The triple bottom line

What the good guys are putting in the annual report

A growing emphasis on social responsibility by companies has taken the concept of "ethical" business into new dimensions, including the disclosure of environmental and social performance. CRAIG DEEGAN reports mixed responses to the challenge of "being green" and keeping stakeholders informed.

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The traditional and dominant focus for external corporate reporting in Australia has been to provide information about an organisation's financial (or economic) performance. However, in recent years many corporations have been providing greater amounts of information about "non-financial" aspects of their operations.

In the early 1990s, following trends in other countries, some companies started offering information about their environmental performance. Initially, the information was provided (voluntarily) in the annual report and tended to be self-laudatory. From about the mid-1990s the standard of environmental performance reporting arguably improved as various environmental reporting guidelines were issued internationally. Companies (mainly in the mining industry) produced stand-alone environmental reports even though there was no legislation requiring them to do so. Two environmental reporting award schemes were introduced in Australia around that time.

While environmental reporting was altering the traditional focus on financial performance, a further shift emerged in the 1990s. Some companies started producing information about their social performance (for example, their support of community-based projects, employee training programs, support for developing countries, support for indigenous people) and a number issued stand-alone social reports. By the end of the 1990s the willingness of corporate managers to disclose environmental and social performance information was becoming a challenge for accountants.

Historically, accountants had tended to fixate on the reporting and audit of financial performance indicators, as bodies such as the Australian Accounting Standards Board (AASB) continue to do, but now there was an expectation of the similar treatment of social and environmental performance information. At issue is whether this is within the ambit of accountants' responsibilities and skills or whether other specialists should have a part in providing this information. Arguably, the accounting profession has been slow to respond and a number of other professions are taking the lead.

WHY REPORT SOCIAL AND ENVIRONMENTAL INFORMATION?

Evidence indicates that corporations are making greater social and environmental disclosures — but why? There could be various reasons. For example, the managers might be reacting to legal requirements; they might believe it is *economically rational* and that the economic benefits from disclosure might offset any associated costs; or, they might simply accept that the organisation has an *accountability* to various stakeholders for how it uses the environmental resources that have been entrusted to it. Determining real (as distinct from reported) motivations is not an easy exercise.

There is no universally accepted way that organisations report social and environmental information. Much experimentation is occurring as accounting bodies throughout the world look at forms of reporting.

At the "radical" end of the experimentation, some organisations have attempted to monetise the environmental costs and benefits (or externalities) arising from their operations. This was promoted by the European Union, which in 1992 issued a document titled

"Towards Sustainability" as part of its *Fifth Action Programme*. The rationale for the EU's proposal, which has not been embraced by the accounting profession, was that if prices reflected the "full costs" of production, including environmental costs, these would flow through the various production and consumption cycles. The resulting higher costs would lead to an inclination towards sustainable consumption patterns.

A number of companies have experimented with full-cost accounting, including Dow Europe, BSO/Origin (Netherlands), Volvo, Ontario Hydro, Baxter International, Landcare Research Ltd (New Zealand), Earth Sanctuaries (Australia) and IBM. Such approaches can be seen as a dramatic departure from conventional accounting.

There are various ways to quantify environmental costs. These range from fairly conservative approaches to full-cost accounting to more radical and experimental methods involving "sustainable costs calculations" (Gray and Bebbington 1992, 1997).

Gray and Bebbington worked with Landcare Research Ltd (NZ) to develop their sustainable-cost calculations and measure the notional costs that would be incurred if the organisation were to have zero environmental impact.

A more common approach to environmental reporting, popular in countries such as Germany, is the "mass-balance" or "eco-balance" method. This requires the organisation to take a systems-based perspective in describing its operations, with all physical inputs to the organisation being traced to their eventual end, whether as product, packaging, emissions or waste. The flow is typically presented in diagrammatic form. No dollar value is placed on the flows. A number of companies in Europe are providing this form of data in their annual reports or in stand-alone environmental reports.

Another common approach to reporting is to identify key emissions or outflows and to provide information about the amount being released. The levels of emissions or releases are often compared with set targets (often called target-based reporting).

STAKEHOLDER REACTION

Numerous studies have sought to determine whether there is a reaction to environmental disclosures — that is, whether environmental performance information is *material* or *relevant* to the decisions of stakeholder groups.

Deegan and Rankin (1977) undertook a survey of stakeholder groups including shareholders, stockbrokers and research analysts, accounting academics, representatives of financial institutions and people from organisations such as consumer associations, employee groups, industry associations and environmental groups. The results indicated that environmental information is material to the decisions undertaken by shareholders and members of organisations performing a review or oversight function.

It is likely that in the new millennium social reporting will be increasingly embraced by corporations, just as the environment became a key reporting issue in the 1990s.

A number of share-price reaction studies have been undertaken in relation to the disclosure of environmental information. The assumption of these studies is that if the capital market reacts to the disclosure of information (as evidenced by changes in the share prices around the time of the disclosures) then the market must be using the information — it must be useful in assessing future cashflows.

There is also evidence that if a severe environmental incident occurs that potentially questions the existence and legitimacy of an entire industry, then those organisations that made environmental disclosures before the incident may not experience as great a negative share-price effect as those that did not. For example, Blacconiere and Patten (1994) examined the market reaction to Union Carbides's chemical leak in India in 1984. Using a sample of 47 US firms, they observed a significant intra-industry market reaction to the event. However, firms with more extensive environmental disclosures in their annual reports before the disaster experienced a smaller negative reaction than those with less extensive disclosures.

