

Social and Environmental Accounting

1. Introduction

Accounting forms the most important quantitative system within an enterprise. Information is offered to users in the form of financial reports, which are the final product of the accounting process.

The purpose of financial reporting is to communicate financial information to interested parties. It is therefore important that financial reports must be presented in such a way that the relevant information is timeously communicated in a meaningful, comprehensible and useful manner, allowing users to act upon it and to use it to aid effective decision-making.

However, environmental reporting embraces a number of quite different concepts and practices, for which different professional disciplines are appropriate. A company may be reporting principally the impact that the business has on the environment; or the impact the environment has on the business. Environmental accounting here is chiefly concerned with the latter (Anon, no date).

This paper will focus on the discussion of whether the social and environmental reporting fulfils the objective of accounting. Moreover, it will give an account of how qualitative characteristics are relevant to such reporting.

2. Social and Environmental Accounting

When the whole world experiences a rapid growth of industry and economic, unfortunately, the natural environment is terribly damaged at the same time. Nowadays, with the increasing awareness of the importance of environment, accounting is no longer just for the economic aspect or financial aspect. For example, the Global Reporting Initiative Guidelines (GRIG) defined their framework for reporting on 3 parts: the economic, environmental and social performance of an organization. Similarly, it can be seen in Accountancy and Business journal (Stikich, 1997), in which high lights that there are three aspects of core values of a modern sustainable business, one of them is environmental responsibility. In fact, a number of companies begin to reflect on and revise their corporate environmental responsibilities, not only because of the pressure and activity coming from non-governmental organizations and the growing sense of environmental issues by the general population, but using it as a part of their management strategies to specify measures for dealing with environmental issues and to internally carry out environmental conservation activities.

Moreover, advocated by many organizations like the United Nations, the World Bank, the Organization for Economic Co-operation and Development (OECD) and the European Union, environmental accounting is widely recognized as an essential tool of a sustainable development, which does not harm the planet's resources needed for the future generations and the development

on the earth.

The question must be asked as to whether the accounting profession can provide reports to management on the use and abuse of natural resources. Some would see accounting as having a wide area of responsibility while not standing separate from the wider society in which it operates. At present financial and management accounting provide information on an organisation's consumption of resources but not specifically natural resources (McChlery, 2000).

Whilst an organisation must report to their shareholders on how they have used/abused their capital, should a company not also report to society on how, they have used/abused the natural resources of the world? Around 70% of the FTSE 350 reported on some form on environmental issues relating to their business (Anon, 1999). For example some companies quantify their emissions to water and to the air. Also more companies now show evidence of having a management system to assess, monitor and record the environmental impact of their organisation.

It may be that environmental accounting may add value to the organisation. On a short-term view point the regard for the environment can provide useful savings. Vauxhall Motors in its first year of applying environmental management principles reduced its electricity bills by 6% and its gas bill by 5%. However, environmental accounting should also have a long-term focus. It could be argued that investment (or the lack of) in environmental management accounting systems and research may be reflected in the current market values as the market has a longer-term perspective.

However looking at the long-term environmental considerations may give rise to difficulties in measuring intangibles. There is a need to devise means of uncertainty. "The lack of reliable and accepted means of quantifying environmental costs for a company is on longer an excuse for their omission", Price Waterhouse USA 1992. The uncertainties may well require the application of techniques such as sensitivity analysis, simulation etc. Academics and environmentalists are often opposed to the quantification of environmental impacts as they regard the uncertainty and subjectiveness of the measurement process leave the figures with a level of credibility that they do not merit (McChlery, 2000)

3. The Qualitative Characteristics of Financial Information

On the same basis as all accounting systems, environmental accounting presents an objective picture of the present situation and changes in the natural heritage, interactions between the economy and the environment, expenditure on preventive measures, environmental protection and the repair of environmental damage. "Environmental accounting aims at achieving sustainable development, maintaining a favorable relationship with the community, and pursuing effective and efficient environmental conservation activities."(Caves, 1992, p.34) These accounting procedures allow a company or an organization to identify the cost of environmental conservation

generated during the normal process of business; identify the benefit gained from such activities. Environmental accounting is aimed to identify, measure and disclose the activities of a company or an organization based on its environmental conservation cost or economic benefit associated from environmental conservation activities and the company's financial performance. The financial performance is supposed to be expressed in a monetary value. While environmental conservation benefits and organization's environmental performance should be stated in physical units.

Users who make economic decisions based on financial statements need these financial statements to provide information which is useful to them. To make sure that financial statements provide useful information to users, the ASB's statement of principles chapter three which is titled the qualitative characteristics of financial information sets out the desirable characteristics of financial information. In chapter three the ASB set out five main qualities that are required of financial. The first one is materiality, which is threshold quality; its purpose is to make sure that any information that is given doesn't impair the usefulness of the other information given. The other four qualities are relevance, reliability, comparability and understandability.

The Statement of Principles gives a explanation of the qualitative characteristics of financial information and some hints, as to the way the conflicts between the characteristics are to be resolved. 'Both the definitions of the qualities and the framework for resolving conflicts are expressed in generalised and abstract terms. As such, they help to focus and move forward the debate about the specification of financial statements but do not provide an operational mechanism for dealing with concrete problems, including, for example, the need to establish tradeoffs between the various qualities and components of those qualities. These will continue to have to be dealt with by judgement in individual cases and whether or not the scheme will be of assistance at this level remains to be seen.' (Brian A., no date)

Also the Statement of Principles lists cost benefit as one of the factors that ASB takes into account in setting standards. Applying a cost-benefit analysis is seen to be an important part of the standard-setting process. 'The benefits from improvements in financial information flow through primarily to the users of the information (in terms of better decisions), though there may also be social benefits from improvements in the allocation of resources and in spurring managers to improve performance. The costs of reporting improved financial information include any incremental resources used to generate and audit the new information compared with what was previously reported; any incremental resources used in disseminating the information (...); potential damage to the reporting entity's commercial position because competitors will also obtain the information; and the costs involved in absorbing and analysing the new information.' (Brian A., no date)

When applying the qualitative characteristics and the cost-benefit analysis should be kept in mind that different users, even within a single user group, will in theory, seek different trade-offs

between the qualitative characteristics and a different balance between costs and benefits.

Finally the use of Prudence in the Statement of Principle has been criticised. Some people comment that it does not go far enough in asserting the importance of providing unbiased information. For others, the traditional approach is preferred:

‘Prudence [as defined by SSAP2] is a mainstay of traditional practice. The Prudence concept creates an essential bias . . . a potent antidote to counteract preparers’ eternal optimism.’ (Davies and Davies, 1999)

4. Conclusion

To achieve sustainable development, there is an increasing pressure from a wide range group of stakeholders including government regulators, media, consumers, investors, employees, competitors and local communities to require the organizations to disclose their performance against environment, society and economy. To meet the need of the stakeholders, social and environmental accounting, a new approach to corporate reporting, has been emerged. However, there is a great challenge for organizations to use it in a regulated and standardized way due to a lot of practical issues.

Reference

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