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UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT
Geneva

GUIDANCE MANUAL

ACCOUNTING AND FINANCIAL REPORTING FOR ENVIRONMENTAL COSTS AND LIABILITIES

PART 3.
ENVIRONMENTAL REPORTING

UNITED NATIONS
Geneva, 2002

3. ENVIRONMENTAL REPORTING

The overall objective of this section is to introduce participants to the development, purpose, users and practice of public environmental reporting.

This section includes presentations on the following:

- What is environmental reporting?
- Which companies are doing it?
- Drivers and benefits

An additional objective is to identify stakeholder groups and their information needs. This section incorporates the following:

- Conventional categorisation of stakeholder groups and their needs.
- Introducing the UNEP/SustainAbility 50 core principles.
- What should be in Corporate Environmental Reports?
- Verification issues.

What is Environmental Reporting?

Environmental reporting is the term now commonly used to describe the disclosure by an entity of environmentally related data, verified (audited) or not, regarding environmental risks, environmental impacts, policies, strategies, targets, costs, liabilities, or environmental performance to those who have an interest in such information as an aid to enabling / enriching their relationship with the reporting entity) via either:

- the annual report and accounts package
- a stand-alone corporate environmental performance report (CER)
- a site-centred environmental statement
- some other medium (e.g. staff newsletter, video, CD Rom, internet site)

The Environmental Task Force of the European Federation of Accountants (FEE) defines the objective of external environmental reporting in a similar way:

> *"the provision of information about the environmental impact and operational performance of an entity that is useful to relevant stakeholders in assessing their relationship with the reporting entity".*

Note the similarity of both definitions to the objectives of financial reporting as explained by the International Accounting Standards Committee (1995):

> *"the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions".*

For the purposes of environmental reporting it is customary to drop the emphasis on the needs of users to make 'economic decisions'.

Corporate Governance, Accountability and Environmental Reporting

Environmental reporting could described either as a branch of the corporate governance tree, or as one aspect of the so-called 'triple bottom line' – whereby data on financial results, environmental performance and social impact are brought together in what might be termed a 'sustainability report'.

Historical Development of Environmental Reporting

Historically, corporate public reporting has developed as follows:

1. Financial accounting and reporting	From the 1850's
2. Financial aspects of corporate governance	From early 1990's
3. Environmental reporting	From early 1990's
4. Social and ethical accounting and reporting	From late 1990's.

1 + 3 + 4 = sustainability reporting or 'the triple bottom line'

Keywords: accountability, transparency.

Public Sector or Private Sector?

The majority of environmental reporting examples are found in the private sector. But there is no hard and fast rule. Despite the wave of privatisation sweeping the world, in many countries environmentally sensitive industries still remain within the public sector. Examples of public sector reporting are provided below.

The Growth in Corporate Environmental Reporting

There has been a remarkable growth in the number of entities issuing environmental performance reports.

1990: No more than 10 or 12 of voluntary public reporting world-wide
1998: Estimated 2,000 + companies internationally

Countries: At least the following: Argentina, Australia, Austria, Belgium, Brazil, Canada, the Czech Republic, Colombia, Denmark, Finland, France, Germany, Hong Kong, Hungary, Ireland, Italy, Japan, Korea, the Netherlands, New Zealand, Nigeria, Norway, Russia, South Africa, Sweden, Switzerland, United Kingdom, USA.

1999 PIRC UK FTSE 350 Survey Results

- 70% of companies in FTSE 350 report in some form on the environment (up from 65% in 1998).

- 62 companies in the FT 350 produced separate environmental reports (up from 60 in 1998).

Note: the UK Government is trying to increase environmental reporting to the point where all 7,000 UK companies with over 250 employees produce an environmental performance report. Denmark and the Netherlands already have environmental reporting requirements on the statute books for specified groups of large/heavily polluting companies.

Best Practice Examples

Included below are names of some organisations that have issued environmental reports. The public sector is not always susceptible to precise definition and so includes examples from the health and education sectors as well as some 'not for profits' examples.

