



**SOME DISCLOSURE ISSUES ARISING FROM THE INQUIRY
INTO ENVIRONMENTAL ACCOUNTING AND REPORTING
CONDUCTED BY THE PARLIAMENT OF VICTORIA**

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The Public Accounts and Estimates Committee of the Parliament of Victoria's Inquiry into Environmental Accounting and Reporting was instigated to review the extent to which public and private sector organizations should be required to disclose information about their environmental activities. The Inquiry process, particularly the submission and evidentiary stages, play a valuable role in identifying disclosure issues. The submission made to the Inquiry provides the views of user groups with regard to aspects of environmental reporting. The evidence given to the Inquiry is grouped into themes that reflect key reporting issues. Quantitative and qualitative research methods are combined to provide a discussion of issues relating to the reporting of an entity's environmental performance, form of displaying environmental reports and the broadening concept of accountability.

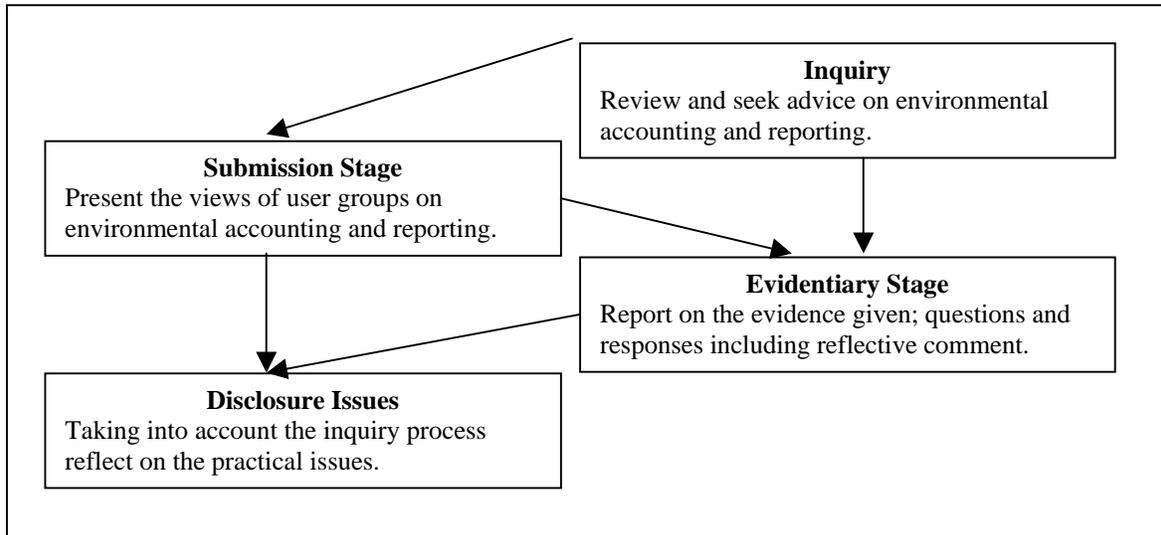


Introduction

In March 1998 the Public Accounts and Estimates Committee of the Parliament of Victoria released an Issues Paper (1998) on Environmental Accounting and Reporting, signalling their intention to conduct an inquiry. The main factor influencing the establishment of an inquiry “was the National Strategy for Ecologically Sustainable Development”. This particular strategy suggests that “long and short term economic, social and equity issues” should be integrated into the decision-making and, therefore, reporting processes of public and private organizations (Forwood 1998). The terms of reference of the Inquiry into Environmental Accounting and Reporting were as follows:

1. Review and seek advice on international and national developments in environmental accounting and reporting;
2. Consider the current application of these developments for both private and public organizations in Australia and overseas;
3. Investigate the implications of these developments for Victorian public sector accounting and reporting; and,
4. Review the extent to which public and private sector organizations in Victoria and in Australia should be required to disclose information about the negative impacts of their activities on the environment and the positive outcomes of their efforts to protect the environment, control pollution and remediate environmental damage. (Parliament of Victoria 1998)

The practical issues of public and private sector entities knowing ‘what’ and ‘how’ to report environmental information is causing problems not only for the entities but also for regulators. The inquiry process, as displayed in Figure 1, provides a comprehensive review of environmental accounting and reporting whilst also providing the basis for discovering some of the disclosure issues confronting the Inquiry.

