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TOWARDS A GENERALLY ACCEPTED FRAMEWORK FOR ENVIRONMENTAL REPORTING

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1. Introduction

1.1 Corporate environmental reporting as a recognised subset of corporate reporting is now nearly a decade old. Over that period considerable progress has been made in identifying the core environmental issues to be reported on and the appropriate performance indicators through which performance can be both computed and communicated. At the same time, however, little progress has been made in establishing the conceptual foundations necessary to provide the secure foundation that any form of public reporting requires.

1.2 This paper reflects the view of the Environmental Working Party of the European Federation of Accountants (FEE) that more attention needs to be paid to the various qualitative reporting characteristics which should under-pin the emerging practice of corporate environmental reporting, if that practice is eventually to achieve anything approaching the same degree of public acceptance and credibility as financial reporting. The work of the group has taken into account recent developments in environmental reporting practice, as well as the different guidelines on environmental reporting that are currently available. On the basis that all forms of public reporting should share certain common properties (timeliness, relevance, etc.) the study also draws upon the body of knowledge, guidelines and standards developed for financial reporting purposes.

What is environmental reporting?

1.3 For the purposes of this paper, "environmental reporting" covers the preparation and provision of information, by management, for the use of multiple stakeholder groups (internal and external), on the environmental status and performance of their company or organisation. This information is most often provided in a separate environmental report, but it may (either as well, or alternatively) be included within other forms of reporting (such as financial or sustainability reporting). Generally speaking, the location of the information should not significantly impact on its credibility. However, financial information relating to the environment, if reported outside the audited financial statements, should be consistent with any related disclosures made *through* the audited accounts.

1.4 The emergence of corporate environmental reporting in the 1990's has been an important development, not only in terms of environmental management, but also more generally for overall corporate governance. At the start of the 1990's, only a very few companies produced environmental reports - these came mainly from the 'heavier polluting' industries. A number of recent surveys, at national and international level, have identified growth not just in the number of companies reporting, but also in the sectoral coverage of such reporting. Based on the evidence of such surveys, it is the larger (usually multinational) companies that appear to have accepted environmental reporting most rapidly.

1.5 The growth in environmental reporting, however, has not been simply a matter of the development of a single type of reporting. A reference to an 'environmental report' may mean different things to different people. Some tend to think of separate (stand alone) environmental reports which have been modelled on the financial statements (annual reports) of the enterprise - these are often referred to as corporate environmental reports (CERs). For others, the focus will be on the environmental content (if any) of the annual report itself.

1.6 In some parts of Europe, the term 'environmental report' may be interpreted as an environmental impact statement or eco-balance report. To a growing number of people (again, particularly in some countries within Europe) an "environmental report" will mean the Environmental Statement required for registration to the EU's EMAS (the EC Eco Management and Audit) Scheme. In the United States, and other places (in Denmark and the Netherlands particularly), the term may mean the reporting of regulatory information for legal compliance purposes.

Scope: from environmental reporting to sustainability reporting

1.7 This paper focuses on providing a conceptual underpinning for public environmental reporting. At the same time, FEE is aware that there is increasing pressure on companies to demonstrate how they are approaching and communicating the major strategic issue of sustainable development. Some companies have sought to extend still further their public reporting frameworks by the inclusion of such issues as:

- social / community impacts,
- business ethics,
- human rights,
- animal testing,
- sustainability.

1.8 FEE believes that many of the qualitative aspects of this position paper will be seen to have general applicability to these other (newer) forms of reporting. Indeed, much of the framework proposed by FEE in the January 1999 version of this document has been absorbed into the "General Reporting Principles" section of the Sustainability Reporting Guidelines first issued in March 1999 by the Global Reporting Initiative. Nevertheless, FEE prefers at present to restrict the scope of this Position paper to issues commonly considered environmental in nature.

The role of this paper

1.9 We have thus seen many different types of report emerge, reports which by their nature and purpose are all 'environmental', and which all have as a common feature the provision of environmental stewardship, compliance or performance data for stakeholder groups. However, with the exception of EMAS based public environmental statements, these reports seem to have emerged through a series of random (sometimes randomly national) initiatives, rather than through any form of co-ordinated or coherent developmental process. It is our belief that corporate environmental reporting has now reached the stage where enterprises and users alike would benefit from greater structure and definition.

1.10 Surveys of environmental reporting practice tend to show that both the quantity and the overall quality of reporting are increasing. It is inevitable, however, with such a new reporting medium, that we should continue to ask how further improvements can be made. In areas such as scope of reporting, consistency of methodological approaches (i.e. recognition and measurement policies) and timeliness of reporting, we believe that improvements in quality are required. Similarly we see the need for better focussed stake-holder related reporting.

1.11 Preparers of environmental reports in particular would like confirmation that their reports are effective, and users of such reports (especially the increasingly environmentally aware financial community) are demanding more consistency in the way(s) in which environmental issues and performance are measured and reported. A formal set of recognised reporting principles and a standardised reporting framework (not dissimilar in principle to those adopted in the EC 4th Directive on Company law) should help overcome any perception that environmental reports lack credibility.

1.12 This paper has taken into account a range of recent developments in public environmental reporting, some of these are identified in Appendix 1. FEE itself is not a standard setter - so its discussion papers can only ever seek to be influential in developing best practice. FEE believes that because of the paper's clear focus on conceptual underpinnings, as opposed to detailed environmental content (which is covered here only in Section 7), this paper will be useful to preparers, assurance providers and users of environmental reports. The paper should be helpful also as a foundation for the development of future reporting standards.

