

The why, what, where and how of corporate environmental reporting

CJ de Villiers

DS Lubbe

Abstract

Although environmental reporting is not compulsory in this country, many companies and other organisations in South Africa disclose information regarding the natural environment. Organisations may therefore decide for themselves whether or not to report such information. As a result of the lack of guidance, each organisation must decide itself whether to report, what to report and where to report. This paper examines several aspects of environmental reporting from a business perspective. These aspects include the advantages of environmental reporting and the types of environmental information that could or should be reported. The advantages and disadvantages of reporting environmental information in the annual report and in a separate report are also discussed. Finally, the paper provides some guidelines on the implementation and management of an environmental information system.

Key words

Environmental reporting
Environmental accounting
Social reporting

1 Introduction

The environment has become an important issue in many spheres of life, including business life. Business enterprises consume resources, create pollution and produce waste. For this reason, they attract the attention of individuals and groups who are concerned about the future of the natural environment. Business enterprises are increasingly scrutinised and pressurised to consider carefully the environmental consequences of their operations.

Although environmental reporting is not compulsory, many South African organisations have elected to disclose environmental information in their annual reports, in separate environmental reports and elsewhere (De Villiers 1997a). The anxiousness of organisations to supply environmental information together with the general absence of legislation and other regulations have resulted in the selection of a variety of vehicles for disclosure as well as of various types and formats for the information disclosed.

Only approximately 125 of the more than 600 companies listed on the Johannesburg Stock Exchange disclose environmental information of any kind (De Villiers 1997a). This fact may prompt business leaders to question the value of environmental disclosure for their organisations. Even if business leaders do decide to disclose environmental issues, they may be at a loss as to what to report and where to report it. Another relevant question is how to establish and manage the reporting function in an organisation. This article will attempt to provide answers to these questions.

To summarise, the objectives of this paper are to provide reasons why environmental reporting is important to business enterprises; indicate what kind of environmental information to report; suggest where to report it; and describe methods of establishing and managing an environmental reporting function in a business enterprise.

The reasons why environmental reporting can be beneficial to business enterprises are discussed in the next section.

2 The reasons for environmental reporting

The reporting of environmental issues is not necessarily a philanthropic exercise. Nor do only executives with a particularly soft spot for nature champion it. Apart from the ethical arguments in favour of green reporting, many arguments can be advanced that make good business sense. For example, the image of the company could benefit from green reporting, which could in turn translate into increased profits.

Gray (1993:211) provides some reasons for green reporting. A summary of these reasons appears in Table 1.

Table 1

Reasons for environmental disclosure
If it is not done voluntarily, it will become mandatory
To legitimise current activity
To distract attention from other areas
To develop the corporate image
To build up expertise in advance of regulation
To have a positive impact on share price
To reduce the perceived company or information risk
To gain political benefits
To gain a competitive advantage
To acknowledge shareholders' and other stakeholders' right to know
To explain expenditure patterns
To tell people what the company has done or achieved
To forestall disclosure by other parties

Source: Gray 1993: 211

The reasons suggested by Gray appear to be varied and to have no common ground, yet legitimacy theory can assist in finding a link. Legitimacy theory is one of the theories used by researchers in the field of social and environmental reporting. According to this theory, organisations will attempt to gain legitimacy in the eyes of society by among other things publishing positive information. Lindblom (1994:2) defines legitimacy as:

...a condition or status which exists when an entity's value system is congruent with the value system of the larger social system of which the entity is a part. When a disparity, actual or potential, exists between the two value systems, there is a threat to the entity's legitimacy.

Of the 13 reasons for environmental reporting in stated Table 1, 11 can clearly be related to legitimacy theory. The reason "building up expertise in advance of legislation" could be regarded as a purely management contingency plan and not related to or aimed at legitimising operations. On the other hand, it could be argued that management is attempting to legitimise the organisation by complying with expected legislation, which is a reflection of societal values. The reason "acknowledge shareholders' and other stakeholders' right to know" is reminiscent of accountability theory, in which

the information rights of stakeholders are emphasised, and this reason is probably not related to legitimacy theory.

Efforts to gain legitimacy can be categorised into four possible strategies. According to Lindblom (1994), organisations may seek to:

- 1 *Educate and inform about changes in the organisation. This happens when the organisation realises it has failed and changes accordingly.*
- 2 *Change perceptions. This happens when the organisation believes there are misconceptions regarding their own actions — people do not know what they already do.*
- 3 *Manipulate perceptions. This happens when the organisation detracts attention from its failures by emphasising good behaviour in other areas.*
- 4 *Change external perceptions. This happens when the organisation believes there are unrealistic expectations of its conduct.*

Corporate environmental reporting can be employed in each of the four strategies mentioned.

