

## **1.0 Executive Summary**

### **Background**

Accounting and reporting for the environment has become increasingly relevant to enterprises. Moreover, how the environmental performance of an enterprise affects its financial health is of growing concern to investors, creditors, governments, and the public at large. The Annual/Financial Report of a company is the principal way in which stakeholders keep themselves informed of the activities, progress and future plans of a company, although currently there is no standard way of presenting environmental information and no analytical standards for their interpretation.

### **Aim**

The aim of this study is therefore to identify disclosures that allow for standardisation and comparability of environmental information being presented in corporate Annual/Financial Reports. Companies (88) participated in this study on the prerequisites that they are based in the EU; operate in the EU; based or operate outside the EU but offer best practice example; produce an Environmental Report. Expert organisations (18) and report user organisations (11) that utilise Annual/Financial Reports as part of their daily business also agreed to participate. The Annual/Financial Reports and Environmental Reports of the companies were analysed and all participants were invited to take part in an online discussion relating to the disclosure of environmental information in the Annual/Financial Report and asked to complete a questionnaire.

### **Discussion and Recommendations**

Environmental information is incorporated within the Annual/Financial Report to increase stakeholders' awareness of the company's activities, performance and interactions with the environment during the year. Stakeholders use this information to assist in their decision making process. However, few companies currently look to guidelines specifically related to the disclosure of environmental information in the Annual/Financial Report which is surprising considering the types of decisions which potentially could be made based on companies disclosure of this topic. Companies need to be more aware of the locations for and the types of environmental information that could usefully be disclosed in the Annual/Financial Report. The following sections present a series of summaries and their associated recommendations which derive from the study.

### ***Overarching Issues Relating to the Disclosure of Environmental Information in the Annual/Financial Report***

The environment is just one of a number of strategic issues needed to be addressed in the Annual/Financial Report. However, many report user organisations and expert organisations consider the environmental disclosures in the Annual/Financial to be 'greenwash' thereby making it difficult to obtain useful and reliable information. It is accepted that there is frequently only limited space within the Annual/Financial Report for environmental information. It became apparent in some cases that the information in the Annual/Financial Report was not the same as information in the Environmental Report because of differences in the reporting cycles. Current environmental disclosures frequently lack contextual information making it hard to interpret, as only selected parts of the picture are being presented. Environmental

disclosures are difficult to compare across companies as they all disclose different environmental topics and present those topics in a variety of ways.

***Recommendation 1... environmental information be given equal disclosure opportunities alongside other strategic issues and should present a ‘true and fair’ view, not just in words but also with quantitative data where possible. When restricted by space in the Annual/Financial Report the reader should be referred to the further information elsewhere in the Report, within the Environmental Report or other environment related documents. However the environmental information in the Annual/Financial Report should not distract companies from producing a stand alone Environmental Report and vice versa. The reporting cycle of the Environmental Report should be made synchronous with that of the Annual/Financial Report and form the basis of an environmental communications strategy. Furthermore environmental disclosures should be presented in context and in a more standardised manner to increase comparability both within and across companies.***

***Location of Environmental Information in Annual Report***

Environmental disclosures can relevantly be located in all 13 sections identified in the Annual Report. The overall level of environmental disclosures by companies was low (excluding the environmental section or subsection). Only two topics were disclosed by over a quarter of the companies (corporate commitment in the Chairman’s or Chief Executive Officer’s statement and environmental products and processes in the review of operations/business units). Almost all the companies disclosed environmental information in the Annual Report (91%), most in 3 out of the 13 possible sections. Three-quarters of the companies provided a separate environmental section or subsection where 5 topics were disclosed by over a quarter of the companies. The amount of space given to the environmental section or subsection is low, typically between 1% and 4% of the space in the Annual Report.

