

Environmental Disclosure in Financial Reporting: Update and Recommendations

Executive Summary

This report summarizes the state of environmental information disclosure in North America, documents the gap in what is being reported and what the market and regulations demand, and proposes concrete steps by which the environmental agencies and ministries in North America could help the securities agencies narrow this gap. One obvious gap is in enforcement of rules requiring disclosure of financially material information. Actions needed to narrow this gap include:

- Hold a high-level meeting between environmental and securities regulatory agencies to explore further collaboration;
- Establish a liaison office for facilitating the flow of information from the environmental agency to the securities regulator;
- Review publicly available environmental databases to make them more accessible and more useful to analysts and investors;
- Explore the possibility of establishing a telephone service for analysts and investors that would direct their questions to relevant branches and sources of expertise within the environmental agencies/ministries;
- Establish within the agency an Internet web site containing links and directories to potentially useful environmental information, searchable by companies;
- In Canada, collaborate with the Department of Finance to strengthen the case for including environmental information in Public Accountability Statements;
- Increase awareness of financial executives of the potential advantages of better evaluation of their companies' prospects by investors and analysts arising from more complete, timely and relevant environmental disclosures about matters beyond just site remediation costs and liabilities.
- Hold a high-level meeting between corporate financial management, environmental agencies/ministries, securities regulators, auditors, accountants and rating agencies to identify options for a public/private partnership that would help foster a healthy financial sector in North America.

I. Environmental Disclosure in Financial Reporting—An Unmet Need

Mandatory disclosure has become a widespread public policy instrument, employed to protect the public and to improve the performance of businesses and government in fields as diverse as food safety, fuel efficiency, management of toxic substances, sales of financial securities and many others. Disclosure is a policy tool that has appealed to both liberals and conservatives because it relies on informed consumer and public choice rather than direct regulation. Disclosure typically increases market efficiency by eliminating informational asymmetries between sellers and potential buyers. Such asymmetries often distort market prices and sometimes deter market transactions altogether. Publicity provides strong incentives for business and government managers to improve performance by lessening the possibility of shielding inferior or excessively risky products and services behind a veil of secrecy.

Trends in mandatory disclosure

The effectiveness of mandatory disclosure as a policy instrument has been reinforced in the last two decades by several ongoing trends. The progress of the Internet and other media technology has dramatically improved the ease and speed of communication and has lowered its costs. Citizens and consumers can now diffuse information across the globe through decentralized linkages within hours or minutes. Complementing these trends, in many sectors of the economy, the market value of many companies has become an increasing multiple of the book value of its tangible capital. Ever more of a company's market value consists of intangible assets, including its brand names and business reputation. Since strategic alliances, supplier networks, complex chains of financial relationships and other networks have become an increasingly prominent aspect of the business world, compromising a firm's reputation can result in devastating loss. Losses of reputation can also undermine consumers' loyalty to a brand and make it more difficult for a company to recruit and retain high-quality employees.

In the environmental realm, mandatory disclosure programs have been notably successful as a tool to promote sustainable development, a prominent objective of the North American Free Trade Agreement. In the United States, the EPA's Toxics Release Inventory has not only informed the public about potential hazards in their communities, it has also provided a strong stimulus for companies generating reportable quantities of toxic substances to reduce their generation and release.¹ Subsequent to the publication of TRI data, prominent companies such as DuPont and Dow Chemical, among many others, have entered into voluntary commitments to achieve major reductions, largely through pollution prevention initiatives. Explaining these commitments, CEOs of these companies have cited the need to protect their firms' reputations. It has also been documented that the companies with the largest reported quantities of toxic materials in the inventory experienced adverse stock market reactions, adding a financial impetus to their management's pollution reduction efforts.

In Canada, the National Pollutant Release Inventory (NPRI) has had a similar success, prompting many companies to embark on accelerated pollution prevention and reduction programs, especially when also under some regulatory threat.² Also, Mexico has initiated a similar reporting system, designated *Registro de Emisiones y Transferencia de Contaminantes* (RETC), with voluntary participation by many significant Mexican companies for the 2000 reporting year.

In 2001, the government passed enabling legislation, paving the way for the issuance of regulations making reporting mandatory.³

Emissions reporting requirements, such as those embodied in the TRI, NPRI, and RETC, have stimulated managers in some companies to quantify emissions on a plant and company-wide basis for the first time. On the principle that “you manage what you measure,” this expanded measurement has by itself encouraged better environmental control. In addition, greater transparency has discouraged management from pursuing unduly risky environmental policies that might save money in the short-run but would expose the company and the public to excessive potential damages longer term.