Relationship to other reporting initiatives

1.13 A number of most well known attempts to influence the development of environmental reporting are identified in Appendix 1. FEE has, at this time, chosen not to become involved in the ongoing debate concerning the form and detailed content of environmental reporting, but rather to bring to bear its public reporting expertise to complement and underpin those reporting frameworks currently seeking to achieve the status of best practice. It is FEE's view that most, if not all, of these reporting frameworks would benefit from a detailed consideration of the issues raised in this paper.

Future revisions

1.14 As will be apparent from a close reading of this paper, not all the under-pinning conceptual issues have yet been fully resolved. Issues such as accounting for outsourcing and indirect environmental impacts present complex and as yet unresolved reporting problems. FEE expects that, as experience in environmental reporting grows, annual or biennial revisions to this paper will be necessary so as to reflect better this growth of experience and opinion. By the same token, as corporate experience with broader forms of accountability reporting grows, FEE may wish to consider expanding the scope of this paper to cover other forms of accountability reporting (such as sustainability reporting).

2. The aim of this paper

2.1 The primary aim of this paper is to encourage discussion between accountancy professionals, providers of environmental information and stakeholder groups (all of whom we assume to have better than general awareness of environmental reporting and related guidelines) regarding the introduction of a framework for qualitative characteristics in environmental reporting. Although it is not the objective of this paper to be *prescriptive* regarding the content or format of the environmental report, we identify in Section 7 a number of potential disclosure items and categories. As noted in the introduction, FEE also believes that its approach to providing a conceptual under-pinning for environmental reporting will be applicable to other developments in corporate reporting.

2.2 Experience with financial reporting, over more than 100 years, has shown that qualitative characteristics, such as relevance, understandability, usefulness and comparability, are just as important as the basic (performance orientated) quantitative content in establishing the credibility of reported data. The general issue addressed by this paper is the process via which similar qualitative principles and frameworks, as applied successfully to financial reporting, can be effectively applied to environmental reporting.

2.3 The focus of this paper is primarily on the <u>separate</u> external reporting of environmental issues and performance by enterprises, whether at corporate or site level. The inclusion of environmental information in financial reports and in internal management reporting is addressed, although we think it reasonable to assume that environmental information included within the <u>audited</u> section of the annual report is produced in accordance with relevant accounting standards. Financial statement auditors have a duty to ensure that data included elsewhere in the annual report package is not in conflict with the audited financial statements themselves.

2.4 A number of environmental reporting guidelines are available to preparers of environmental reports [see Appendix 1]. The focus of these guidelines is mostly on 'what' should be reported (for example, to include bad as well as good news; to report against objectives and targets; to include financial /economic data), rather than on those qualitative characteristics that would make the reports more useful (i.e. the "how" of reporting). In addition, we note that there are some national regulations (or standards) covering environmental reporting (for example in Denmark, the Netherlands and Sweden).

2.5 The role of all conceptual frameworks is to standardise and underpin external corporate reporting, thus giving users greater confidence in the reporting process itself and the credibility of the information reported. The FEE Environmental Working Party believes that the practice of corporate environmental reporting will benefit as much from the development of an under-pinning conceptual framework as has the practice of financial reporting.

2.6 A number of conceptual frameworks for financial reporting already exist and the Working Party has looked to these to provide a suitable starting point. In particular the International Accounting Standards Committee (IASC) framework for the Preparation and Presentation of Financial Statements (“Framework”) has been adopted as a model for this paper because, in the view of the Working Party, it is the one conceptual framework to which the phrase "generally accepted" can realistically be applied at the global level.

2.7 There are additional reasons for wishing to secure the conceptual foundations of this new discipline. Assurance providers would benefit from the existence of a conceptual framework underpinning environmental reporting. So too would any group seeking to issue formal reporting guidance. Also, environmental reporting, though itself only in its infancy, is already beginning to mutate into "sustainability reporting", "social reporting" and "triple bottom line reporting". We believe that, unless a generally applicable qualitative framework for non-financial reporting is developed, these extensions of corporate environmental reporting will fail to engender the support and credibility that their proponents apparently expect.

3. The objective of environmental reporting

3.1 In a world where the long-term environmental sustainability of the planet is increasingly in question, enterprises report on the environmental consequences of their activities, both beneficial and adverse, so that the results of management's stewardship of the environmental resources entrusted to it may be demonstrated. The FEE Environmental Working Party has defines an environmental report as being "the information provided by an entity in respect of the environmental issues associated with its operations" and the objective of external environmental reporting as being "the provision of information about the environmental impact and performance of an entity that is useful to stakeholders in assessing their relationship with the reporting entity".

3.2 In many cases users will wish to assess management's environmental stewardship or accountability so that opinions can be formed about environmental status, policies and performance in general terms. The consequences of this assessment will usually be one of a number of factors in influencing a user's opinion in regard to more specific decisions (such as the purchase of corporate assets). In the case of governmental organisations, the focus will usually be on management's accountability for use and management of 'public' environmental resources.

3.3 In financial reporting there is a strong link between reporting recommendations and commercial or economic decisions, such as the purchase/sale of shares, lending or corporate acquisitions and mergers. In most cases we think that environmental reporting will not be directed towards purely economic decision-making, although we recognise that 'general purpose' environmental reports may often provide the only (partially reliable) source of published information of an environmental nature.

3.4 At present we believe that environmental reporting is used more to give a <u>general understanding</u> of environmental issues, and related risk, and as an indication of performance levels. It is reasonable, we believe, to expect that, as environmental reporting becomes more focused, and as practice with regard to reporting environmental impacts and performance becomes more developed (particularly on a sectoral basis), financial sector users will find that such reporting becomes increasingly more important. At whatever level, however, recognised qualitative characteristics have an important role to play in establishing the credibility of the reported data.

4. Users and their information needs

4.1 There are various conceptual models that can be applied when deciding on the content and presentation of any kind of corporate reporting.