***Recommendation 2... environmental disclosures should be given equal disclosure opportunities for inclusion in the:-***

- **Review of operations/business units section, in particular in relation to the development and demand for environmental products and processes, environmental legislation and compliance and Environmental Management Systems and their associated standards. However these topics are not exclusive or exhaustive in that they should not restrict other environmental topics from being disclosed here if appropriate for example developments or initiatives specific to individual business units.**
- **Chairman’s or Chief Executive Officers Statement which should include references to the existence of environmental policy/principles, Environmental Management Systems, environmental targets or objectives and refer the reader to locations within the Annual Report, Environmental Report or other publications where more detailed information can be found.**
- **Company description, in particular a statement of corporate commitment towards environmental improvement, possibly mentioning the existence of the company environmental policy.**
- **Shareholder value section which should include a reference to the Environmental Report and other environmental related publications**

**including the website, if applicable, alongside details of how to obtain copies of those documents in a variety of ways (e.g. address, fax, telephone and Internet).**

- **Highlights section, in which disclosures will vary from year to year depending on the individual activities and progress within each company during the year.**
- **Financial review section which should include, where significant, environmental financial information that is quantified and accompanied by additional information to qualify the data presented.**
- **Research and technology section which should contain information in relation to environmental research and development.**

***Recommendation 3...environmental disclosures should be made in a separate environmental section or subsection within the Annual Report that is given a relevant percentage of space in the Annual Report with respect to other strategic issues and listed in the contents of the Annual Report.***

### ***Types of Environmental Information in Annual Report***

Under this heading there are nine recommendations which relate to the indicator areas identified as key indicator areas by WBCSD or GRI: Environmental Management Systems and their associated standards; environmental targets and objectives; environmental policy or principles; environmental legislation or compliance; reference to their Environmental Report; environmental products and processes; emissions; water; waste; recycling; energy efficiency and consumption; and environmental financial information. It was suggested by the expert organisations and the report user organisations that absolute and normalised data should both be presented to allow report users to either utilise the given normalised data or to apply their own normaliser. Suggested normalisers were units of production, units of turnover or an indicator of service. The current disclosure of those indicator areas in the Annual Report were analysed in more detail. Disclosures relating to Environmental Management Systems and their associated standards were frequently cursory, for example stating the number of sites which are certified. However when this is compared to the total number of sites at which these companies operate these claims are frequently put into perspective. Most companies only mentioned progress towards one or two environmental targets or objectives, although with some companies having up to 45 targets the space restrictions in the Annual Report do not allow for all of them to be disclosed. As no other company policies or codes of conduct appear in full in the Annual Report the environmental policy should be no different. Few companies currently present environmental legislation and compliance information in context, for example future environmental legislation and how they plan to comply with it. Although many companies referred to the Environmental Report, few referred to other environmental related documents or stated how the Environmental Report can be obtained. Disclosures relating to environmental products and processes were frequently cursory although two companies did demonstrate the financial link by providing graphs of the increase in demand for environmental products. Few companies currently disclose quantitative data relating to emissions, water, waste, recycling, reuse or energy efficiency and consumption. In relation to environmental financial disclosures there appeared to be no standardised format as to what information to disclose or how to disclose it.

**Recommendation 4...** the environmental indicator areas mentioned above should be disclosed by companies in the Annual Report. However these are not exhaustive or exclusive in that they should not restrict companies from disclosing other environmental indicators if they are relevant and applicable. Data should be presented in absolute and normalised form using a normaliser such as a unit of production, unit of turnover or an indicator of service.

**Recommendation 5...** companies should disclose the existence of any Environmental Management System. If they have sites certified to an Environmental Management System standard they should specify which standard has been achieved and quantify the absolute number of sites certified as well as the percentage of the total number of sites they represent.

**Recommendation 6...** companies should mention the existence of their environmental targets and objectives, how many are in place, how many they achieved during the year or are ongoing, postponed or abolished. If significant progress was made against any one or two targets those targets should be presented alongside information relating to actions undertaken and progress made, possibly using time series data.