It is clear from the above categorisation that the reasons for disclosures can range from the principled (information rights of stakeholders) to the pragmatic (legitimacy).

It could be argued that the reasons and arguments given thus far do not apply to the South African situation to the same extent as they do to Western countries. For this reason, De Villiers and Vorster (1995) performed a survey of South African attitudes regarding environmental reporting. In their study, it was found that most managers, auditors of financial statements and users of financial statements agreed that more corporate environmental reporting is needed. In a subsequent study by De Villiers (1998), this finding was confirmed. In fact, the same three groups agreed that more corporate environmental reporting on a compulsory basis was advisable. The individuals included in the study represented the most important stakeholder groups for the purpose of considering the desirability of environmental reporting, i.e. the stakeholders who prepare, audit and use annual reports.

South African stakeholders appear to be in favour of increased environmental reporting, but it could be argued that people are generally inclined to ask for additional amounts of any free item, including information. That does not necessarily mean that they actually need the information or even that they will use it if it is supplied. In a survey of

portfolio managers of South African unit trusts (De Vries & De Villiers 1997b), 90% of the portfolio managers included in the survey indicated that they needed more environmental information. More significantly though, 75% of the portfolio managers indicated that they would use the additional information to make informed investment decisions. In other words, they wanted additional environmental information to assist them to make sound investment decisions.

An Australian study, devoted entirely to this subject, provides more evidence that environmental reporting gives essential information and is not merely “nice to have”. Deegan & Rankin (1997:580) concluded from their survey that shareholders consider environmental information to be material to the decisions they take.

In addition to the stakeholders normally considered, a new type of stakeholder (or potential investor in an organisation) is emerging. They are called ethical investors. These investors want a reasonable return on their investments, but have other important “ethical” criteria for investments. They attempt to influence capital flows in such a way that “ethical” organisations have greater access to capital and therefore thrive. The “ethical” criteria typically include issues such as involvement in tobacco, human rights issues, sound labour practices and sound environmental policies. Investment in an ethical company is sometimes regarded as an investment in a better world for future generations (Brill & Reder 1993:56). This attitude has led to the establishment of ethical funds that invest in companies that ultimately have an environmentally sustainable and humane effect on society. A fund is normally regarded to be ethical if it applies either negative or positive ethical criteria in respect of investment. In the case of negative criteria, funds may steer clear of, for example, tobacco companies, whereas positive criteria could involve actively seeking to invest in companies that have good employment practices. Ethical investments and funds are quite popular in Western countries and the amount of capital managed by such funds is increasing. It is to be expected that the ethical investment industry in South Africa will expand.

In reaction to the growing social pressures exerted by the community, South African institutions began to develop infrastructure funds, development funds or RDP funds during the early 1990s (Mathews 1996:7). Some of the South African funds that cater(ed) for ethical investors are (De Vries & De Villiers 1997a: 19; Pretoria News 1998:4):

- Sanlam's Development Fund
- Southern Life's Future Growth Fund
- Standard Bank's Infrastructure Fund
- Fedsure's Sechaba Portfolio
- Norwich's Oasis Crescent Fund
- Syfret's Community Growth Fund and
- Southern's Pure Specialist Fund

Organisations which want to attract funds from these investors have to ensure that they comply with the ethical criteria of the investor/fund and give an account of their operations by publishing relevant information.

Another possible reason why organisations publish environmental information is to obtain positive publicity through the entry of their publications for an environmental reporting award. Two major South African reporting awards concentrate on environmental reporting. They are the WWF Environmental Annual Report Award and the University of Pretoria Award. The former invites entries and considers separate environmental reports. The UP Award is directed at environmental reporting in the annual report of all JSE-listed companies. Both of these awards afford opportunities for publicity and enhanced legitimacy.

Other forces at work in the popularising of environmental reporting is the International Standards Organisation's ISO 14 000 series of environmental management standards (ISO 14 001 1996) and a recent guideline by the South African Institute of Chartered Accountants (SAICA 1997). To gain ISO 14 001 certification, an organisation is required to implement an environmental management system. This entails among other things the reporting of relevant environmental information to top management (ISO 14 001 1996:3) and the organisation has to "consider processes for external communication on its significant environmental aspects" (ISO 14 001 1996:4). The customers of many South African organisations in Western countries, particularly Germany, oblige the organisations to gain ISO 14 001 certification. The SAICA guideline encourages the inclusion of among other things environmental information in the annual report.

