented.
- (c) Comment on the social implications for the residents of Clifearn if (i) David Mark closes the supermarket, (ii) Peter Gaskin's recommendation is undertaken.

Question 3

- (a) You are required to prepare a value added statement to be included in the corporate report of Hythe plc for the year ended 31 December 20X6, including the comparatives for 20X5, using the information given below:

	20X6	20X5
	£000	£000
Non-current assets (net book value)	3,725	3,594
Trade receivables	870	769
Trade payables	530	448
14% debentures	1,200	1,080
6% preference shares	400	400
Ordinary shares (£1 each)	3,200	3,200
Sales	5,124	4,604
Materials consumed	2,934	2,482
Wages	607	598
Depreciation	155	144
Fuel consumed	290	242
Hire of plant and machinery	41	38
Salaries	203	198
Auditors' remuneration	10	8
Corporation tax provision	402	393
Ordinary share dividend	9p	8p
Number of employees	40	42

- (b) Although value added statements were recommended by *The Corporate Report*, as yet there is no accounting standard related to them. Explain what a value added statement is and provide reasons as to why you think it has not yet become mandatory to produce such a statement as a component of current financial statements either through a Financial Reporting Standard or company law.

Question 4

Gettry Doffit plc is an international company with worldwide turnover of £26 million. The activities of the company include the breaking down and disposal of noxious chemicals at a specialised plant in the remote Scottish countryside. During the preparation of the financial statements for the year ended 31 March 20X5, it was discovered that:

- 1 Quantities of chemicals for disposals on site at the year-end included:

(A) Axlyotl peroxide	40,000 gallons
(B) Pterodactyl chlorate	35 tons

Chemical A is disposed of for a South Korean company, which was invoiced for 170 million won on 30 January 20X5, for payment in 120 days. It is estimated that the costs of disposal will not exceed £75,000. £60,000 of costs have been incurred at the year-end.

Chemical B is disposed of for a British company on a standard contract for 'cost of disposal plus 35%', one month after processing. At the year-end the chemical has been broken down into harmless by-products at a cost of £77,000. The by-products, which belong to Gettry Doffit plc, are worth £2,500.

- 2 To cover against exchange risks, the company entered into two forward contracts on 30 January 20X5:

No. 03067	Sell 170 million won at 1,950 won	= £1:	31 May 20X5
No. 03068	Buy \$70,000 at \$1.60	= £1:	31 May 20X5

Actual sterling exchange rates were:

	won	\$
30 January 20X5	1,900	1.70
31 March 20X5	2,000	1.38
30 April 20X5 (today)	2,100	1.80

The company often purchases a standard chemical used in processing from a North American company, and the dollars will be applied towards this purpose.

- 3 The company entered into a contract to import a specialised chemical used in the breaking down of magnesium perambulate from a Nigerian company which demanded the raising of an irrevocable letter of credit for £65,000 to cover 130 tons of the chemical. By 31 March 20X5 bills of lading for 60 tons had been received and paid for under the letter of credit. It now appears that the total needed for the requirements of Gettry Doffit plc for the foreseeable future is only 90 tons.
- 4 On 16 October 20X4 Gettry Doffit plc entered into a joint venture as partners with Dumpet Andrunn plc to process perfidious recalcitrant (PR) at the Gettry Doffit plc site using Dumpet Andrunn plc's technology. Unfortunately, a spillage at the site on 15 April 20X5 has led to claims being filed against the two companies for £12 million. A public inquiry has been set up, to assess the cause of the accident and to determine liability, which the finance director of Gettry Doffit plc fears will be, at the very least, £3 million.

Required:

Discuss how these matters should be reflected in the financial statements of Gettry Doffit plc as on and for the year ended 31 March 20X5.

Question 5

Examine the EPA's website (www.epa.gov/epahome/aboutepa.htm) and prepare one of the cases as a presentation to the group showing clearly how environmental accounting was used and the results of the exercise.

Question 6

The following items have been extracted from the accounts:

	2005 (€m)	2004 (€m)
Other income	844	980
Cost of materials	25,694	24,467
Financial income	-188	54
Depreciation/amortisation	4,207	3,589
Providers of finance	1,351	1,059
Retained	1,815	1,823
Revenues	46,656	44,335
Government	1,590	1,794
Other expenses	4,925	5,093
Shareholders	424	419
Employees	7,306	7,125

Required:

- Prepare a Value Added Statement showing % for each year and % change
- Draft a note for inclusion in the Annual Report commenting on the Statement you have prepared.

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