**Recommendation 7...** companies should mention the existence of their environmental policy or principles. If revised or updated during the year state why and how it has changed and give consideration to the inclusion in full of the revised policy. Companies should state how copies of the environmental policy can be obtained.

**Recommendation 8...** companies should make disclosures in relation to environmental legislation and compliance specifically information relating to the affects of current and future environmental legislation and actions undertaken to comply with this legislation, environmental fines or penalties and legal proceedings.

**Recommendation 9...** references should be made to the Environmental Report from throughout the Annual Report, if possible referring to specific pages or information. A variety of ways should be given through which those documents can be obtained (e.g. address, telephone, fax, email, and webaddress).

**Recommendation 10...** companies should disclose information in relation to their environmental products and processes placing these disclosures in context and, where possible, alongside quantitative data relating to the demand for environmental products or sales from environmental products highlighting the financial link to environmental product developments.

**Recommendation 11...** that the following should be quantified, where possible:-

- Emission levels and/or reductions.
- Water consumption, efficiency and/or water quality.
- Waste levels and/or reductions.
- Recycling levels.
- Energy efficiency and/or consumption.

Consideration should be given to presenting this information graphically or in tables thus allowing for time series data and targets to be presented. It should also be accompanied by qualitative information that can explain anomalies or trends and describe actions related to improving their performance.

***Recommendation 12...*** companies should look to existing definitions such as EUROSTAT's (see Appendix C) and guidelines such as the recommendations from the EU 1995 'Financial issues in Accounting' (see Appendix D) and the UN ISAR 15<sup>th</sup> Report be considered (see Appendix E). Environmental financial disclosures are examined in more detail under types of environmental information disclosed in the Financial Report (see Recommendations 14 to 20)

#### ***Location of Environmental Information in Financial Report***

Environmental information can be disclosed relevantly in seven sections in the Financial Report, if material. The number of companies who disclosed environmental information in the Financial Report was considerably lower than those who disclosed in the Annual Report. The income statement, balance sheet and director's responsibility all only received disclosure from one company. Furthermore two thirds of the companies either disclosed no environmental information in the Financial Report or only in one out of the eight sections.

***Recommendation 13...*** environmental disclosures should be made in the following sections of the Financial Report so as to be covered by the statutory audit:-

- **Director's report, in particular in relation to environmental legislation and compliance, quantified environmental provisions and/or environmental expenditures or environmental contingent liabilities.**
- **Accounting policy or principles, in particular in relation to the contextual information to explain when environmental provisions are incurred, what they cover, how the actual level is determined, and how they are accounted for, also what environmental expenditures cover, and how they are accounted for.**
- **Income statement or notes to the income statement, in particular quantified environmental expenditures, if material and reasonably possible.**
- **Balance sheet or notes to the balance sheet, in particular quantified provisions for environmental liabilities, if material and reasonably possible.**
- **Other unassigned notes to the accounts, in particular in relation to environmental related contingent liabilities environmental legislation and compliance and involvement in legal proceedings.**

#### ***Types of Environmental Information in Financial Report***

Under this heading there are six recommendations relating to the complex environmental financial disclosures in the Financial Report. In relation to environmental legislation and compliance, disclosures differed from those in the Annual Report, they are disclaimer statements accepting that the company is restricted by environmental legislation and that this in turn can have a financial impact on the company. However some companies also mentioned their involvement in legal proceedings including being named as a PRP. Of those companies quantifying their environmental provisions few went on to quantify the amount of accrual cancelled or