- The *"Accountability Model"* assumes that stakeholders are not always adequately qualified to determine their own needs and/or that their needs are (or may appear to be) difficult to define. In this case financial and/or environmental reporting recommendations are based largely on a normative interpretation of 'what users *should* know about'.

- The *"Users Needs Model / Decision Usefulness Model"* makes the opposite assumption: i.e. that through a process of discussion and involvement, the information needs of a range of potential users can be identified adequately in advance of the reporting process, and can also be defined in terms of appropriate accounting disclosures (based upon relevant recognition and measurement techniques).

4.2 In practice, FEE believes that corporate financial reporting is usually based on a mixture of both approaches, combining some normative assumptions as to *what* the enterprise *should* be accountable for (normally informed by the law or by custom), with a practical understanding (based upon empirical research) of what information users / stakeholders *would actually wish* to receive.

4.3 In preparing this paper, we have observed that, although both approaches can be identified in the past and current practice of environmental reporting, the current trend amongst more progressive companies is wherever possible to seek to identify and involve actual or prospective stakeholders in the identification of key reporting issues (and associated reporting metrics). In this respect, environmental reporting contrasts with financial reporting where report content is not normally determined through stakeholder engagement processes. FEE recognises the central role that stakeholder dialogue plays in determining what information should be reported and in what form, and believes that all public environmental reporting should make the stakeholder engagement process and dialogue process(es) transparent.

Stakeholders for environmental reporting

4.4 Conventional financial reporting has been premised on the notion that, although a number of identifiable user groups exist, the primary consumers of financial statements are shareholders, prospective investors and financial intermediaries. The emergence of environmental reporting and other forms of corporate social responsibility reporting reflect a recognition that the span of corporate accountability is changing to reflect more obviously a range of new stakeholder groups including employees, local communities, consumers, suppliers and customers. Other influential groups with an interest in environmental reporting include activist and lobby groups. This broadening in the span of corporate accountability can be argued to flow from various sources, including:

(i) the increasing criticality of environmental issues facing business and society;

(ii) the increasing vulnerability of corporate reputations in the face of better informed stakeholder groups; and

(iii) improved IT technologies which inform and enable users to act on the information much more quickly than was previously the case.

4.5 The following sections explore the information needs of conventional and emerging stakeholder groups. Although many environmental reporters have indicated that employees are their main stakeholder group for reporting purposes, the analysis which follows does not attempt to prioritise. FEE also acknowledges that, despite being recognised as having attained "stakeholder" status, some groups - particularly community groups and overseas based non-governmental organisations (NGOs) - may not yet have found satisfactory ways of engaging reporting companies in effective dialogue (and vice versa). FEE believes that the underlying assumptions and characteristics set out in Sections 5 and 6 of this paper, when applied to the reported data, should serve to improve both the clarity and the credibility of that data. FEE also believes that others - such as the lobby groups referred to above - may benefit indirectly from improved environmental reporting because of the associated implied improvements in corporate governance.

(a) Investors

4.6 Environmental performance is increasingly seen to have an influence (either directly or indirectly) over financial performance and financial risk assessment. Mainstream (or conventional) investors in risk capital should ideally obtain most of the information they need from audited financial statements (e.g. on environmental provisions, liabilities, contingencies, expenditures, risk exposures and other financial implications). We suspect that, at present, they tend to make only general use of environmental reports.

4.7 For some other financial stakeholders, for example the emerging groups of environmental and social/ethical investments funds, information needs go well beyond the narrowly financial, and include could information to help them form a judgement on the environmental, ethical and sustainability issues facing the reporting company. Non-financial environmental information may thus have a direct influence over their investment decision-making.

4.8 Non-parallel disclosure requirements between the USA and the rest of the world may also create an "information gap" for financial stakeholders - the disclosure requirements of the US Securities and Exchange Commission (SEC) are frequently argued to be stronger than their counterparts elsewhere (for example in requiring disclosure of environmental provisions for contaminated land). FEE could usefully research the reality of such an "information gap" at some time in the future.

(b) Employees

4.9 Generally speaking, anything that can have an *economic* impact on their employers should be of interest to employees. However, with growing general/public environmental awareness, for example of the impact of business activities on non-renewable elements of the environment, employees may increasingly request information purely to help them understand the enterprise's environmental status. They may take an interest in whether their employer is seen by local community groups (and by wider stakeholder groups) as a responsible company. They will also wish to see their employer's business as a going concern, recognising that environmental performance may have some influence on this.

4.10 From a company perspective, the growing social and environmental awareness of the workforce, together with increasingly sophisticated regulations relating to whistle-blowing, will mean that employee concerns need to be factored into the information disclosure process at an early stage. Out-sourcing may result in the transfer of traditional manufacturing activities to non-traditional legal domains, but it does not follow that companies engaging in out-sourcing activities can safely assume that environmental or product related information disclosures may be lessened as a result. Additional disclosures may be necessary in order to demonstrate how the reporting entity maintains effective environmental control over the out-sourced activity.

(c) Lenders

4.11 The information needs of lenders may be likened to those of shareholders. Certainly the banking industry has been actively involved in the development of environmental reporting. Environmental reports should be of particular interest to lenders if there are direct financial implications or risks associated with environmental issues. Lenders will need to understand the quality of an entity's assets, its environmental management systems, its compliance record, its technological status and its market-place positioning, as all of these may be influenced by environmental factors

4.12 The information needs and lobbying activities of the lending / investing community will of course be heavily influenced its ability to enforce non - traditional / privately contracted means of information disclosure. Information gained as a result of due-diligence procedures undertaken in the course of take-over bids may be of more significance to these groups than disclosures made in an environmental report.

