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COMMITTEE
ON
THE FINANCIAL ASPECTS
OF CORPORATE GOVERNANCE

23rd December, 1991

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Professor R. H. Gray,
Matthew Professor of Accounting
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Dear Professor Gray,

I am writing on Sir Adrian Cadbury's behalf to thank you very much for your letter of 5th December, and attached notes on social and environmental accounting.

The Committee's work is focussed on the financial aspects of corporate governance - in particular financial reporting, and the role of the auditor. Your notes are thus on matters outside the mainstream of our consideration, but we have, nevertheless, read them with great interest.

Yours sincerely,

Nigel Peace

Nigel Peace
Secretary

University Of Dundee



ACCOUNTANCY & BUSINESS FINANCE

(Attachment
rec'd
18/12).
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RHG/pms

5 December 1991

Sir Adrian Cadbury
Committee on the Financial Aspects
of Corporate Governance
PO Box 433
Moorgate Place
London EC2P 2BJ

Dear Sir

Committee on the Financial Aspects of Corporate Governance

I enclose a few short notes on social and environmental accounting. To my belief, and that of an increasing proportion of industry, these matters can no longer be ignored in accounting regulation. It would be a real tragedy if the failure of the Corporate Report initiative was to be repeated. We may not get a third chance.

I should be most happy to supply anything further if that would be helpful to the Committee.

Yours sincerely

R. H. Gray

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**SOCIAL AND ENVIRONMENTAL ACCOUNTING:
A Briefing Paper**

by
Rob Gray¹
University of Dundee

Introduction

Social Accounting was a term which gained wide currency in the early 1970s as a result of the debate on the nature of corporate social responsibility. It tried to determine whether organisations could (and should) account for their social responsibilities.

Social accounting was concerned with issues such as:

(i) were investors the only group with rights to regular information? Social accounting examined the rights of labour, the local community, consumers and society in general.

(ii) should regular accounting information restrict itself to only financial information about the direct economic activities of the organisation? Social accounting examined whether organisations could account for their impact on employees, on communities and on the environment.

(iii) was the process of accounting only to enable investors buy and sell shares in capital markets and did it necessarily have to restrict itself to accounting using financial numbers? Social accounting tended to be concerned with accounting as a discharge of stewardship and accountability - a function that accounting badly serves at the moment - and tended to question whether accounting discharged its public interest function in its restriction to providing only financial accounts for a narrow group of users with very narrow - and not necessarily socially desirable - objectives. 7.

Despite widespread interest in social accounting in the accounting profession and examination of the issues in Government and Opposition white and green papers throughout the 1970s the issues died in about 1979.

The present concern with environmental matters generally has brought the specific element of accounting for the environment back onto the accounting agenda.

¹ Address for correspondence: R.H.Gray, Mathew Professor of Accounting and Information Systems, Department of Accountancy and Business Finance, University of Dundee, Dundee, DD1 4HN. Rob Gray is author of the ACCA monograph The Greening of Accountancy published in June 1990, co-author of Corporate Social Reporting: Accounting and accountability (London: Prentice Hall, 1987), a member of the CIMA environmental accounting working group and the author of many articles on social and environmental accounting.

Accountants and the Environment

The extent of the interest amongst accountants is indicated by the response of the professional accounting bodies. The Institute of Chartered Accountants in England and Wales recently held a one-day seminar on "Chartered Accountants and the Environment" which has led to the formation of a separate research initiative into this area - the committee is still formulating strategy and looking at proposals. The Chartered Institute of Management Accountants established an environmental working party in 1990 which is looking at ways in which accountants in industry and commerce can contribute to the greening of their organisations. The Chartered Association of Certified Accountants (CACA) have been the most active to date. They funded a substantial line of research at the end of 1989. The first stage of this was published in June 1990 and the next stages - analysing practicable ways in which environmental accounting can be developed - will be completed in 1991. As part of this initiative CACA have worked closely with many of the major players in the development of environmentally sensitive organisations in the UK. Another illustration of the import attached to the issues is the organisation by the European Institute for Advanced Studies in Management of a two-day workshop on green accounting in December 1990.