The Private Sector	**The 'Public' Sector**
• Anglian Water; BP Amoco; BT; The Body Shop International; British Airways; National Power; NatWest Bank; Shell (UK); United Utilities • Novo Nordisk (Denmark) • Neste (Finland) • Kirin Brewery, Sony ; Toyota (Japan) • China Light & Power (Hong Kong) • Baxter Healthcare; General Motors; Procter & gamble; Sun Company (USA) • Northern Telecom Ltd (Canada) • Kvaerner ; ASG; SAS; Volvo (Sweden) • Bayer; Lufthansa; VW (Germany) • South African Breweries (S Africa) • Dow Europe • Aracruz Celulose S.A. (Brazil)	• New York State Pension Fund for the Fire Services • DSB / Banelstyrelsen (Denmark's national railway company) • Eskom (South Africa) • Dutch hospital group AZU • London Borough of Sutton (Local authority) • Liverpool John Moores University (education sector) • The Corporation of London • The Environment Council (NGO) • The New Economics Foundation (social report) • Department of Environment, Transport & Regions (Gov Dept UK)

A Sectoral Analysis

An analysis of environmental reporting internationally (KPMG 1999) shows how the various industrial and service sectors represented in the Global 250 companies are performing in terms of public reporting, as well as the top 100 companies in each of 11 countries.

	The global 250	**1100 in 11 countries**
Pharmaceuticals	100% (4)	50% (30)
Mining	100% (1)	47% (15)
Forestry pulp and paper	100% (1)	55% (22)

Chemicals & synthetics	88% (8)	59% (64)
Transport	80% (5)	33% (51)
Automotive	69% (16)	38% (34)
Electronics & computers	67% (24)	30% (69)
Oil & gas	63% (19)	53% (53)
Metals, engineering & other manufacturing	50% (10)	17% (105)
Utilities	40% (10)	55% (55)
Finance, insurance & securities	15% (74)	8% (127)
Food & beverages	20% (10)	22% (104)
Communications & media	20% (15)	16% (62)
Trade & retail	17% (42)	7% (161)
Other services	0% (9)	4% (91)
Construction & building materials	0% (4)	18% (57)
	35% (88)	24% (267)

Key Measurement and Environmental Reporting Drivers

Companies report a number of factors which drive them into the reporting process:

- international standards / mandatory requirements (US, Denmark, Netherlands, Thailand)
- competitive advantage / best in class
- environmental management systems base
- supply chain pressures
- credit & investment conditionality
- other stakeholder concerns
- peer group pressure

The Costs and Benefits of Environmental Reporting

The costs of reporting are mostly direct	**The costs of not reporting are mostly indirect**
• installing the appropriate environmental management systems • employing specialist staff / internal auditors • appointing external verifiers • publication / distribution costs / web site design costs • there is also a potential 'reporting risk' cost	• poor environmental profile *vis a vis* competitors • potential loss of markets / investors • loss / foregoing of other benefits referred to on next slide

The benefits of environmental reporting vary from company to company. Environmental reporting:

- provides strong focal point for internal EMS development and managerial buy-in
- enhances employee / workforce morale
- includes the setting and publishing of performance standards which drives continuous improvement
- establishes environmental issues as a key policy / strategy element
- enables companies to re-assure investors / lenders as to environmental risk and corporate environmental engagement
- enables good environmental performers to differentiate themselves from the also-rans
- may minimise risk of regulatory intervention
- may create local community opportunities
- may provide improved access to supply chain (including public procurement opportunities)
- may provide quality public relations / profiling opportunities
- supports the audit / reporting culture which will make a company more receptive to new developments – e.g. social and ethical reporting

Different Approaches to Environmental Reporting

Different methodological approaches to environmental reporting have evolved, mainly because of local cultural / regulatory differences.

Compliance based reporting

Reporting the level of compliance with external regulations and consent limits is a common feature of the environmental reports of heavily regulated utilities (water, electricity).

TRI (Toxic Release Inventory) based reporting

Many US companies are required by law to publish lists (detailed in physical quantities) of emissions of specific toxic substances.

Impact based performance reporting

Most private sector companies that are not subject to specific consent requirements identify their key environment impacts and base their reporting around target setting and performance (over time) in achieving those targets.

