

UNITED NATIONS CONFERENCE ON TRADE AND DEVELOPMENT

GUIDANCE MANUAL

ACCOUNTING AND FINANCIAL REPORTING FOR ENVIRONMENTAL COSTS AND LIABILITIES



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ACCOUNTING AND FINANCIAL REPORTING FOR ENVIRONMENTAL COSTS AND LIABILITIES

Workshop Manual

*prepared for the United Nations Conference on Trade and
Development (UNCTAD) by:*

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*UNCTAD/ISAR: Intergovernmental Working Group of Experts on International
Standards of Accounting and Reporting (ISAR)*

CICA: Canadian Institute of Chartered Accountants

ACCA: Association of Chartered Certified Accountants.

Ellipson Ltd.

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Workshop Manual

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1. INTRODUCTION TO GUIDANCE MANUAL ACCOUNTING AND FINANCIAL REPORTING FOR ENVIRONMENTAL COSTS AND LIABILITIES

Introduction

Environmental financial accounting deals with accounting for and reporting on environmental transactions and events that affect, or are likely to affect, the financial position of an enterprise. One of the challenges is to ensure that 1) environmental costs and liabilities are accounted for by following relevant accounting standards or, in their absence, generally accepted accounting practices, and 2) the meaningful disclosure of the environmental performance of an enterprise is provided. A further challenge is to ensure that appropriate management accounting procedures are, where necessary, developed, and used, for instance, to cost out pollution controls, to compare alternative materials that can be used in manufacturing, and to investigate recycling alternatives.

Objective of the Manual

The objective of this manual is to inform and give guidance on environmental accounting issues, and identify best practices that may be considered by national standard setters in the development of their own accounting standards, rules or regulations. The manual was originally designed as a training tool for the UNCTAD's workshop series on Environmental Accounting and Reporting. In order to explore the full range of possible disclosures on environmental issues, sections on environmental reporting and environmental performance indicators (EPIS) have been added to the manual. These complementary section reflect the findings of UNCTADs broader work programme.

It is not UNCTADs objective for actual guidelines or standards to be written during the workshop. An ultimate aim coming out of the workshops is for local partners to adopt this guidance material and to create local centres of excellence, promulgating this material. At the conclusion of the workshop, participants should:

- **be familiar** with the various issues of environmental accounting
- be able to begin to **integrate** environmental issues into conventional financial accounting, cost accounting and the financial statement audit
- **identify** areas where accounting guidance is needed
- **know** which enterprises are currently 'leading the field' in environmental accounting and their pronouncements; and be able to use these pronouncements for designing future guidance.

Scope of the Manual

This manual is primarily based on work that has been, undertaken by the UNCTAD-ISAR¹ group, the European Accounting Advisory Forum, and accounting organisations and standard-setting bodies in Canada, the United Kingdom and the United States. A survey of other countries was undertaken, and responses were received from Brazil, China, the Czech Republic, Germany, Korea, Mauritius, the Netherlands, Pakistan, Poland, Russia and Switzerland. A number of countries indicated that they had Statements on the basic concepts on accounting similar to those that had been issued by UNCTAD-ISAR and the IASC, which, as is noted in the preamble to the *Position Paper*,² provide the basic underpinning for accounting for environmental costs and liabilities.

The *Position Paper Accounting and Reporting for Environmental Costs and Liabilities within the Existing Financial Reporting Framework (1998)* on which the manual is based deals with accounting for and reporting of environmental costs and liabilities arising from transactions and events that affect, or will likely affect, the financial position and results of an enterprise and, as such, should be reported in an enterprise's financial statements. The recognition and measurement of costs or events that are not absorbed by the enterprise are not covered.

What It Is – What It Is Not

The manual covers only those environmental costs that can be dealt with under the existing financial reporting framework. These are often referred to as 'internal costs' and generally arise because of a transaction between the reporting entity and another party.

The manual does not cover the recognition and measurement of costs that are external to the entity, such as the impact of air pollution and water pollution on the environment, and that are not currently absorbed by the entity (often referred to as 'external costs'). It should be noted, however, that the boundaries of internal costs are not static. Legislation and other measures can impose an obligation on an entity to undertake specific action for which there was previously no such obligation, thereby converting an 'external cost' into an 'internal cost.' It should also be noted that a number of entities and industry associations are exploring appropriate ways of reporting 'external costs' relating to the environmental impacts of their operations.

Technical updates

The 2002 edition of the manual includes technical accounting developments that have taken place since the release of the UNCTAD Position Paper in 1998 and additional teaching materials used by trainers during the UNCTAD workshop series.

¹ The United Nations Conference on Trade and Development – (United Nations Intergovernmental Working Group of Experts on) International Standards of Accounting and Reporting.

² The technical position paper endorsed by the Inter-governmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) was presented on its fifteenth session February 1998.

To date there is no general statement that addresses the environment directly and the subject does not feature in the agenda of the International Accounting Standards Board (IASB). There is no international accounting standard requiring the automatic disclosure of any such items. In the absence of any mandatory reporting requirement the recognition, measurement and separate disclosure of environmental expenditures and liabilities is governed by the accounting concept of materiality.

The nearest the IASB has come to dealing with environmental issues directly is *International Accounting Standard (IAS) 37 on Provisions, Contingent Liabilities and Contingent Assets* whose appendices draw on environmental examples to illustrate accounting treatment. Accounting issues identified by IAS 37 will be subject to the application of the materiality concept. In addition, the International Federation of Accountants (IFAC) is currently working on proposals for an accounting standard for public sector bodies (*Exposure Draft 21 Provisions, Contingent Liabilities and Contingent Assets*) drawn up primarily from IAS 37. It is noteworthy that standards and related guidance are not always mandatory in the local context. IAS 37 is only currently subject to voluntary adoption (introduced 1 July 1999).

Across Europe national standards tend to take precedence. The UK's Financial Reporting Standard (FRS) 12 and IAS37 are almost identical standards on Provisions, Contingent Liabilities and Contingent Assets. From 2005 all listed companies within the European Union will be required to use International Financial Reporting Standards (IFRS's is the new name for International Accounting Standards).

ISAR is also pleased to acknowledge that the European Commission's 2001 *Recommendation on the recognition, measurement and disclosure of environmental issues in the annual accounts* compares favourably with ISAR's Position Paper.

How to use the manual

As noted previously, this manual was prepared by UNCTAD as a guide to environmental accounting and reporting. It includes guidance on the use of financial and non-financial performance indicators of environmental performance. The manual has been designed as a starting point for all those interested in environmental accounting from policy makers and standard setters to practitioners and academics, trainers and students. It can be read in its entirety or each section can be read as a standalone unit of analysis.

UNCTAD's international workshop series provides one example of how the manual can be used. The manual was initially designed as the main background document for workshop participants. The three technical guidance sections formed the basic structure of each workshop. Workshop participants highlighted the use of the manual as both a classroom

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