

Making Green Issues Count: The Trend of Environmental Accounting

By Wayne Visser

There is a growing international trend towards environmental accounting. This is closely related to the evolution of generally accepted standards of financial reporting. Increasingly, disclosed financial information will have to include environmental costs and liabilities in order to encourage effective environmental management decisions, accurate assessment of business risk and transparent public disclosure.

What is Environmental Accounting?

Most commonly, environmental accounting refers to what might be more accurately described as “environmental management accounting” - a framework for organisations to identify and account for past, current and future environmental costs in order to support management decision-making, control and public disclosure. The ICAEW suggests that environmental costs should include:

- Environmental measures taken to prevent, reduce or repair damage to the environment which results from an entity’s operating activities; and
- Environmental losses which are costs incurred by an entity in relation to the environment for which there is no return or benefit (e.g. fines, penalties, clean-up costs).

Who Is Promoting Environmental Accounting?

A number of different international bodies already support and promote environmental accounting, including: The American Institute of Certified Public Accountants; The Canadian Institute of Chartered Accountants; The Institute of Chartered Accountants in England & Wales (ICAEW); The International Accounting Standards Committee (IASC); The International Federation of Accountants and The US Environmental Protection Agency (EPA). All of these organisations have issued guidance documents on the subject and, most significantly, a global environmental accounting standard is due to be released by the IASC before the end of the year.

To date, SAICA have not issued any accounting statements or auditing standards with regard to environmental accounting or environmental auditing. However, in August 1997 an Exposure Draft (ED 113) was issued by SAICA entitled “The Consideration of Environmental Matters in the Audit of Financial Statements”. Although not addressing

environmental accounting directly, this ED makes useful references to the consideration of relevant environmental laws and regulations, defining environmental matters for businesses, and how environmental matters can affect financial statements.

Who Is Implementing Environmental Accounting?

A number of international companies are already implementing environmental accounting. Among the leaders are: AT&T, Baxter International, Bristol Myers-Squibb, BT, Dow Chemicals, Monsanto, Ontario Hydro, and Pacific Gas & Electric.

The practice is less well established in South Africa. According to recent research which assessed the environmental progress and priorities of South Africa's largest 150 companies, while 40% of companies include an environmental section in their annual financial report, only 13% have produced a separate environmental report, 11% have obtained third party verification of this reporting, and just 4% have any kind of environmental accounting system. Since the research was conducted, a number of companies in South Africa (such as Sasol and Eskom), have begun pursuing environmental accounting more actively.

Benefits of Environmental Accounting

Environmental accounting is an effective tool for placing environmental issues firmly on top management's agenda, providing useful data to inform environmental and financial managers' decision making, and concretely demonstrating environmental commitment to stakeholders. The EPA adds the following benefits:

Many environmental costs can be significantly reduced or eliminated as a result of effective decisions; Environmental costs (and potential savings) may be obscured in overheads or otherwise overlooked; Environmental costs can be offset by generating revenues through sale of waste or by-products; Understanding of environmental costs can promote more accurate costing and pricing of products; Competitive advantage with customers can result from processes, products and services which can be demonstrated to be environmentally friendly; and Accounting for environmental costs and performance can support a company's development and operation of an overall environmental management system (e.g. ISO 14001).

Issues To Consider Before Implementing Environmental Accounting

A number of issues will impact on how environmental accounting is implemented within an organisation. For example:

- What definitions of environmental costs and liabilities are appropriate for the industry and/or company?
- How does the structure of the organisation or the environmental function influence the way in which environmental financial information should be recorded, collated

and reported?

- How can the extraction of environmental information be integrated with existing financial reporting and accounting systems?
- Who is the information intended for and does this influence what is collected and how?
- Will the information be independently verifiable for the purposes of management assurance and stakeholder credibility?

What Process Of Change Does Environmental Accounting Require?

The approach to environmental accounting will vary for each company. However, at KPMG we have developed a genuine methodology with the following steps:

- Review the status quo of environmental accounting within the business;
- Define the criteria for determining environmental costs and liabilities;
- Determine environmental accounting definitions;
- Create guidelines for the allocation of environmental costs and liabilities;
- Make modifications to the current accounting system to extract environmental information; and
- Agree to standards for environmental accounting disclosure and treatment.

It is often appropriate for companies to tackle various aspects of environmental accounting in phases. For example, begin with environmental capital expenditure, then focus on operating environmental costs, followed by environmental liabilities and lastly evaluate external environmental costs to society. Similarly, integration with other systems or methodologies, such as Activity-Based Costing or Life Cycle Assessment, may only be appropriate as an enhancement of a more basic environmental accounting system.

If the successful international environmental accounting benchmarks are anything to go by (e.g. AT&T, Dow Chemicals, Ontario Hydro), companies should plan for a change process which will take five years to be fully implemented.

Conclusion

Environmental accounting is an emerging discipline which will impact on companies sooner or later. It may be driven by their own proactive initiative, the growing requirements of financial auditors or the demands for greater transparency by the public. In the final analysis, environmental accounting is critical because an organisation

can only manage effectively what it measures, and is effectively measured on what it reports.

Source:

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