(d) Suppliers and other Trade Creditors

4.13 From a suppliers perspective it may be that disclosures such as creditor payment policies and going concern assurance are of primary interest. Environmental reports, however, could help them to understand the environmental issues of their major customers. Such an understanding may present them with a market opportunity to protect or to expand their business through product support and because of their own (superior) environmental performance.

4.14 Trade suppliers are also the focus of much attention from the preparers perspective - many environmental reporters seek to demonstrate their involvement in supply chain issues via the environmental report. The growing awareness of the damage that can be done to corporate reputations as a result of poor environmental or social practices have also led to an increased focus on communicating down the supply chain the policies of the buying company.

(e) Customers

4.15 Where environmental liabilities and regulatory compliance issues are relevant, customers will have an interest in information concerning the financial viability of a supplier. More commonly, however, customers are recognising the links with their suppliers in terms of the environmental life-cycle. Suppliers, through their use of certain substances and materials, may directly affect their customers' environmental performance. Some companies are already demanding that "first-line" suppliers are accredited to a recognised Environmental Management System (e.g. EMAS or ISO 14001).

4.16 An increasing number of companies are taking a positive interest in information which identifies and illustrates the quality of environmental practices in the supply chain. Product related disclosures which demonstrate life-cycle awareness across the full range of products produced and marketed are of increasing importance. Assertions regarding the down-stream effect of products entering the supply chain maybe the most complex and difficult to establish credibly.

(f) Governments and their Agencies

4.17 Government departments, with responsibility for environmental legislation, and the relevant regulatory/enforcement bodies, have an interest in information that gives an indication or assurance of good environmental management. This may help them in making regulatory decisions, which in turn may affect the level and cost of monitoring and inspection. For example, many governments carry out surveys to collect data on environmental expenditures and regulatory (consent) compliance.

4.18 Governments are also responsible for making the public policy decisions which reflect society's response to calls for more sustainable methods of managing our economies. Some governments have also begun to provide explicit guidance on environmental reporting. Mandatory reporting regimes are now in place in Denmark, the Netherlands and Sweden. In the UK, the government has issued guidance on measuring and reporting CO2 emissions and waste. Environmental reporting should reflect the response and pace of progress of entities operating at the micro level.

(g) The Public/Neighbours

4.19 Enterprises affect members of the public in a variety of ways - as members of the neighbouring local community, as consumers, as employees, as shareholders. Some individuals will occupy more than one stakeholder role. For example:

- an employee may also live in close proximity to the site where he or she works;
- an employee may also be a shareholder via a staff share ownership scheme;
- an employee may also be a consumer of the employing organisations producers or services;
- an employee will be a part of a larger social group most of whose members will only have indirect contact with the entity in question.

4.20 Neighbours will have some very specific concerns: noise, dangerous / dirty emissions, smells, traffic congestion, contribution to local economy, longer-term stability, site restoration, etc. - probably many more. Environmental reporters need to recognise local community interests in deciding on both the reporting approach to be adopted and the performance indicators to be selected.

4.21 Increasingly, members of the public wish to see that enterprises are behaving as good neighbours in the local community, not just from a compliance perspective, but also in respect of longer - term sustainability and trust. Credible, understandable environmental information will help them in their evaluation of this. Environmental performance may also affect an enterprise's longer-term viability, and in this respect members of the public will have an interest in information that shows that the enterprise is making a contribution to the local economy.

4.22 When reporting on environmental performance, organisations should bear in mind the need to create trust and the need to build an open dialogue with the general public. This may mean making environmental performance data both more accessible and more understandable than may be the case when reports are delivered to specialised, technical audiences.

Conclusion

4.23 Environmental reporting is typically directed at a variety of stakeholder groups, each with potentially different information needs. A considerable body of research effort is currently being directed at the stakeholder issue to identify more precisely the information requirements of different groups. The analysis above does not pretend to be exhaustive, but even such a brief survey of potential information needs lays bare some common threads.

5. The underlying assumptions of environmental reporting

5.1 The building blocks of the IASC conceptual framework include "underlying assumptions" and "qualitative characteristics". Broadly speaking the difference between an underlying assumption and a qualitative characteristic is that underlying assumptions have a more direct and significant effect on the absolute numbers reported. To be useful to these various groups environmental data must be:

1. relevant,
2. reliable,
3. understandable,
4. neutral,
5. complete,
6. prudent,
7. comparable,
8. timely.

These various qualitative characteristics should underpin all public environmental reporting and are discussed in more detail in Section 6 below. The presence of such a conceptual framework is in itself, however, insufficient to compensate for lack of relevant content or contextual information.

5.2 Reporting on the nature of environmental impacts means that, in order to make the processes of measurement and reporting feasible and credible, certain underlying assumptions may need to be made about either the reporting enterprise or the data being reported on. This is partly due to the fact that environmental impacts do not always naturally occur in the same time period as the activity which has caused them. Similarly, impacts do not always occur within the physical boundaries of the reporting enterprise. More importantly perhaps, there is a need to present data in as uniform manner as possible if it is to be of any significant use to external stakeholders.

5.3 This Section (Section 5) considers the following "underlying assumptions" and Section 6 the following "qualitative characteristics:

Underlying assumptions (Section 5)	**Qualitative characteristics (Section 6)**
1. The entity assumption 2. The accruals basis of accounting 3. The "going concern" assumption 4 The concept of materiality	1. Relevance 2. Reliability 3. Clarity 4. Neutrality 5. Completeness 6. Prudence 7. Comparability 8. Timeliness 9. Credibility

The Entity Assumption

5.4 In any form of corporate reporting it is essential that the boundaries of the reporting entity are clearly defined by management and reported clearly and explicitly in any public statement. Financial accounting and reporting standards have been developed to deal with variations in the form through which corporate control is exercised (e.g. via joint ventures, associates or subsidiary operations).