The environmental surveys of KPMG (KPMG 1997, 1996) and their environmental consultancy business, both in South Africa and abroad, demonstrate the relevance and importance of the environment for contemporary business enterprises. An example that illustrates the fact that organisations can not ignore the environmental concerns of the community is

that of the Brent Spa oilrig. Royal Dutch/Shell had a permit to sink the rig in the North Sea when it reached the end of its economic life, but pressure from the environmental group Greenpeace forced the organisation to reconsider this option and to dispose of the rig in a more expensive way (Sunter 1997:32).

Many reasons and considerations for environmental reporting have been mentioned, but perhaps the importance of environmental issues, also for South African organisations, is illustrated best by what Jan Fourie, the executive director of Sasol, wrote recently (Fourie 1998:9):

...safe-guarding the environment... has become a corporate priority among world leading companies... To implement this vision and policy may require substantial changes in a company, but will ultimately lead to greater efficiency, increased profits, clear accountability and a happier workforce...

Thus far the importance of environmental reporting has been demonstrated, but no mention has been made of the types of environmental information that could or should be reported. This issue is addressed in the next section.

3 What to report: criteria for good practice

Environmental information may sometimes be required in the financial statements to comply with the requirements of generally accepted accounting practice (GAAP), for example a contingent liability of an environmental nature. However, the environment is not mentioned explicitly in any of the statements of GAAP. Other than these general (GAAP) requirements, there are no specific environmental reporting regulations in South Africa (Rabie, 1992:83). Some international bodies have, however, come up with recommendations regarding the environmental issues that should be disclosed by corporations. Perhaps the most influential of these organisations is the United Nations (1991:19-21). The United Nations' recommendations are pragmatic in nature and fairly simple to implement. Because of this emphasis on practicality and the importance of the United Nations as a world-representative organisation, its recommendations should carry considerable weight for enterprises that are considering environmental reporting. The United Nations (1998) recently published a more comprehensive "position paper" on the subject.

Another important body to have made recommendations is the Canadian Institute of Chartered Accountants. The CICA (1993) framework is somewhat more comprehensive than the United Nations' recommendations. It is also more structured and follows a natural flow from more general to more specific information. The proposed structure has two sections. The first mainly comprises general narrative information and the second detailed quantitative and narrative information. If a corporation follows this structure and reports the fact that it follows the CICA structure, users will gain valuable insight into the corporation's activities and be assured that it does not report good environmental news only.

In its recommendations, the Institute of Chartered Accountants in England and Wales (ICAEW 1992) did not go as far as its Canadian counterpart. Its publication is called a "policy and research agenda" instead of a discussion paper. The ICAEW's framework is again fairly comprehensive and could be used as a guide to more complete environmental reporting. The recommendations and frameworks of the United Nations, CICA and ICAEW are some of the most important initiatives in the establishment of environmental reporting standards. Other bodies and researchers have made recommendations and created guidelines of their own, but they will not be considered in the present context.

The many recommendations on the items of environmental information that should be disclosed, could be confusing. Some overlap and others have divergent structures. Apart from their lack of correspondence in respect of content and structure, they also do not agree on the extent of the detail required.

In addition to these problems, De Villiers (1996:201) found that the provision of too much information could lead to information overload, which could have the effect that disclosure has more costs than benefits. De Villiers therefore recommended minimum corporate environmental reporting requirements that take these constraints into account and are based on the popularity of the various types of disclosure amongst the users of financial statements. His recommendations are reproduced in Table 2.

Table 2

Recommended minimum requirements for corporate environmental reporting
<ul style="list-style-type: none"> • A descriptive overview of the major environmental risks and impacts of the organisation • The environmental policy of the organisation • Measurable targets in physical units and rand amounts, where applicable, based on the environmental policy, e.g. emissions • Performance against environmental targets and comparative figures (previous year) • Accounting policies for recording liabilities, provisions, contingent liabilities and catastrophe reserves • Environmental costs (energy; waste handling; treatment and disposal; legal compliance; packaging; fines; rehabilitation; recycling; etc) by category, charged to operating expenses during the period • Rand amounts of environmental liabilities, contingent liabilities and reserves established in the current period • Government environmental grants received • Likely effect of environmental policy on future capital investment and earnings • Environmental litigation in which the organisation is currently involved • Independent third party attestation of all environmental reporting

Source: De Villiers 1996: 202

The choice of where to disclose environmental information may also have a bearing on the type of information disclosed. For example, more detailed environmental information could be included in a separate environmental report than in an annual report. The issue of where to report, is discussed in more detail in the next section.