the amount added to the accrual that year, or make statements relating to when environmental provisions are incurred, what they cover, how their levels are determined or how they are accounted for. Although the accounting policy or principles was the exception in that more companies disclosed contextual information than quantified the amount of environmental provisions because its function is to present the basis on which the accounts were prepared and not the actual figures themselves. Some companies qualified what was included in their calculation of environmental expenditure however, other companies did not quantify their environmental expenditures but merely stated that they exist. Moreover, capitalised environmental costs were disclosed by 7 companies in the director's report while operational expenditures were only disclosed by 2 companies. Several companies disclosed environmental contingent liabilities including 5 companies in the forward looking or cautionary statement in the director's report. Disclosures of recoveries from third parties including insurance claims related to a) whether environmental provisions take into account potential recoveries; b) claims that have been filed; and c) when insurance recoveries are recorded. Only 5 companies mentioned utilising environmental financial related accounting guidelines or standards. Many companies stated the differences between their national Generally Accepted Accounting Principles (GAAP) and other international accounting standards. However two companies made reference to how this had affected their environmental expenditures in the former case, and environmental provisions in the latter.

***Recommendation 14...* companies should disclose whether they are involved in legal proceedings including being named as a PRP. In the latter case they should disclose the number of sites at which they have been designated as PRP and whether they expect to be successful in sharing responsibility.**

***Recommendation 15...* provisions for environmental liabilities should be quantified, where material. They should be accompanied either alongside or in the accounting policy or principles by the following explanatory information:-**

- **Statement of why the environmental provisions were made and what they cover.**
- **Statement relating to when the environmental provisions were incurred for example when 'possible' and 'reasonably probable.'**
- **Quantification of the level of environmental provisions at the beginning of the year, how much was added to the provisions during the year, how much of the provision was cancelled during the year, and what is the balance at the end of the year. If no change occurred to the accrual then a statement should be made to explain why.**
- **Statement relating to how the actual level of the environmental provisions accrual is determined.**
- **Statement relating to how environmental provisions are accounted for and identifying uncertainties, if any, which could effect the environmental costs and therefore the level of environmental liability accruals required.**
- **Quantification of environmental provisions for decommissioning, if appropriate and treated separately, along with statements relating to when the accruals were made etc.**

***Recommendation 16...* environmental expenditures should be quantified, where**

material. They should be accompanied either alongside or in the accounting policy or principles by the following explanatory information:-

- Definition of what is incorporated within the environmental expenditure, preferably quantified break down of that expenditure e.g. expenditure on environmental research and development, environmental taxes etc.
- Statement of whether environmental expenditures are expensed or capitalised, preferably quantification of amount expensed and capitalised.
- Statement of whether 'in process' and 'end of pipe' expenditures were included in the calculation, justification for this. If 'in process' expenditures were included a statement should explain how they were determined.
- Statement relating to whether the environmental expenditures are expected to result in additional revenues, for example through the sales of products launched with environmental profiles etc.

***Recommendation 17...*** environmental contingent liabilities should be disclosed, when material. They should be accompanied by a statement relating to what the contingent liability is and whether it is expected to have a material impact on the company's consolidated balance sheet or financial position. Moreover actions to reduce the potential of future liabilities should be disclosed if applicable.

***Recommendation 18...*** compensation from third parties should be disclosed, and should be accompanied by statements relating to the existence of insurance cover for environmental liabilities, claims made by the company and recoveries received. Statements should also be made as to whether environmental liability accruals have been reduced for possible insurance recoveries.

***Recommendation 19...*** existing definitions and guidelines relating to the measurement, monitoring, display and disclosure of environmental financial information in the Financial Report should be more widely considered by companies. For example EUROSTAT's definitions on environmental expenditure (see Appendix D), the recommendations from the EU 1995 'Financial issues in Accounting' (see Appendix E) and the UN ISAR 15<sup>th</sup> Report be considered (see Appendix F). Companies that are utilising specific guidelines where it be those mentioned above or not should highlight this fact stating when the guidelines were implemented and whether their implementation had an effect on the financial position of the company.

***Recommendation 20...*** differences between national and international accounting standards affecting environmental financial information should be disclosed. They should be accompanied by statements relating to the effect on environmental financial information of differences between national accounting standards and other national or international standards applied along with a statement of the impact of those affects.