Figure 1: The Inquiry Process

The focus in this paper is on a discussion of issues relating to the reporting of an entity's environmental performance, form of displaying environmental reports and the broadening concept of accountability. The submission was based on research conducted into environmental financial reporting from a user perspective. The evidentiary stage relates the evidence given to the Inquiry in a question and answer format to aspects of the submission. In the following sections the research methods employed and subsequent discussion provide the basis for the exploration of the issues in environmental reporting.



Research Method

The research method is an amalgam of approaches stemming from the submission and evidentiary stages of the inquiry process. The submission was based on the results of a postal questionnaire sent to three user groups; shareholders, shareholders/environmentalists and environmentalists. The views of the user groups on the following were specifically covered:

- the type of environmental information that users would like reported
- the entities that should report environmental information
- the favoured medium for being informed
- the preferred format of any report
- the level of disclosure considered material, and
- to whom environmental financial information should be addressed.

Cross-tabulations were used to illustrate the results in the areas mentioned.

The companies, randomly selected from the Australian Stock Exchange's top 50 companies, were; Australia & New Zealand Banking Group Ltd (ANZ), Pacific Dunlop Ltd (PDP) and ICI Australia Ltd now Orica Ltd (ICI). Participants were randomly selected from the three companies mentioned above. Surveyed environmentalists were drawn from the membership of the Environmental Institute of Australia (EIA). Participants were natural persons resident in Australia and over the age of eighteen. Organizations and companies, that formed a significant part of the databases mentioned above, were excluded when establishing mailing lists. There were 810 shareholder participants and 1072 environmental participants in the survey; a total of 1882. The overall response rate was 57.8%, whilst for environmentalists the rate was 61.6%, and for shareholders the rate was 52.8%. The usable responses were 256 for shareholders, 232 for shareholder/environmentalists and 376 for environmentalists.

The submission was influenced by the quantitative research design used to collect data. The interpretative or qualitative approach to the evidentiary stage of the Inquiry provides an opportunity to evaluate aspects of environmental disclosures in the context of the

submission. The questions asked and responses given at the hearing have been grouped into themes and tabulated to reflect certain disclosure issues. Whilst responses to questions appear brief and in some circumstances too simplistic it must be remembered that the giving of evidence is time restricted. On reflection some answers lack explanation and the intent is often unclear. As the process is political, questioning by the Inquiry can tend to support certain perceptions and views. The written word is not reflective of the spoken as Hansard confirms so the questions and responses provided have been modified to improve flow and understanding.

Discussion

Certain themes have been developed from the submission and evidentiary stages of the inquiry process. Each theme contains a description of the information contained in the submission and evidentiary stages. The descriptions are then followed by a brief discussion of the issue. At times there seems to be quite a deal of distance between information provided in the submission and the questioning at the hearing. Some of these differences can be explained by differing political agenda and by the nuances of the Inquiry process. The submission primarily involves the private sector but the terms of reference for the Inquiry include ‘implications of these developments for Victorian public sector accounting and reporting’ (op cit) hence the relevance to the public sector.

Reporting Environmental Performance

The type of environmental information and changing reporting needs created by the ‘environmental agenda’ indicating the importance of certain environmental activities and events were investigated. Results from the questionnaire reveal little difference across the user groups with regard to the ranking of environmental activities and events. Users perceived the following four types of environmental information to be the most important; ‘pollution reduction,’ ‘environmental planning,’ ‘compliance with regulations’ and ‘environmental health and safety’.

Industry categories were adapted from earlier studies and included; chemical, iron and steel, paper, petroleum refinery, primary non-ferrous and textiles. A recent Australian



study by Deegan and Gordon (1995) indicated the industry sectors that were environmentally sensitive. Prior researchers examined the sensitivity of certain industry sectors rather than a more general approach to ascertain if differential reporting is considered appropriate by users. Shareholders' ranking of industry sectors tends to support the notion of differential reporting. Results from the shareholder/environmentalist and environmentalist groups indicate that respondents did not clearly rank the industry sectors which indicates that these groups believe that all sectors should report.