5.5 In financial reporting, identification of the legal status and boundaries of the reporting unit are vital in determining accountability and in avoiding accusations of misleading financial reporting (e.g. by ignoring "off-balance sheet liabilities"). In the case of environmental reporting, it is similarly important to identify clearly the boundaries of the reporting entity and not to permit or encourage the originator of, or contributor to, environmental impacts to shelter within formal legal boundaries, as may be the case in the purchase of sensitive materials such as rainforest hardwood.

5.6 Further, where organisations form part of a supply chain, comprehensive accountability may require the total life-cycle impact of the product, from resource extraction to disposal, to be covered in some way. Whilst it would be controversial (and possibly misleading) to require consolidated environmental reports that included separate legal entities along the entire supply chain, it would nevertheless be helpful to some users if environmental reports included wider reference to the more significant environmental impacts (such as from off-site waste disposal or product use and disposal) up - or down - stream from the reporting entity. The traditional entity concept therefore requires modification for environmental reporting purposes. To avoid confusion, however, information relating to the supply chain, as opposed to the reporting entity, should be clearly identified as such.

5.7 A minimum requirement for environmental reporting is therefore that the report itself
(or any accompanying verification statement) clearly identifies the extent to which the entity (as defined for financial reporting purposes) is fully disclosing the significance and impact of its environmental activities. Environmental reporting standards - when developed - should contain provisions which stipulate disclosure relating to

- the legal (or administrative) scope of the reporting entity,
- the operations reported upon,
- the completeness of disclosure vis a vis significant environmental aspects.

5.8 Related matters concern the impact of environmental consequences of:

(a) acquisitions or disposals of significant elements of the operation (and the need to adjust prior year comparatives accordingly);

(b) outsourcing and its impact on (i) historic trends and (ii) external communities; and

(c) disclosure of the accounting policy adopted as regards entity boundaries.

The Accruals Basis of Accounting

5.9 The practical application of the accruals basis of accounting requires that the results or impacts of activities should be disclosed in the period in which those activities occur. In financial reporting, for example, use of the accruals basis is driven by recognition of the “critical event” (usually defined as the point of sale). There may, however, be variations on this central theme, including recognition of revenue and profit on a percentage of completion basis in the case of long-term contracts.

5.10 For environmental reporting, the need for prompt reporting probably means that full recognition of ultimate impacts will normally require an accruals approach based on the point of production, if not earlier. Examples may include remote impacts from air emissions (acid rain), land pollution (potential groundwater impacts), and raw material extraction (ecological disturbance). The inclusion of a "year end physical inventory" section in some recent "eco-balance" statements illustrates the importance of adopting the accruals basis in environmental accounting and reporting.

5.11 Environmental reporting standards - when developed - will need to address the accruals (or matching concept) to ensure that information about production activities, emissions and waste are appropriately related to the activity concerned.

5.12 There is still some debate relating to the timing (and measurement) of provisions for environmental liabilities and remediation costs, in particular costs relating to the de-commissioning of long-lived assets e.g. oil rigs or nuclear plants. International Accounting Standard IAS 37 indicates that for financial reporting purposes these liabilities will be provided for in full at current values at the time the environmental damage is caused.

5.13 Despite the obvious potential applications of the accruals (or "matching") concept, however, it is clear that from an environmental reporting perspective the link between *event* and *environmental impact* may not always be obvious. In some instances an event (e.g. an accidental emission) may have no obvious environment consequence until some years have elapsed. In other cases an environmental impact or consequence may be identified (e.g. contaminated land) for which no causal event can ever be identified.

The Going Concern Assumption

5.14 An enterprise which is categorised as being "a going concern" is generally expected to continue operations for the foreseeable future (note that "foreseeable future" in financial terms is rarely longer than 18 months after the balance sheet date). This principle is adopted in financial reporting with the result that assets are conventionally carried at current or historical cost rather than at liquidation values.

5.15 Liabilities for environmental costs (such as land remediation) will need to be recognised in the financial statements under the going concern concept, as long as there is either a legal or constructive obligation present.

5.16 Since longer-term environmental impacts and prospective environmental legislation can be very important for the financial statements it seems appropriate that environmental reporting standards - when developed - should include a requirement that, when potential environmental liabilities are significant, the environmental report should provide a clear indication of whether the enterprise is capable of funding necessary remediation/clean-up procedures.

5.17 On a related point it can also be argued that whilst environmental liability provisions do serve to inhibit the ability of a company to make distributions to its shareholders, this does not at the same time guarantee the availability of cash resources to fund a necessary remediation process. In the event of a corporate failure this may throw the cost burden onto the public purse. At a policy level there may be strong arguments for requiring companies operating in environmentally sensitive industries to ensure adequate provision of financial resources. In part this may be handled through the conventional insurance framework - but for known long-term liabilities some form of "environmental bonding" could serve to insure society should the organisation in question fail as a financial going concern.

The Materiality Principle

5.18 Materiality is a principle which is related to relevance and which is sometimes referred to as a "threshold characteristic". The underlying assumption here is that information is only relevant to a user if it is material in financial terms - which means does its presence or absence influence the user's decision? For financial reporting purposes materiality is usually assessed by preparers and auditors in strictly financial terms, as a (commonly accepted) percentage of some "headline" accounting number - such as turnover, operating income, net assets employed etc. The nature and circumstance of an item are also relevant factors.

5.19 We believe, however, that the application of the materiality concept in environmental reporting situations is more complex, and may be more dependent on the nature and circumstances of an item or event (as well as its scale). In particular, the carrying capacity of the receiving environment (such as availability of landfill capacity or background air pollution levels) will be just one factor in the materiality of the release / discharge of one tonne or one kilogram of waste, air emissions or effluent.