4 Where to report

The annual report of a corporation reaches a wide range of stakeholders and is regarded as a document that has considerable legitimacy. This may be a result of the fact that the annual financial statements, which are attested by an

independent third party, form an integral part of the document. Those parts of the annual report not required by the statute can be said to glimmer in the light of the legitimacy of the annual financial statements. The annual report is therefore an ideal medium to report on the environment. It has legitimacy and reaches a wide range of stakeholders. Gray *et al* (1995:82) regard the annual report as a means of creating and managing the image of the organisation when they state that:

...in keeping with the majority of the literature, the annual report is used as the principle focus of reporting. There is some justification for this. The annual report not only is a statutory document, produced regularly, but it also represents what is probably the most important document in terms of the organisation's construction of its own social imagery.

A variety of stakeholders also want environmental information to be published in the annual report. De Villiers (1998:159) found that the majority of South African managers, auditors and users of financial statements want more environmental information in annual reports. In the survey undertaken by De Vries & De Villiers (1997), mentioned earlier, 90% of the portfolio managers of unit trusts in South Africa indicated that they want more environmental information to be published annual reports. Deegan & Rankin (1997:5 80) also concluded that shareholders, stockbrokers, analysts, accounting academics and financial institutions regard the annual report "to be significantly more important than any other source of information concerning the organisation's interaction with the environment".

The 1996 annual reports of AECI and Palabora Mining Company were joint winners of the University of Pretoria Environmental Report Award for that year. Environmental information is typically found in various parts of the annual report. For example, references could be made to the following environmental aspects in parts of the annual report:

- 1 Mission statement of a company
- 2 Review of operations
- 3 Section on corporate governance
- 4 A dedicated environmental section
- 5 Chairman's report
- 6 Directors' report
- 7 Statement of accounting policy
- 8 Financial statements

In the AECI's annual report for 1996, the company disclosed its primary

objectives. One of the five objectives listed, concerns the environment, namely:

Advance safety, health and environmental standards and practice on an ongoing basis to ensure the well being of employees and of the communities in which the group operates.

This statement demonstrates a clear commitment by senior management to environmental concerns.

In another example of environmental reporting, the review by the Chairman, Deputy Chairman and Chief Executive of Palabora Mining Company indicated in the company's 1996 annual report that R17 million has been set aside for safety, health and environmental projects to be executed in 1997.

Separate environmental reports have their own advantages. For example, more information regarding the environment can be published in these reports and the contents can be tailored to the needs of a specific stakeholder group.

The 1996/1997 environmental report of Umgeni Water, which won the 1997 WWF Environmental Annual Report Award, is a good example of a separate environmental report. It is a 21 page, A4 size, full-colour document that comprises the following sections:

- 1 Foreword
- 2 Introduction to the company
- 3 Review of 1996/1997 environmental performance
- 4 Environmental policy
- 5 Environmental management programme
- 6 Integrated environmental management and the project life cycle
- 7 Impacts on the environment (with several subsections)
- 8 Umgeni Water's environmental outreach (with several subsections)

The report includes both narrative and quantitative information. Most of the quantitative information is not of a financial nature. It also includes many photographs, pictures and graphic representations.

Although the inclusion of environmental information in the annual report and the publication of a separate environmental report are not the only vehicles for the disclosure of environmental information, they can be described as the principal options. Specific circumstances may, however,

dictate swift reaction to events at a time when the annual report and/or the separate report may not be due for a considerable period of time. Press releases, information on the Internet and postal drops in neighbourhoods surrounding a particular site of operations are examples of alternatives for the publication of environmental information.

The management of an information system is an important part of the disclosure of environmental information. Some ideas on the issue are discussed in the following section.

5 How to establish and manage an environmental reporting system

De Villiers (1997b) suggested a checklist of activities for the achievement of excellence in environmental reporting. The checklist is given in Table 3.

Table 3

Checklist for the achievement of excellence in corporate environmental reporting
<ul style="list-style-type: none">• Ensure genuine commitment by top management• Train accountants• Set up a task force with the involvement of the accountant and environmental management• Set up systems to enable accountants to get the information they need in the format in which they need it• Do not duplicate data collection and processing - accountants should attempt to fit in with the existing system or it should be changed to satisfy everyone's requirements• Ensure that relevant items are disclosed• Ensure that items of environmental reporting of particular prominence in the industry are covered• Ensure that the information needs of all stakeholders are catered for

Source: De Villiers 1997b

The checklist has a few shortcomings. For example, it assumes that accountants will be involved. This is not necessarily the case, although the advantage of involving accountants is that they have extensive experience of

information systems. Another shortcoming of the checklist concerns the sequence of implementation. It could be decided what information is required for publication before establishing a system of data collection. The “relevant” information, important industry information and information needs of stakeholders may have to be considered before the system is established. In addition, the identification of stakeholders and their information needs can be given greater prominence.