The Eco-balance approach

Some companies (including many from Germany) construct a formal 'eco-balance' (= resource inputs *vs.* product and non-product output) from which they then derive performance indicators.

The environmental burden approach (ICI)

ICI (the UK chemicals manufacturer) has developed an externally focused reporting approach which quantifies the company's impact on 6 or 8 environmental quality measures.

Greenhouse Gas Indicator

Converting energy use from all sources into a measure of CO2 emissions (and other greenhouse gases) which can be expressed per unit of (say) turnover. Developed by UNEP in conjunction with NPI and Imperial College London.

Triple bottom line / sustainability reporting

Sustainability reporting involves combining environmental reporting with the reporting of both financial and social / ethical / community performance measures.

In practice many companies combine one or more of the above approaches (e.g. TRI plus impact based; impact based plus environmental burden; etc.).

What is Normally Found in an Environmental Report?

UNEP, working with the UK consultancy SustainAbility, have developed a core set of 50 issues which merit separate disclosure in environmental reports. The main sub-headings within which the disclosures can be grouped are:

I. Organisational overview, management policies and systems: core issues
II. Input/output inventory (take, make, waste) (Oko-bilanz)
III. Finance
IV. Stakeholder relationships and partnership
V. Sustainable development
VI. Report design.

I. Organisational Overview, Management Policies and Systems: Core Issues	**Further Development**
0. Introduction / overview / report contents /highlights section	Use of graphics / business process pictogram / core EPIs
1. Senior management commitment statement	The 'CEO agenda' including at minimum (i) environmental performance improvement commitment (ii) risk exposure and (ii) sustainability intentions
2. Management responsibility and accountability	Board and group structure. Evidence of integration into the business process
3. Corporate context / general site / company information	Overview of products / services / staff / finances / geography etc.
4. Formal corporate environmental (HS&E/ sustainability) policy statement	Adherence to other charters (ICC, CEPHIC, Responsible Care, CERES etc.)
5. Environmental management systems	EMS certification details and plans (EMAS / ISO 14001). Global application of environmental (etc.) policies. Training issues / procedural manuals etc.; description of measures implemented
6. Environmental auditing	Internal and external auditing procedures, audit cycles and results; attitude towards third party verification

7. Consideration of significant environmental aspects.	Criteria for deciding what are the significant aspects or impacts. Discussion of industry related issues.
8. Scope / purpose of the report	E/H/S/Social/Sustainability? – extent of group / site / business segment coverage
9. Goals and targets	(i) realisation of objectives over reporting period (ii) new goals for .... foreseeable future
10.Legal compliance	Laws to be complied with; compliance record; complaints (upheld); instances of non-compliance; fines / penalties incurred;
11. Research and development	Corporate attitude – expenditure details
12.Awards	Details
13.Verification	Scope of engagement; statement from external party; reference to unsolved problems
14. Reporting & accounting polices	Timing / regularity of reports? continuity of report structure; data evaluation methods; comparability over time and within sector.
II. Input/Output Inventory (Take, Make, Waste) (Oko-bilanz)	**Further Development**
Inputs	
15. Organisation (or site) specific information on material and energy flows	Absolute physical data on materials use; energy consumption; water consumption
Process management	Details / EPIs
16. Eco-efficiency / clean technology	H&S statistics & EPIs
17. Health & safety	Statistics
18. Accident & emergency response	Contingency planning details
19. Risk management & EIAs	Financial liability and causation details / contingent or actual liability?
20. Land contamination & remediation	State of the environment / sustainability indicators
21. Stewardship of local habitats & eco-systems	Data/EPIs, waste minimisation & management plans
Outputs	
22. Waste/residual products	Data / EPIs , environmental effects
23. Air emissions	Data / EPIs, ditto
24. Water effluents	Data / EPIs, ditto
25. Noise & odours	Data / EPIs, ditto
26. Transportation	Data / EPIs, ditto
Products	
27. Life-cycle design	Treatment of significant aspects of product life cycle
28. Environmental impacts	Policy towards environmental impact assessments
29. Product stewardship	Presentation of significant aspects of product development
30. Packaging	Packaging issues; strategies; absolutes; EPIs
31. Any other significant factors	Single figure composite performance index
III. Finance	**Further Development**
32. Explicit linkage through to financial statements	Annual report and accounts contain clear environmental performance / financial message
33. Environmental / social / community spending	Environmental and / or social costs / investments / charitable contributions etc.
34. Environmental liabilities and provisions	Details of contaminated land; de-commissioning costs; discount rates etc.
35. Financially quantified benefits	Recycling revenues; cost savings; new market opportunities