5.20 Furthermore, what will be considered as material by one user group, may be different from the view of another group. What is important for the producer of the environmental report is that the results of reasonable study and analysis of user needs, and related decisions or uses of information, will be important in determining relevance and materiality.

5.21 We suggest that environmental reporting standards - when developed - should address the issue of materiality from an empirically researched and scientifically supportable environmental impact / user driven perspective.

Conclusion

5.22 Adoption by the reporting entity of the fundamental assumptions discussed above does not need to be stated explicitly. FEE believes that reporting entities should the key policies adopted in preparing the environmental report.

6. The importance of qualitative characteristics in environmental reporting

6.1 In financial reporting it is considered that qualitative characteristics are the attributes that make published information useful. FEE believes that appropriately modified interpretations of the same characteristics will enhance the usefulness and consequently the relevance of environmental reports.

Relevance

6.2 To be useful, information must be relevant to the decision-making needs of user-groups. In environmental reporting, the predictive role of information may be less important than is the case in financial reporting. The most relevant information is likely to be useful for attention-directing, knowledge-building and opinion-forming rather than clear decision-making. In environmental reporting the issue of what is or is not relevant may best be gauged as a result of surveys of stakeholder needs (such as those conducted by UNEP/SustainAbility, or at the corporate level by many companies.

Reliability

6.3 Information has the quality of reliability when it is free from bias and material error. Users should be able to depend upon the fact that the information is faithfully represented. A number of different inter-linked attributes contribute to reliability:

6.4 *Valid description*: the way in which environmental aspects are described will be Important for the users' understanding. This is of particular importance in environmental reporting where it is often the case that reports are technical in nature. The common characteristics that exist between generic types of air emissions, waste water discharges and wastes should allow some guidance to be given on the types of description that might be considered to be valid. How 'waste' is described, or air emissions are referenced could vary considerably between reports, and lead to confusion.

6.5 *Substance*: presenting the information in accordance with their environmental substance and context rather than a strict legal form is important. In environmental reporting, the data may often be accurate but without context or benchmark it may not be useful. For example, a furniture manufacturer that produces hardwood furniture may present accurately the quantity of wood procured, but it will require the 'substance' of the source of that timber to be within a valid context. Similarly, should we talk only of sulphur dioxide emissions? Or should we also discuss the contribution of SOx to acid rain, or the capital investment requirements of flue-gas desulphurisation?

6.6 *Neutrality (freedom from bias)*: environmental reports are not neutral if by selection/omission or presentation of information they influence a decision or judgement - information needs to be presented in an even-handed way. The absence of generally accepted environmental reporting standards currently leaves any report open to charges of deliberate selection.

6.7 Environmental reports that arouse suspicions that management has "cherry picked" only "good news" stories for inclusion will not establish the desired degree of trust with those stakeholder groups considered most influential. Bad news stories should be reported when appropriate and adverse trends and performance outcomes should be flagged and explained. The accidental or deliberate use of inappropriately constructed graphs or the omission of controversial issues, such as frequent pollution incidents, or historical land contamination, or the storage of highly toxic/hazardous materials may bias the judgements and opinions of the user groups

6.8 *Completeness*: All issues, which may be considered to be significant, should be reported. Consideration should be given to the reporting of indirect, as well as direct, environmental effects The absence of generally accepted environmental reporting standards means that reports are often criticised for being "incomplete". "Completeness" in this sense can be better understood through a process of stakeholder engagement and dialogue. For example, issues such as genetically modified foods, global warming and renewable energy may be uncomfortable issues to deal with in a reporting context but ignoring them may risk alienating influential stakeholders.

6.9 *Prudence*: Uncertainty is a major factor in environmental reporting, particularly concerning the likely or potential consequences of environmental incidents and uncontrolled releases. The exercise of a proper degree of prudence in environmental reporting should serve to ensure that:

1. adverse environmental impacts are not downplayed;

2. positive environmental progress is not misreported - for example by claiming that the entity is "sustainable" in some way or other;

3. the reporting entity demonstrates its prudent anticipation of increasingly stringent environmental laws.

6.10 The application of the prudence concept does not mean the reporting entities should omit the reporting of environmental benefits and improvements. It may, however, be imprudent to make claims of improvements, as yet unrealised or proven, as a result of investments. For example, a statement that capital expenditure has been made to reduce discharges to a local river in order to reduce pollution levels should not lead people to believe that the quality of the river has already been improved.

6.11 The qualitative characteristic of 'prudence' may be linked to the so-called 'precautionary principle'. Understandably from almost all stakeholder perspectives, pollution *prevention* is always a preferred alternative to post-contamination *remediation* or clean-up. From this prudential perspective has developed the so-called "precautionary principle" - a principle often cited by policy makers and green lobby groups as a defence against the introduction of new technologies and procedures. The operation of the "precautionary principle" is illustrated in a short extract adapted from *"Environmental Science for Environmental Management"* by T. O'Riordan:

- there should be thoughtful action in advance of scientific proof of cause;

- decision-makers should leave ecological space as "room for ignorance", or as a margin of error, because of lack of information or scientific evidence;

- there should be a reversal in the normal "burden of proof", from affected party to the corporate decision-maker.

6.12 FEE suggests that environmental reporting disclosures could usefully include a reference to the extent to which the precautionary principle is embedded in the environmental policies, programmes and decision-making processes of the reporting entity.

Clarity

6.13 Clarity is an essential quality of any form of reporting. In financial reporting, a reasonable knowledge in business and economic activities and accounting is assumed. In environmental reporting a broad understanding of the problems facing an industrial sector should be assumed, although such knowledge may not be sufficient to enable the user to readily understand the technical information being presented.

6.14 In environmental reporting it is not at this stage valid to identify any single group as the 'primary' user group. Also it is difficult to make general assumptions about the level of environmental education and experience of user groups. Consequently technical and scientific terms should be used carefully and fully explained within the report.