The categories in Table 1 have been based on a study by Chang & Most (1981). Adaptation to an Australian context took into account the work of Anderson & Epstein (1995). As one of the target user groups for this project included environmentalists, adjustments to the sources of information were made to reflect the inclusion of environmental sources.

Table 1: Sources of Information

Information Source	Shareholders		Shareholders & Environmentalists		Environmentalists	
	No.	Rank	No.	Rank	No.	Rank
Sharebrokers	142	2	92	4	40	11
Financial Advisory Services	83	6	82	5	87	10
Environmental Organisations	29	8	71	8	164	2
Ethical Investment Organs.	24	9	53	10	96	7
Annual Reports	115	3	108	2	169	1
Newspapers etc. –Financial	166	1	136	1	129	5
Newspapers etc. - General	90	5	98	3	146	4
Newspapers etc. - Environ.	16	11	75	6	154	3
Company Announcements	93	4	73	7	93	8
Advise of Friends & Relatives	67	7	55	9	88	9
Tips & Rumours	21	10	22	13	27	12
Government Agencies	7	13	40	11	110	6
Other	13	12	26	12	26	13

The ranking of sharebrokers, newspapers and magazines, and the annual reports are consistent with earlier studies in the USA, NZ and Australia reported by Courtis (1978) and the more recent study by Anderson and Epstein (1995). The different ranking of the annual report by shareholder/environmentalists and environmentalists, the former ranking annual reports second and the latter ranking them first, is an interesting outcome that is broadly consistent with the findings of Tilt (1994).

Respondents were asked their opinions as to whom they believed information regarding an entity's environmental activities should be addressed. Five categories were indicated and respondents could choose more than one. All user groups believe that reports should be addressed to the public.

The questions and responses provided in Table 2 seem to confuse the decisions that users may make suggesting that only 'financial' information is used to make decisions regarding resource allocation. It is conceivable that users could make resource allocation decisions with 'non-financial' information. Goldberg's 'accountable relationships' which centre on property rights and the limits to property rights have been further developed by Diegling et al (1996) to identify five accountability rationalities as legal, economic, technical, social and political. By identifying what an entity is accountable for it is possible to determine the decisions that may be made with disclosures, therefore identifying the types of decisions users may make.

The presentation format or the issue of what is 'financial' information in the context of the above becomes less important from the perspective of presenting information regarding 'accountable relationships'. The accounting profession has some significant choices concerning the role of accounting; an expanded role that encompasses the five accountability rationalities; or continue with the traditional role of reporting the economic performance of entities. The former choice would require a range of changes one of which might be the triple-bottom-line.



Table 2: Reporting Environmental Performance

Question/Statement	Response
How would you quantify the social performance of an entity?	There are other ways to disclose information than in dollar or statistical form. The research being undertaken indicates a strong preference for narrative disclosure.
What do you think of the notion of a triple bottom line?	Users have trouble understanding accounting disclosures as they are at present. The introduction of triple-bottom-line reporting would serve merely to confuse understanding. The incapacity of users to understand accounting would only be compounded if a triple bottom line were to be introduced.
Do you believe that sort of non-dollar information should become compulsory and should we encourage companies to add that sort of statistical information into an annual report or whether there should be a separate environmental report. Do you have a view on that?	It is interesting that shareholders read annual reports only as second or third choice. People who read annual reports are implicit users – environmentalists. Other research supports this outcome and as a consequence environmental financial information should be included as part of the annual report.
Some believe annual reports should not be clogged up with information of a non-financial nature and that the accountant's job is to get the dollars, the bottom line upon which you make decisions relating to capital. Decisions about social or environmental issues should be kept separate. You do not agree with that?	No, separate reports would cost companies significantly more and the research indicates that implicit users prefer to see environmental financial information in the annual report. The information is fairly superficial but that is where users would prefer to read about the environmental activities of an entity.



Format of Disclosures

In the submission some evidence of the desired format of reports that users would prefer was reported. The logic being that if a narrative format is preferred then the detail inherent in any report would be better understood presented in that format. Traditional monetary presentations of triple-bottom-line reporting may be inappropriate and other presentation formats such as narrative more useful in providing an account of entity performance.