36. Market solutions, instruments and opportunities	Government economic penalties and incentives; impact of green taxes
37. Environmental cost accounting	> disclosure of conventional internal accounting mechanisms > disclosure and discussion of experiments with cost internalisation and sustainability accounting
38. Future costs/investment needs business opportunities & risks	Future technological / legislative changes; evaluation of market situation and potential
IV. Stakeholder Relationships and Partnership	**Further Development**
39. Employees	Disclosure of stakeholder directed initiatives (and consequent response) Different reports issued Design of EPIs driven by stakeholder interests.
40. Politicians, legislators & regulators	
41. Local communities	
42. Investors	
43. Suppliers & contractors	
44. Customers & consumers	
45. Environment groups	
46. Science & education	
47. Other	
V. Sustainable Development	**Further Development**
48. Technology co-operation	Corporate attitude towards sustainable development / quality of the environment type indicators
49. Global environment	
50. Global development standards	
51. Global operating standards	
52. Visions, scenarios, future trends	
VI. Report Design	**Further Development**
53. Report design	• Layout & appearance; clarity – easy to follow presentation & structure • Visual design: attractiveness; picture quality; graphics etc.; typeface • Comprehensibility of information; information value of headings; style; quick overview of content

Optional Syndicate Exercise 1

Please review (briefly) the points highlighted on the left hand column in the above table (points 0–53) and identify any environment related issues which you believe:

a. are missing from the list (and which ought to be included) or

b. are included in the list but are – in your view – politically or practically 'undeliverable'.

This section of the manual covers the objective – to identify stakeholder groups and their information needs.

Who are the Customers for Environmental Reporting?

In financial reporting the shareholders (present and future) are assumed to be primary consumers financial performance information – and the existence and importance of other customers (stakeholders), while admitted, is often played down – especially be the standard setters. The definitions of environmental reporting provided above included the following:

'the provision of information about the environmental impact and operational performance of an entity that is useful to relevant stakeholders in assessing their relationship with the reporting entity'.

Who might these 'relevant stakeholders' be? Conventional environmental reporting practice can be argued to focus on the interests of all (or some) of the following.

- Shareholders / potential owners
- Internal line managers
- Employees
- Competitors
- Lenders and insurers
- Financial advisers and analysts
- Journalists / media
- Suppliers and customers
- Neighbours, local communities
- Local and regulatory authorities (& national government)
- Environmental organisations / NGOs

Optional Syndicate Exercise 2

Review the above list of potential stakeholders.

Decide:

(a) which of them are the most important (or relevant) from your national context and

(b) what – in very general terms – their environmental information needs might be (e.g. a potential bidder might be most concerned to see that there were no unrecorded environmental liabilities in the financial statements).

Tailoring Environmental Reports to User Needs

Experience seems to suggest that there is no single correct way of publishing or communicating environmental performance data. Environmental reporters have experimented with many different approaches including:

- separate sections in the annual report and accounts package
- hard copy stand alone environmental performance reports
- community directed site reports
- employee newsletters (corporate intranet)
- abbreviated / simplified reports
- customers directed reports
- corporate videos
- CD Roms with back-up information
- corporate web sites.

Identifying Stakeholder Expectations – The UNEP / SustainAbility 'Engaging Stakeholders' Project

UNEP and the UK based consultancy firm SustainAbility are pursuing a lengthy research programme under the general title 'Engaging Stakeholders'. 'Engaging Stakeholders Vol 2 – the case studies' – contains a series of 12 case study discussions with stakeholder groups.

Good Corporate Stakeholder Consultation Experiments

- BP
- Glaxo Wellcome
- IBM

Obtaining Feedback

It is good practice to obtain feedback from readers of the report so as to tailor it ever more closely to their needs. Feedback can be obtained through the use of feedback forms, e-mail channels (both with and without web-sites), focus groups, etc.