Comparability

6.15 Some users of environmental information will want to monitor and compare the results of environmental performance over time in order to identify significant trends. Some will also wish to compare the results of different enterprises, particularly within industry sectors. Consistency in the recognition, measurement and presentation of environmental information is therefore essential. Consistency should initially be established internally, determined by the information needs of the enterprise's user groups. Caution is needed when seeking to benchmark between enterprises within the same sector, as even apparently minor differences in process, product or location can be significant in terms of environmental effect. As with financial reporting, it is important that corresponding information for preceding periods be reported on comparable and consistent basis.

6.16 There is a considerable amount of effort currently being expended on the development of appropriate benchmarks and environmental performance indicators (for example by the CERES GRI, by the World Business Council for Sustainable Development and by the UN ISAR group of experts). These initiatives range from the generic (e.g. the ISO 14031 environmental performance evaluation measures) to the specific (e.g. metrics appropriate to, for example, the water or telecoms industries). In the longer term the appropriateness of the metrics selected for publication will need to pass some "generally accepted" test.

Timeliness (frequency of reporting)

6.17 This is not addressed by the IASC Framework as the reporting periods for financial reporting are well defined, in many cases within company law. For environmental reporting, however, some guidance is required to set out how the frequency of reporting should be determined. One of the problems not yet directly addressed by preparers of environmental reports is that the ecological impact cycle of their operations may not easily lend itself to meaningful public reporting in that it may not be as predictably cyclical in nature as the financial cycle. An alternative formulation of this argument is to say that "continuous improvement" may not be easily identifiable if the reporting cycle is too short.

6.18 At this time FEE does not seek to prescribe how and when environmental reports should be published. We recommend, however, that all environmental reports contain a clear indication of the reporting period covered and the reasoning behind the choice of reporting period and/or frequency of reporting.

6.19 Some reporters have chosen to issue full reports each year. Others have indicated that the "pace of change" (or the ability to identify and clearly demonstrate continuous improvement) in systems, processes and results is relatively slow. Thus, in the view of this latter group, a full report may be necessary only every two or three years. Such reporters normally produce short-form interim reports dealing with key emissions / performance data. We suggest that, in the interests of standardisation and comparability, report issuers seek to synchronise their financial and environmental reporting period ends.

Credibility

6.20 In order to establish the necessary degree of trust with the various stakeholder groups, management needs to ensure that the reported information is both credible and reliable. Independent external verification is one method of enhancing the credibility of external reports. It follows that - as afar as is possible - the information contained within the report and which is the subject of an independent third party's opinion should be verifiable.

6.21 Financial statement standard setters have historically sought to keep the content of the audited accounts narrowly focused on financially quantified objectively determined data in the belief that such data is more verifiable than non-financial values-derived information. Environmental reporting techniques are now beginning to evolve towards a point where environmental management systems are providing increasing amounts of objective, verifiable physical data.

6.22 It remains the case, however, that environmental reports typically also contain some information that is neither objectively determined nor physically quantified (discussions on environmental impact and long term sustainability for example). In our view it is important that statements provided by independent verifiers clearly identify the scope of their examination, and the verification standards applied, in order that unsupported assertions or unverifiable data can be highlighted.

6.23 The FEE discussion paper "Providing Assurance on Environmental Reports" deals with environmental report verification practices. The discussion in that paper may serve as a useful complement to the conceptual positions adopted in this reporting framework paper.

Conclusion

6.24 As noted in the introduction to this Chapter, qualitative characteristics are the attributes that make published information useful. Whilst not being issues that require separate disclosure within the environmental report itself, they are matters that those responsible for both preparing and verifying such reports should keep central in their minds.

7. Contents of environmental reports

7.1 Although the focus of this paper is on developing a framework of fundamental assumptions and qualitative characteristics which underpin environmental reporting, there is a strong case for extending the framework to provide guidance on the elements to be included within environmental reports. Most of the existing guidelines (see appendix 1) address only content issues.

7.2 However, there remains an urgent need for further definition and increased clarity as regards content. Without such definition and clarity, environmental reports will not be comparable and, as a result, may be an irrelevance to many users. At the time of writing, some agreement appears to be emerging on both content and presentation.

7.3 The United Nations Environmental Programme (UNEP) has published a statement identifying fifty core features of environmental reports and there is considerable common ground between the UNEP guidance and other similar pieces of guidance. It is important to recognise, however, that the UNEP approach is primarily intended for application in the case of separate (stand alone) environmental reports. Where environmental reporting is integrated into the annual report and accounts package, a shorter set of key elements may be appropriate (although the need for a firm under-pinning framework of assumptions and qualitative characteristics should not be in any way diminished).

7.4 Another reporting framework that has captured much attention recently is that proposed by the Global Reporting Initiative (GRI). This is a framework for sustainability reporting and consequently includes material relating to economic and social indicators as well as environmental ones. FEE has been an active contributor to the GRI process and supports further development of the GRI reporting guidelines.

7.5 Companies wishing to move towards "sustainability reporting" in the longer term could usefully review both the environmental disclosures suggested by the GRI reporting guidelines and the recommended report structure, so that immediate decisions on the selection of environmental indicators for purely environmental reporting purposes are made in the light of developing best practice.

7.6 FEE strongly recommends further research into the development of a widely acceptable generic framework for "elements" of environmental reports, especially if produced on an industry sector basis.

8. Recommendations and conclusions

8.1 In this paper we have explored the relevance of existing conceptual frameworks (particularly that developed by the International Accounting Standards Committee) to environmental reporting issues. We find that at the qualitative level of reporting the accounting framework is highly relevant.