Various researchers (Trotman 1979, Guthrie & Parker 1990, Gibson and O'Donovan 1994 and Gray et al 1995) have conducted content analyses of the disclosures made by companies in their annual reports and whilst not being directly related these studies form the basis for the formats used in the survey. After an evaluation of the terms used the following display classification was established; monetary, statistical, narrative and pictorial. The preferred method of display will depend on a number of variables, weighted differently by various users, because individuals interpret information differently. As a consequence, users, taking into account issues discussed earlier, make different decisions with the same information. Effective communication should maximize the decision usefulness of information transfer through the display medium.

Table 3: Preferred Reporting Formats

Information Type	Shareholders		Shareholders & Environmentalists		Environmentalists		Total	
	No.	%	No.	%	No.	%	No.	%
Monetary	86	10.4	31	3.7	35	4.2	152	18.3
Statistical	49	5.9	31	3.7	53	6.4	133	16.0
Narrative	68	8.2	104	12.6	163	19.7	335	40.5
Pictorial	1	.1	-	-	1	.1	2	.2
Other	1	.1	3	.4	4	.5	8	1.0
Incorrectly Answered	<u>51</u>	<u>6.2</u>	<u>62</u>	<u>7.5</u>	<u>85</u>	<u>10.3</u>	<u>198</u>	<u>24.0</u>
Total	256	30.9	231	27.9	341	41.2	828	100.0

Results regarding presentation formats are contained in Table 3 and are quite compelling. Anecdotally, the large percentage of 'incorrectly answered' occurred through respondents marking all categories. Whilst a third of shareholders would prefer a narrative format, when considering the responses of shareholder/environmentalists and environmentalists this rises to nearly half. This is quite important and perhaps the drafting of any reporting regulations should take this aspect into account.



Environmental reporting at present is largely voluntary and one of the Inquiry's stated terms of reference is to determine whether reporting should be compulsory. But of greater issue is the verifiability of the information being provided. This raises a number of points, firstly, what sort of verification can be provided for voluntary or mandatory reports? Secondly, would different report presentations prove difficult to verify? And lastly, who should perform the report verification?

A perspective on these questions is provided in Table 4 but is not the only approach that could be taken. The role of the accounting profession in report verification would seem logical given the tradition of audit that exists in accounting. However, the complexity of environmental issues most certainly requires an interdisciplinary approach, which, whilst used in some areas of the public sector, is relatively new and therefore investigations into this approach need to be undertaken. If, as the results contained in the submission indicate, that a narrative report would be the most appropriate format for disclosing environmental information, then, how would verification of information contained in the report be undertaken? This poses a particularly difficult problem requiring extensive research into areas such as societal expectations of corporate environmental behaviour. This could lead to the establishment of a social 'corporate reputation index' to measure the environmental performance of companies much the same as the Australian stock exchange index provides a measure of the economic performance of companies.



Table 4: Auditing Narratives

Question/Statement	Response
Would you support voluntary or mandatory reporting of environmental information?	Research evidence suggests that voluntary disclosures reflect positively the activities of an entity. Perhaps the choice is not only between voluntary or mandatory disclosure but could include a third alternative that of audited disclosures. The weakest alternative is voluntary disclosure. The concern is that environmental audits are not necessarily being performed by accountants. The accounting profession has an audit tradition and should be heavily involved in the new process to ensure audit reliability.
Are there environmental or other qualified groups that could perform the audit function?	The accounting profession has the experience to maintain the integrity of an audit process. An audit is usually performed by a team and an environmental audit team would include experts from other professions. In this way an audit team would benefit from interdisciplinary expertise.
Doesn't that create a significant problem for anybody trying to produce some standard by which there can be meaningful reporting?	The intention of the research is to discover which style of format users, explicit and implicit, favour. Preliminary results indicate that narrative disclosures are preferred.
But users would prefer narrative disclosures to be capable of being audited, wouldn't they?	It is difficult to audit narrative disclosures because of semantic difference and understanding. However, at present standards are in narrative form and are interpreted in a monetary context.
If a standard is measurable in monetary or narrative form then it should be capable of being independently verified by a certified verifier therefore bringing rigour to the system. How do you grapple with setting standards?	Quite a lot of work is being undertaken on the different meanings of some of the quantifiable phrases used in accounting standards such as 'virtually certain' and 'more likely than less likely' and what they mean in terms of probability.