Identifying Key Sector Specific Reporting Issues

Every industry sector has a set of 'key environmental issues' facing it. One indicator of quality when reviewing public environmental reporting is how well a company addresses those issues.

Retail banks

1. What steps have you taken to minimise the direct environmental impacts of the bank's activities? (Energy conservation, waste paper recycling etc.)
2. Lending policy: (a) Has the bank signed the UN Statement on banking and the Environment? (b) Do you have procedures to avoid lending to business causing significant environmental damage?

Distributors

1. What measures do you take to reduce energy use and in particular energy used for transport?
2. Do you ask your suppliers for details of their environmental policies for production of their products prior to marketing and distribution?

Engineering

1. Are environmental factors taken into account early in planning new products to reduce environmental impacts throughout their lifetimes (production, use, re-use and disposal)?
2. Have you set targets for waste minimisation, particularly for hazardous waste?

Health care

1. What procedures do you have to dispose of clinical and / or other hazardous wastes?
2. Do you operate any targets, schemes or procedures to ensure that energy usage is reduced?
3. (Nursing homes only). What initiatives do you take to enhance the quality of life for residents?

Household goods

1. What is your policy on selection of raw materials and environmental performance of suppliers?
2. In what ways is your packaging designed to facilitate recycling, re-use or recovery?

Leisure and hotels

1. How do you ensure that new developments / investments have no adverse effect on the (local) environment? Are there different procedures for developing countries?
2. Do you have targets / schemes to reduce energy, water use and minimise waste to landfill at your operational and office sites?

Retailers, general

1. Have you any initiatives to reduce energy use in (a) retail premises and (b) your distribution fleet?
2. What measures have you taken to reduce packaging waste and set up facilities for recycling in anticipation of the incoming packaging legislation?
3. When sourcing from developing countries (or from companies with facilities in such areas) what specifications do you have for overseas workers conditions? How do you ensure these are adhered to?

Pharmaceuticals

1. What targets have you set to reduce emissions of hazardous waste? What procedures govern waste disposal?
2. Do you produce a regular report on your emissions to air, water and wastes or do you intend to in the future?
3. What is your policy on animal testing? What steps have you taken to reduce animal testing?

Optional Syndicate Group Exercise 3

Identification of key industry/sector specific reporting issues

In syndicate groups consider the key environmental issues facing the following industry sectors that you believe should be highlighted in the public environmental reports issued by companies within that particular sector:

- Agriculture and fisheries
- Airlines, transportation, shipping
- Building and construction
- Chemicals
- Forestry, paper and pulp
- Oil, gas and other extractive industries (e.g. mining).
- Textiles

Verification Related Issues

The objective of independent third party verification is to add credibility to the published report. The 1999 KPMG International Survey showed that only 18% of environmental reports were verified by an independent third party (up from 15% in 1996). As the research findings shown below demonstrate, the objective of adding credibility is not always being achieved.

The IRRC Study	
'Environmental Reporting and Third Party Statements'	None of the stakeholder groups participating in the study believed that recent third party statements added much, if any, incremental value to corporate environmental reports published in 1994.
Investor Responsibility Research Centre 1996	The conclusion of the participants was that without agreed standards of reporting, the third party statements are 'meaningless'.
Conclusions	In order to add substantively to the credibility of environmental reports at least three new attestation elements must be incorporated into 3rd party attestation statements: (i) a statement that all major risks are included in the report (ii) recommendations on performance improvements (iii) a prioritisation of outstanding environmental challenges facing the company.
The FEE Study	
'FEE Research Paper on Expert Statements in Environmental Reports' Federation des Experts Comptables Europeen 1996	In the absence of generally accepted guidelines on how to perform an audit of an environmental report or how to report, the (expert) statement should include a description of the scope of the audit/audit objectives. A description of the nature of the audit procedures performed should be given to support the level of assurance that can be given.
Conclusions on expert statements generally	The conclusions in the expert statement

	must be carefully stated, particularly if the scope of the engagement is limited. Experts should reconsider their use of 'true and fair' and similar phrases which may result in unreasonable expectations.
The SustainAbility / UNEP Study	
'Engaging Stakeholders – 2 The Case Studies' SustainAbility / UNEP 1996	Increasing requirement for environmental reports to be independently verified – particularly in countries where environmental reporting legislation is being introduced or where stock exchange listing requirements are starting to embrace environmental issues and disclosures.

