

CHAPTER 1

THE RESEARCH PROBLEM AND BACKGROUND

1.1 INTRODUCTION

This introductory chapter gives a background to the subject matter of the study. The importance of the study is explained and the problem to be investigated is defined. The delimitations of the study are also outlined. The overall problem is separated into the different hypotheses to be examined. Finally the outline of the study is given by way of a chapter review.

1.2 BACKGROUND

The environment is increasingly discussed within the context of various disciplines. The corporate sector is no exception and the environment is establishing itself as an important business issue. The proliferation of reports and supplements in the financial press dealing with environmental issues bears testimony to this fact (for example: Financial Mail 1992; Finansies en Tegniek 1994; Financial Mail 1994; Gous 1994:6). The business community finds itself under increasing pressure from environmental groups and the community at large to conduct themselves in a more environment-friendly manner. Larger corporations may also be influenced by national and international conventions and programmes. Agenda 21, the United Nations non-binding plan of action for sustainable development, is an attempt to influence as wide an audience as possible to embrace environmentally sound policies (Wynberg 1993). In South Africa, the Reconstruction and Development Programme (RDP) recognises environmental concerns

as an important constraint to indiscriminate development (Ministry in the Office of the President 1994).

Business enterprises do not only use resources that they own but also resources that they do not own, such as fresh air and water. These resources, arguably, belong to society. Society gives business enterprises the right to use these resources. Society can, therefore, also take away these rights. This can be achieved through legislation or through protests or through market forces (not buying the products of a particular business enterprise). In other words, society expects business enterprises to act responsibly towards the environment. If they do not, then society will penalise them by taking away some of their rights. Business enterprises can be said to have a stewardship function over the environmental resources under their control. If society is not satisfied with their conduct, their legitimacy will be questioned.

Business enterprises have constantly to meet the test of legitimacy as defined by society (Shocker & Sethi 1974:67). If they do not measure up, their continued existence will be at stake. The legitimacy argument is only one of many for business enterprises to make voluntary environmental disclosures (Gray 1993:211).

Shareholders, the suppliers of foreign capital, the government, employees, customers and potential customers, as well as the general public all claim a right to environmental information (Canadian Institute of Chartered Accountants (CICA) 1993:1-2). Some of these groups are only interested in environmental information to enable them to assess the financial impact of the corporation's environmental conduct, whilst others may have moral motives or watchdog motives. Whatever the motives of those who demand the information or those who disclose the information may be, the fact remains that environmental disclosure is on the increase in South Africa (Steyn and Vorster 1994:44).

Due to a lack of legislation in South Africa, disclosure is done voluntarily. The only compulsory disclosure is where generally accepted accounting practice (GAAP) dictate it.

An example is contingent liabilities, where the contingency is of an environmental nature. The question arises whether different stakeholder groups are aware of the implications of current financial implications and disclosure requirements of environmental matters.

Because disclosure of environmental matters is voluntary many companies will continue to refrain from disclosure or concentrate on positive aspects, while information on negative aspects is withheld (Bogiages and Vorster 1993:53; Deegan and Rankin 1995:13,14). If users of financial statements expect negative environmental information to be withheld, the value of the disclosed information to the users is limited. This is because it would be difficult to assess the completeness of disclosures and it becomes little more than a public relations exercise. Should some form of environmental disclosure be made compulsory, more information will become available and from the user's perspective the value of the disclosures currently made could be increased.

Environmental disclosure could be made compulsory by amongst other things amending the Companies Act or by issuing a statement of generally accepted accounting practice (GAAP). Regulation will, however, only be feasible if a need is perceived by the community. The question therefore arises whether the community (or groups within the community) wants more corporate environmental disclosure or whether the status quo should be maintained.

1.3 THE PROBLEM

This research proposes to establish the awareness levels of individuals belonging to various stakeholder groups of the potential financial impact and disclosure requirements of environmental issues on business enterprises. Furthermore, the willingness of those individuals to support more comprehensive corporate environmental reporting will be established. An appropriate approach by the accounting profession to the future of corporate environmental reporting will be drafted with the benefit of the study of the literature and the insights gained from the empirical study.

1.4 THE IMPORTANCE OF THE STUDY

The study will highlight awareness levels and the reaction to more comprehensive environmental reporting of various stakeholder groups. If, as hypothesis 1 suggests, the awareness levels are low, the education of the different groups may be advised. This is so, because if a material environmental item is not adequately covered in the financial statements in the fashion dictated by GAAP, users may take "wrong" decisions which could be to their detriment financially. The managers of such companies and their auditors may be at risk of being sued for damages.

If the willingness to support more comprehensive environmental reporting is low, then this will probably not happen. If, however, the stakeholder groups are found to be positive about more environmental reporting, more reporting will follow either spontaneously or through the intervention of laws and rules.

Just as the environment is an important issue in society, corporate environmental reporting is an important issue in the business community. The future of this kind of reporting needs to be subjected to scientific investigation.

1.5 DELIMITATIONS

The stakeholder groups to be included in the study are limited to the preparers, the auditors and the users of the financial statements.

The preparers of financial statements are regarded as being the managers and the directors of business enterprises. Only directors of companies listed on the Johannesburg Stock Exchange (JSE) are included in this group.

Auditors of financial statements are members of the South African Institute of Chartered Accountants (SAICA) who are also registered with the Public Accountants' and Auditors' Board (PAAB). Members not resident in South Africa are excluded.

In the user group an attempt was made to accommodate the various types of users as defined in the accounting framework (SAICA 1990:09). However, the users included in the survey had to have a level of "financial awareness", otherwise they would not have a framework for the proper appreciation of the questions.

Further elaboration on the delimitations mentioned above is to be found in the methodology sections of Chapters 4 and 5.

1.6 HYPOTHESES

The problem described in 1.4 can logically be divided into 3 sub-problems. The sub-problems will be investigated with the use of hypothesis testing and analysis as explained below:

Hypothesis 1

Regarding the awareness levels of individuals belonging to various stakeholder groups of the potential financial impact and disclosure requirements of environmental issues on business enterprises:

H₀ Awareness levels amongst individuals in the three stakeholder groups are low.

H₁ Awareness levels amongst individuals in the three stakeholder groups are high.

Hypothesis 2

Regarding the willingness of individuals belonging to various stakeholder groups to support more comprehensive corporate environmental reporting:

H₀ Individuals are on average not willing to support more comprehensive corporate environmental reporting.

H₁ Individuals are on average willing to support more comprehensive corporate environmental reporting.

Recommendations for the accounting profession and government

Regarding the future of corporate environmental reporting.

The guidelines will be based on the literature study and the empirical study.

Recommendations for the accounting profession and government

Regarding the minimum requirements for corporate environmental reporting.

The guidelines will be based on the literature study and the empirical study.

1.7 THE OUTLINE OF THE STUDY

The outline of the study by chapter is explained below:

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| Chapter 1 | The background, importance, delimitations, hypotheses and the outline of the study. |
| Chapter 2 | The reasons for and against corporate environmental reporting are discussed. |
| Chapter 3 | Current reporting requirements are examined. The types of corporate environmental reporting done in practice and the reporting recommended by various bodies and individuals are described. The reasons for various questions in the questionnaire are provided. |
| Chapter 4 | The research methodology of the first empirical study is explained. The research results and conclusions based on the first empirical study are outlined. |
| Chapter 5 | The research methodology of the second empirical study is explained. The research results and conclusions based on the second empirical study are outlined. The research results of the two empirical studies are contrasted to each other. |
| Chapter 6 | The final conclusions and recommendations are summarised. |