Probably the most significant development to date has come from the United Nation Centre for Transnational Corporations who, following a survey of different company practices in a variety of countries, are proposing detailed requirements which they would like to see sovereign governments incorporate into their company reporting requirements.

The UN proposals closely parallel my own conclusions and represent, to my mind, the best approach to formulating environmental accounting policies for companies - in the immediate term.

The United Nations Proposals

The UN proposals have been developing rapidly in the last year and look set to continue that development although, of course, there is no guarantee that the proposals will be accepted in full. The proposals are, with only a few exceptions, eminently practicable - although British industry is unlikely to find them acceptable without legal backing. The proposals at the moment are that the following items should be disclosed in company Annual Report:

(a) A statement of the type of environmental issues pertinent to the company;

- (b) A statement of the company's environmental policy (the best initiative in this area is the "Valdez Principles" - summarised in Appendix 1);
- (c) Statement of environmental programmes undertaken by the company including whether an environmental audit has been undertaken and, if so, the result thereof;
- (d) The improvements made in key areas since the introduction of the policy or 5/10 years whichever is less;
- (e) The environmental emissions targets that the company has set for itself and how it is performing against these;
- (f) The extent to which environmental protection measures have been undertaken in response to government legislation and the extent to which legislation standards are being achieved;
- (g) The financial effects of undertaking these environmental measures;
- (h) The accounting policies statement should include how environmental expenditures have been treated in the accounting process including:
- * charging of expenditure;
 - * capitalising of expenditure;
 - * recording liabilities;
 - * setting up provisions and catastrophe funds;
 - * disclosing contingent liabilities;
 - * insuring against harmful effects;
 - * treatment of grants;
 - * impact of taxation rules;
- (i) Where material, the amounts involved above should normally be disclosed.

Environmental versus Wider Social Accounting

The emphasis is on environmental issues because these are politically visible at the moment. It is probably worth remembering that environmental issues are only one part (although a major part) of the companies' wider social impact. The simplest and most practicable way of addressing all these issues has always been to require all organisations to state the extent of their compliance with law and other regulations. Hence in addition to information disclosure about environmental activities, an equal case must exist for disclosure of compliance with (e.g.) provisions on health and safety at work, equal opportunities and disabled employees as well as information on such things as involvement with the community and compliance with the ethical codes and the codes of practice of the company and the industry as appropriate.

The Medium and Longer Term

The UN proposals represent the maximum achievable in the present climate

but are essentially short-term. That is they will not deal with the major long term issues leading to environmental disaster. For this, serious attention has to be given to the concept of sustainability. (More detail of which is given in Appendix 2 which is a short article commissioned for the CBI environmental newsletter). That is, all organisational activity reduces the total amount of natural resources available for future generations. Accounting must find some way of monitoring this reduction so that some estimate of the **true** cost of organisational activity can be charged against current income. This is an especially difficult objective but probably critical to the continuance of industrial activity as we know it. At a minimum, it is essential to recognise that current claims being made for "sustainable activity" and "sustainable growth" are simply nonsense.

However, until some reliable method can be found (and such a method accepted by government and industry) it seems to make sense to encourage all attempts to nibble at sustainability. For this, organisations need to be encouraged to undertake environmental audits, to design programmes for environmental enhancement and to engage in greater accountability and transparency.

A major stumbling block is that this will cost organisations - quite significantly. Not only do organisations need encouragement (and "reward") for this but because of the implications for international competitiveness and the short run impact on such things as employment it seems to be essential that whilst voluntary and national attempts are valuable, the major thrust must come from supra-national bodies. For this reason, if no other, it seems Britain must support the attempts being made by the EC and by the United Nations to establish world-wide approaches to dealing with organisational destruction of the physical environment - before it is too late.