Expanding Concepts and Notions

Accounting has principally been involved in economic descriptions of the wealth of an entity. An account of the environmental impact a company is having places strains on traditional definitions particularly from a user perspective. Definitions of financial information usually refer to information presented in monetary format so in relation to an annual report information would be considered to be financial if it is monetary. However the complexity of user decision processes is not necessarily geared to receiving information in an economic form. In fact, the decision to buy, sell or hold shares may be undertaken not using ‘financial’ information at all. From the user perspective it may be better to define financial information in terms of the decisions that users make. In this context financial information would be any information that users use to make an economic decision. This defines financial information in terms of its use rather than its intrinsic nature.

Table 5: Broadening Concepts

Question/Statement	Response
A discussion of the environmental accounting and reporting needs of users from a financial accounting perspective is in the submission. Could you explain what is meant by terms used?	Financial information is considered to be that information which contributes to the decisions of users. For example, a shareholder may use a narrative disclosure regarding the environment to make decisions about whether to buy, sell, or hold shares in a particular entity. Environmentalists may use statistical information to make their decisions. Users may not use traditional financial disclosure, that is, monetary disclosures, to make decisions.
So you are discovering that different users of information have different needs, and would like to see it presented in different ways?	Users have been classified as either explicit or implicit which is different from the classification in SAC 2. Explicit user describes those users that have property rights or a specific fiduciary connection with an entity. Explicit users have primarily an economic association, that is, a more traditional relationship. Implicit users do not have the traditional associations but consider that entities are accountable to the broader community for actions affecting, for instance, the environment.



In the context of the Australian accounting conceptual framework (CF) users are considered to be rational economic users. Again, from a user perspective, describing users in terms of their inherent relationship to an entity better enables users to be defined. A dichotomous distinction on the basis of property rights enables those users with an economic relationship to be distinguished from users that have an environmental interest in an entity. Explicit users are those that have an economic interest whilst implicit users have an environmental interest in an entity. The CF does not identify the implicit user group. The simple distinction allows an entity to cater to the differing decisions needs of the two groups and allows for an expanded notion of users that is more inclusive of society in general.

This perspective raises both theoretical and practical issues. Goldberg (1965) identified that social relationships are the primary focus for accounting researchers.

One of the tasks of the accounting theorist is to elucidate the characteristics in relationships that make them accountable. It is submitted that accountable relationships are chiefly (though not solely) social in character, that is, they derive the greater part of their meaning from a social context. (p38)

Later, Goldberg identified two specific relationships that are important for concepts of disclosure. The relationship of persons to property rights and the limits placed on those property rights; change is identified as constantly occurring. More recently it seems that society is placing greater limits on property rights; particularly as they relate to environmental degradation. How this change reflects on corporations and their 'accountable relationships' is of particular importance. Firstly, to theorists with regard to legitimacy, stakeholder and political economy theories and; secondly, in a practical sense, with regard to whether the disclosure is in a traditional monetary format or some other display format. Defining the relationships that reflect altered circumstances is the first step towards adapting accounting to changing societal needs.

Conclusion

The present regulatory framework is administered through the Australian Accounting Standards Board (AASB) which administers both private and public sector accounting standards; corporate law and the Australian Stock Exchange listing requirements. A perusal of this structure indicates little or no involvement of state governments. The thrust of the Inquiry, therefore, is quite unique in that it indicates that the Victorian Government is contemplating regulating public and private sector entities' disclosures of environmental information. It is only in recent times that state governments passed the regulation of corporate financial disclosures over to federal bodies so for them to be considering re-entering the corporate regulatory arena is interesting in itself but more so when the issue necessitating the re-entry is environmental disclosures.



Putting aside the problem alluded to above and considering some of the more theoretical and practical issues of instigating regulated environmental reporting there are significant disclosure issues that need to be addressed. Theoretical issues of the way in which key terms are defined in accounting provide fundamental barriers to change. The role of the accounting profession with regard to the reporting of ‘accountable relationships’, audit participation and report formats are practical issues that require extensive investigation.



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