Appropriate verification standards and practices are slowly beginning to emerge. The International Audit Assurance Standards Board (IAASB) (formerly International Auditing Practices Committee IAPC) and the Environmental Task Force of the European Federation of Accountants (FEE) are both working on this topic.

FEE issued a series of discussion papers between Autumn 1999 and 2000 on "Providing Assurance on Environmental Reports" and more recently have extended their interests to "Providing Assurance on Sustainability Reports (see appendix 2 for a list of their publications). As noted in section 2 the IAASB are currently reviewing a potential standard for the verification of environmental reports (anticipated 2003).

The example shown below (BP HSE Facts 1997 report) is typical of verification statements issued by Big 5 accounting firms.

Ernst & Young Report

To: The Board of Directors of the British Petroleum Company plc.

We have carried out a review of *HSE Facts 1997,* the preparation of which is the sole responsibility of the directors. Our objective was to form an independent view on the information reported, and the processes by which the data was collected and collated.

Basis of our Review

In accordance with your instructions, our review comprised the following steps:

1. A review of the processes by which HSE data was collected and collated through discussions with management and review of the HSE data systems at: head office; the exploration regional office at Stavanger, Norway; Grangemouth oil refinery in Scotland; and Lima chemicals manufacturing site in Ohio, USA.
2. Discussions with a selection of HSE executives throughout BP and a review of documents including Board minutes and Ethics and Environment Assurance Committee minutes for 1997, to ensure that all significant HSE incidents reported at group level in 1997 have been considered for inclusion in HSE Facts.
3. A review of documents, both internal and publicly available, to ensure that statements made in HSE Facts 1997 are consistent with underlying information.

Conclusions

Over the six years we have been carrying out this review, we have seen increasing evidence of BP's commitment to HSE at all levels of the company, as well as greater attention to consistency of data measurement and estimation.

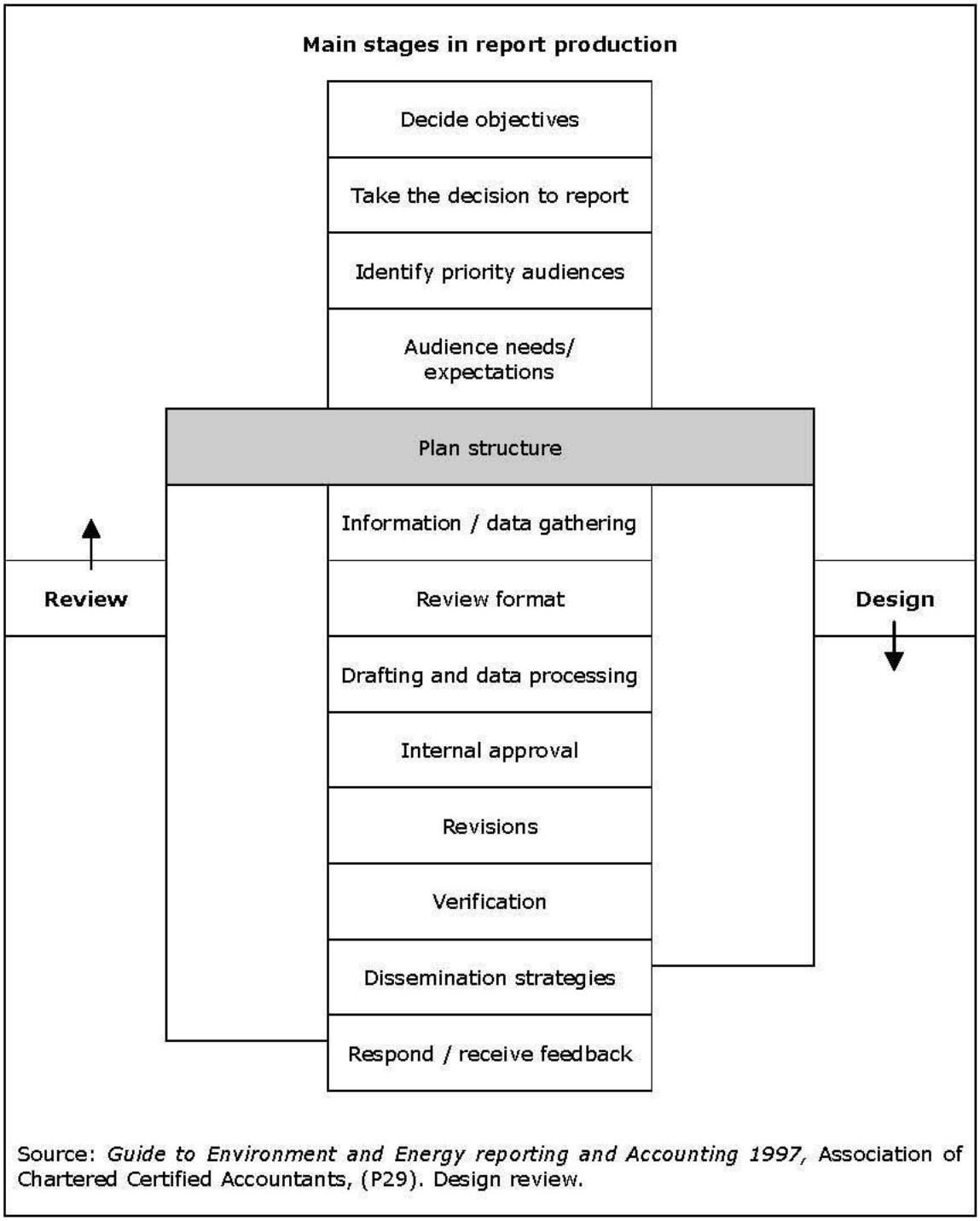
On the basis of the review described above, we have formed the following views of HSE Facts 1997.