The first item on the checklist is undoubtedly important. It is a fact of life in organisations that top management decides on the priorities and that these priorities are given precedence over all others. Jan Fourie (1998:6), the executive director of Sasol, writes:

The chief executive personifies the corporation. It is therefore not surprising that more and more chief executive officers play a direct and important role in giving a sustainable enterprise the attention and, thereby, the legitimacy it deserves.

Without the commitment of top management, any new initiative or programme is doomed to failure. The champion in the organisation for environmental reporting should ensure this important ingredient if progress is to be made.

The function of top management is by definition concerned with the continued success of the organisation. This may be defined in different ways for different organisations. Typically, growth and profitability may feature strongly. In recent times, economic value added and market value added have gained popularity as measures of success. These definitions of success may cascade into more detailed objectives or focal areas, such as an emphasis on customer service and quality. If any issue is to capture the attention of top management, it has to fit into at least one of these focal areas.

There are alternatives. If it is possible to demonstrate that the legitimacy of the organisation is at stake, top management may be compelled to rethink the existing focal areas or add a new one. Another, perhaps closely related, alternative is to show that the long-term survival of the organisation is at stake. Jan Fourie (1998: 6) of Sasol states that “more and more chief executives are making the connection between environmental management and survival”.

The champion of environmental concerns in an organisation has to secure

the commitment of top management to the issue. To achieve this, it is necessary to show how environmental concerns fit into the existing strategic focal areas or why they should become one of the strategic focal areas.

In the checklist, reference is made to the fact that “relevant” information should be disclosed and also that those environmental issues of importance to the industry should be disclosed. In the environmental management scheme ISO 14 001 (1,3), reference is made to “environmental aspects”. An environmental aspect is defined as an “element of an organisation’s activities, products or services that can interact with the environment”. It is furthermore envisaged that organisations should identify their own environmental aspects (ISO 14 001:3). Information on these environmental aspects will have to be disclosed. In other words, organisations that have ISO 14 001 certification have already identified the “relevant” environmental information.

In ISO 14 004, further guidance is given regarding environmental reporting. The guideline emphasises feedback from interested parties such as employees and the community (ISO 14 004:18). According to the guideline, there should be a process whereby employees and other interested parties can voice their environmental concerns. These concerns as well as the environmental policy and performance should be reported to interested parties, including the general public. The process for the identification of the concerns and the information needs of interested parties is represented by the last item on the checklist (stakeholder requirements). The information requirements of stakeholders will have to be addressed by research and it may be necessary for each organisation to conduct research in order to identify these information needs independently. The first step in this process would be to identify the stakeholders of the organisation and then to identify the most important (environmental) information needs of each of these groups. The process may be referred to as a stakeholder analysis.

Many problems in respect of an environmental information system will only emerge in the course of its implementation and will have to be dealt with as they arise.

6 Summary and conclusions

The environment is a major issue in the management of corporations. The disclosure of environmental information is an important way of

demonstrating the commitment of the corporation to sound environmental policies and practices. The demand for environmental information is on the increase. This trend could be viewed with trepidation or it could be considered to be an opportunity to explore the possibilities of disclosure and to take the lead. A positive reaction could inspire others to follow suit, but, more importantly, it could result in the promotion of the image of the corporation; and a positive image could result in an improved bottom line.

Environmental reporting can also be used in a constructive way to legitimise an organisation, attract ethical investors and win reporting awards. There appear to be many reasons why environmental disclosure makes good business sense.

A recommendation on the environmental issues that should be disclosed is contained in Table 2. Corporations can choose to disclose environmental information by using a variety of vehicles, including the annual report and a separate environmental report.

If there is a threat to an organisation's legitimacy, the threat will be of strategic importance to its management. Bringing the importance of the threat to the attention of top management and obtaining their commitment is the first step. Once their commitment has been secured, the organisation should be able to implement and manage an environmental management and reporting system.

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CJ de Villiers
Professor
Department of Accounting
University of Pretoria
Pretoria

DS Lubbe
Professor
Head: Gencor Auditing Research Unit
University of the Free State
Bloemfontein