8.2 Environmental reporting is now established as a mainstream element of corporate reporting, but there is an urgent need to improve the conceptual under-pinning and thus the quality of external environmental reporting itself. This conceptual under-pinning requires the development of a framework of general assumptions and qualitative characteristics. This paper has identified a range of such assumptions and qualitative characteristics and has sought to establish their environmental relevance and context. Some, however, require further discussion and development.

8.3 The framework of assumptions and qualitative characteristics set out in this paper is complementary to and supportive of the work being carried out by other groups on the issue of the content of / elements of environmental reports.

8.4 In principle, the FEE Environmental Working Party supports and encourages further development of an inclusive environmental reporting framework based around:

(a) the assumptions and qualitative characteristics identified in Section 5 and 6 above;

(b) a practicable combination of the UN 50 key elements (see Section 7); and

(c) the hierarchy of elements such as is currently being evolved by various groups including the GRI (see also Section 7).

8.5 FEE intends to continue with the process of consulting with relevant individuals and organisations in order to agree a general reporting framework which we also believe should, eventually, be adopted internationally.

APPENDICES

1. **Environmental reporting guidelines**

2. **Conceptual frameworks for financial reporting**

3. **The conceptual framework of the International Accounting Standards Committee**

Appendix 1

Environmental reporting guidelines (*)

ACBE	*(UK Government's) Advisory Committee on Business and the Environment*	*Environmental Reporting and the Financial Sector - An Approach to Good Practice (1997)*
ACCA	*Association of Chartered Certified Accountants (UK)*	*Guide to Environment and Energy Reporting and Accounting (1997)*
CBI	*Confederation of British Industry (UK)*	*Introducing Environmental Reporting - Guidelines for Business (1993)*
CIA	*Chemical Industries Association (UK)*	*Reporting to Your Local Community (1995)*
CICA	*Canadian Institute of Chartered Accountants (Canada)*	*Reporting on Environmental Performance (1994)*
D&T	*Deloitte & Touche (Denmark)*	*Assessor's manual for the Analysis and Evaluation of Corporate Environmental Reporting (1996)*
EFFAS	*European Federation of Financial Analysts' Societies*	*Eco-Efficiency and Financial Analysis - The Financial Analyst's Views (1996)*
EMAS	*EC Eco-Management and Audit Scheme*	*Requirements for the environmental statement (1998 revision)*
FEEM	*Fondazione ENI Enrico Mattei (Italy)*	*Company Environmental Reports - Guidelines for Preparation (1995)*
GEMI	*Global Environmental Management Initiative (USA)*	*Environmental Reporting in a Total Quality Management Framework (1994)*
GRI	*Global Reporting Initiative*	*Sustainability Reporting Guidelines (1999/2000)*
ICAEW	*Institute of Chartered Accountants in England and Wales (UK)*	*Environmental Issues in Financial Reporting (1996)*
		Business, Accountancy and the Environment: A Policy and Research Agenda (1992)
ICC	*International Chambers of Commerce*	*The Business Charter for Sustainable Development (1991)*
ISAR	*United Nations*	*Conclusions on Accounting and Reporting by Trans-national Corporations (annual)*
100 Group	*The 100 Group of Finance Directors (UK)*	*Environmental Reporting: the Hundred Group Statement of Good Practice (1991)*
PERI	*Public Environmental Reporting Initiative (USA)*	*The PERI Guidelines (1992)*
UNEP	*United Nations Environment Programme (& SustainAbility)*	*Engaging Stakeholders; 2nd International Progress Report on Company Environmental Reporting (1996)*
WICE	*World Industry Council for the Environment (now part of WBCSD)*	*Environmental Reporting - a Managers Guide (1994)*

(*) This list of reporting guidelines does not claim to be complete - FEE would welcome any suggested additions.

Appendix 2

Conceptual frameworks for financial reporting

Europe

FEE study "FEE Comparative Study of Conceptual Accounting Frameworks in Europe" (FEE May 1997) reviews conceptual accounting frameworks as developed in the following EU and non-EU countries:

- EU: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, UK;

- Non-EU: Czech Republic, Norway, Hungary, Switzerland.

Amongst the conclusions of the FEE study are the following comments:

1. "Despite the accounting harmonisation achieved by the Accounting Directives, numerous different concepts and interpretations still exist in EU member States and (these) explain persistent important differences in accounting practices" (p. 11)

2. "In order to progress accounting comparability at a European level and influence the international accounting standardisation process there is an overall need to understand and solve internal inconsistencies in Europe. The survey concludes that, without a framework, it will be difficult and this may prevent the right solutions being found" (p. 11)

3. "Given that a written an accepted one (framework) already exists at an international level (the IASC Framework - see below and Appendix 4), any attempt to write a European Framework would be of doubtful use." (p. 11)

International

International Accounting Standards Committee "Framework for the Preparation and Presentation of Financial Statements" (IASC 1989)

UK

Accounting Standards Board "Statement of Principles for Financial Reporting" (ASB 1999)

USA

Financial Accounting Standards Board "Statements of Financial Accounting Concepts 1 - 7" (FASB 1986)

Appendix 3

International Accounting Standards Committee "Framework for the Preparation and Presentation of Financial Statements"

The IASC framework is structured as follows:

The Objective of Financial Statements Financial Position, Performance and Changes in Financial Position	
Underlying assumptions (1) accruals basis (2) going concern	
Qualitative characteristics of financial statements	
Understandability Relevance (> Materiality) Comparability	Reliability (> faithful representation > substance over form > neutrality > prudence > completeness)
Constraints on relevant and reliable information	Timeliness Balance between Benefit and Cost Balance between Qualitative Characteristics
True and fair view // fair presentation	
The Elements of Financial Statements	
Financial position	Performance
Assets	Income
Liabilities	Expenses
Equity	
Recognition of the elements in the financial statements **Measurement of the elements in the financial statements**	