- The reported data has been properly collated at head office from the data provided by BP's operations.
- The BP sites visited this year and last year each employed a systematic approach to HSE data collection. We have not yet reviewed data collection processes applied at Mobil sites. However, with the publication of group reporting guidelines in 1997, BP is aiming to harmonise data collection across all sites. We have recommended to management areas for improvement in data collection and collation procedures.
- We are not aware of any significant HSE incidents which were not considered for inclusion in HSE Facts.
- The information appearing in HSE Facts is consistent with supporting evidence obtained during our review.

Ernst & Young
London
8 April 1998

Note: This statement was prepared taking into account the guidelines of the European Federation of Accountants (FEE) Research Paper on Expert Statements in Environmental Reports.

Conclusion 1: Getting Started



Source: *Guide to Environment and Energy reporting and Accounting 1997,* Association of Chartered Certified Accountants, (P29). Design review.

Conclusion 2: Other Issues

Mandatory vs. *Voluntary Reporting – The Arguments*

- De-regulation or better regulation?
- Cost / benefit assessments
- Welcome experimentation in a new and expanding area *vs.* urgentcneed for comparability
- Denmark and the Netherlands: mandatory environmental reporting regimes
- USA, Norway, Thailand: mandatory disclosures re financial regulators
- UK: voluntary at present but threat of a 'big stick' for all companies over 250 employees.

Sustainable Development and Environmental Reporting

Increasing recognition of the 'triple bottom line' – incorporating:

- Economic performance
- Environmental performance
- Social / ethical performance.

Tomorrow's Company must be 'inclusive' – i.e. 'triple bottom line' focussed as well as being innovative and adaptable. An increasing number of large 'blue-chip' companies going BEYOND the environmental – Shell, BP, Body Shop, Scottish Power, GrandMet, (now Diageo) EB Eddy, Monsanto, Novo Nordisk, BT

Environmental Reporting and the Financial Community

Issues:

- Is it just liability that matters?
- Relevance of purely environmental data?
- How is it used (if at all)?
- Should more eco-financial indicators be developed? If so which?
- Is increased annual report disclosure required? If so what needs to be disclosed?
- Can good environmental performance be linked to good financial performance.