EVOLUTION OF SOCIAL AND ENVIRONMENTAL REPORTING

In recent years a deal of attention has been directed to "triple-bottom-line reporting", defined by Elkington (1997) as reporting that provides information about the economic, environmental and social performance of an entity. The notion of reporting against these three components (or "bottom lines") is directly tied to the concept and goal of sustainable development. Triple bottom line reporting, if properly implemented, will provide information to enable others to assess the sustainability of an organisation's or community's operations. The perspective taken is that for an organisation or a community to be sustainable it must be financially secure, as evidenced through such measures as profitability; it must minimise, or ideally eliminate, its negative environmental impacts; and it must act in conformity with societal expectations. These three factors are obviously highly inter-related.

The practice of social reporting was widely promoted in the 1970s but lost prominence in the 1980s. In the early 1990s attention was devoted to environmental reporting from an eco-efficiency perspective. Social reporting did not reappear until the mid-to-late 1990s.

It is likely that in the new millennium social reporting will be increasingly embraced by corporations, just as the environment became a key reporting issue in the 1990s. Social accounting acknowledges that the organisation has many stakeholders. For many of these organisations that are currently producing stand-alone social accounts, it is stakeholders' expectations (learned through various consultation mechanisms) that are being used to drive the reporting process.

The production of stand-alone social reports is fairly common overseas among companies such as Body Shop (UK), Traidcraft (UK), Nat West (UK), Co-Operative Bank (UK), South Africa Brewing, APSO (Ireland), British Telecom, BP (UK) and Shell (UK). The practice is more limited in Australia (Body Shop Australia, Rio Tinto Ltd, BHP Ltd and

WMC Ltd). A review of the social accounts currently being produced indicates that much of the disclosure relates to whether the organisation is meeting stakeholder expectations and, if not, what remedial action is being taken. Stakeholder expectations are learned through direct consultation mechanisms which engage various stakeholder groups.

Reflecting the rising interest in social accounting and social auditing, a social accounting standard was released in 1998 by the Council for Economic Priorities. The standard, SA8000, focuses on issues associated with human rights, health and safety and equal opportunities.

In late 1999 the Institute of Social and Ethical Accountability (ISEA) launched a standard, AA1000, which is concerned with the processes of setting up and operating voluntary social and ethical accounting and auditing systems. The guidelines stress the need to clearly define social and ethical goals and to report levels of achievement. The importance of involving stakeholders in the process is emphasised.

Activities such as social audits can act as a catalyst for organisations, and importantly, for senior management, to embrace new values. Failure to comply with community expectations can have implications for the survival of the organisation (regardless of how efficiently it uses financial resources or the environment). As WMC Ltd states in its Environmental Progress Report 1997, "the greater the community's confidence in a company, the more secure its long-term viability". It appears that some organisations are undertaking social audits as a means of gaining (or regaining) legitimacy in the eyes of their stakeholders. Undertaking a social audit, particularly if the audit is undertaken by a credible, independent party, should increase the transparency of the organisation.

Organisations must arguably consider not only the expectations of the communities in which they operate but also their stakeholders worldwide — many of which will focus on eco-justice issues. Companies must be able to show that they are not exploiting particular communities or sub-groups — even though they might be complying with local laws. For example, consider the implications for Nike when it became apparent that its sportswear was being produced in Indonesia by workers paid less than $10 a week at the same time that it was paying Michael Jordan millions of dollars to endorse the products, or the implications for BHP Ltd of the environmental damage caused in Papua New Guinea by associated operations.

Anticipating the view that corporations will increasingly consider the social implications of their operations, many large accounting and consulting firms, such as the Big 5 accounting firms, are acquiring or developing expertise to undertake such work.

MANDATORY REPORTING REQUIREMENTS

In 1998 a provision was introduced into the Corporations Law requiring entities such as public companies (both listed and unlisted) and large proprietary companies to report "if the entity's operations are subject to any particular and significant environmental regulation under a law of the Commonwealth or of a State or Territory — details of the entity's performance in relation to environmental regulation".

Hence for many companies that had previously elected not to provide environmental reports, we can now expect to find some disclosure. While the spirit of the Corporations Law requirement accords with the view that companies should account for their environmental performance, it is clear that there is much ambiguity.

A review of disclosures made by a number of publicly listed companies shows that disclosures range in quality. Some companies have provided brief or no disclosure while others issue pages of useful information. Mining companies seem to report the most information (and this has been the case for a number of years) while some companies in less sensitive industries, such as the communication and service sectors, appear to provide very little information. At this stage, little is being done about compliance with the requirement.

Rather, industry argues for flexible, non-mandatory reporting. The problem with flexibility is that it facilitates the omission of information that might not be favourable to a corporation's image. Industry has played a central part in a consultancy developing voluntary reporting guidelines which clearly focus on flexibility in reporting. This could be construed as indicating that industry has attempted to capture major parts of the environmental reporting debate in Australia. Because stakeholders other than industry have a right to be informed about corporate environmental performance, this represents a dilemma. Notions of right-to-know seem to have disappeared from the debate as arguments for flexibility, cost considerations and international competitiveness have come to the forefront, as evidenced by submissions made to the Parliamentary Joint Committee on Corporations and Securities. Fortunately, a number of industry members (mavericks?) provide disclosures that are of world-best-practice quality.

An audiotape and the full paper presented at the seminar can be purchased from the Securities Institute. Contact Sally Bamford on Tel: 61 2 8248 7534.

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