Public disclosure can be an even more advantageous policy tool in countries in which the government’s administrative capacities to operate an efficient environmental regulatory system is less fully developed. In such settings, publicity can serve as a powerful instrument with which to mobilize public opinion against those companies with lax environmental practices. A recent World Bank publication has documented the effectiveness of disclosure programs in influencing industrial polluters in countries throughout South and Southeast Asia.⁴

When disclosure is warranted

Within an overall information strategy, a mandatory requirement that companies disclose to the investment community the material financial implications of their environmental exposures is also increasingly important. When the Securities and Securities Exchange Acts of 1933 and 1934 enshrined disclosure as the principal means for regulating financial markets in the United States, Justice Brandeis said, “Sunlight is the best disinfectant.” Since then, financial disclosure has become even more powerful, for several reasons. For one, the influence of external financial markets on management decision-making has become more pronounced. As a source of capital, relationship-driven banking has declined in importance while more impersonal financing through publicly traded securities has increased. Within financial markets, an ever-larger percentage of assets are controlled by institutional money managers, who are capable of large, rapid portfolio shifts in response to new information. Consequently, unpleasant surprises can lead to massive sell-off of a company’s securities and rapid decline in their value. This is particularly true when the surprising information undermines investor confidence in a company’s management and raises investor uncertainty about possible future revelations.

For example, the stock of Solutia, a company formed when Monsanto spun off its chemical division, plunged by almost 60 percent within a few weeks when an article in the *Washington Post* revealed that Monsanto had dumped tons of PCBs in Anniston, Alabama, and had covered up its behavior for decades. The company’s behavior was deemed “outrageous” by an Alabama jury that held the company liable for negligence, suppression of truth, and nuisance, opening Solutia to further lawsuits. In another well-known case, the stock of US Liquids, Inc., a Houston waste-management firm, fell 58 percent in one week when employees revealed to government authorities that the company had illegally dumped hazardous wastes and falsified records. Consequently, shareholders filed suit against the company for violation of securities law by issuing false and misleading reports and failing to disclose material information.

These instances illustrate not only the power of publicity in financial markets but also the temptations into which managers can fall when they think imprudent or improper activities can be hidden from public scrutiny. As managers' compensation is more closely tied to stock market performance through stock options and performance-linked bonuses, and as financial analysts focus ever more closely on quarter-by-quarter earnings, the temptation to manage earnings through short-sighted strategies has become more powerful. Though in recent years this has been made more obvious by the accounting irregularities and financial engineering of such companies as Enron and Worldcom, the temptation to pursue short-sighted environmental practices may be no less strong. The experiences with Solutia and US Liquids also illustrate the dramatic damages that can be suffered by companies and investors through lack of transparency regarding environmental risks and exposures. The recent revelations in the United States of accounting irregularities, executive self-dealing, and other corporate scandals have reduced investor confidence in corporate management to a minimum and, if anything, have increased the potential damages to companies and investors when hidden information becomes public.

Disclosure and investment

Another important objective of the North American Free Trade Agreement is to promote investment in the signatory countries. Financial transparency is an important means to this goal. By reducing uncertainty and perceived risk, greater transparency reduces financial volatility and lowers the cost of capital. An important reason for the home-country bias that impedes international investment in particular is the disadvantageous informational asymmetry that investors perceive in venturing outside their own borders. The contagion that aggravated past international financial crises stemmed mainly from investors' inability to differentiate between one emerging financial market and others, largely because of lack of transparency. Therefore, actions that will increase the amount of financially material information readily available to investors will promote investment, including cross-border investment, reduce financial market volatility, and lower the costs of capital.

Improved disclosure will also increase the efficiency with which financial markets allocate capital to the most productive uses. At present, because information is not adequately available about environmental exposures that may affect future costs, earnings, and capital outlays, investors have difficulty in identifying companies that have better prospects and lower risks. Several studies of environmentally sensitive sectors of the economy, such as oil and gas, pulp and paper, and electric power, have demonstrated that individual companies within those sectors vary widely in their financial exposure to impending environmental developments, largely because of the companies' past business decisions.⁵ These differences in exposure can lead to competitive advantages and disadvantages among companies within an industry and highly material impacts on shareholder value for the most exposed companies. In environmentally sensitive industries, the success with which companies manage their environmental exposures and risks can be a significant determinant of their value.

When more could be disclosed

Yet there is a significant unmet need in financial markets for greater disclosure of material environmental information. At present, although some companies release environmental reports and statements, these are very rarely linked to financial reports nor are their financial

implications explained.⁶ Financial analysts report great difficulty in linking environmental to financial information. Consequently, analysts typically place little weight on environmental factors in evaluating a securities risks and potential returns, even in those sectors in which such factors are demonstrably significant.⁷

Despite a general rule in the securities laws of all three NAFTA member countries that publicly traded companies disclose all financially material information in a timely manner, few companies with significant environmental exposures actually do provide such information in their financial statements and filings. A study of thirteen large companies in the US pulp and paper industry found that, for the most exposed companies, the most likely estimate of the financial impact of important impending environmental rules was an 8 to 10 percent loss in total shareholder value. Yet only three of the thirteen companies mentioned these environmental issues at all in their financial statements, and those three did so only in a cursory, qualitative fashion.⁸ Comparable studies in other industries have arrived at similar findings.

The lack of material environmental information is especially pronounced in those sections of financial statements intended to disclose business trends and uncertainties significant for the company's future earnings and financial conditions, such as the Management Discussion and Analysis of financial statements. A report recently made public by the Securities and Exchange Commission on their review of financial statements filed by the largest US Fortune 500 companies stated:

We found that we issued more comments on the MD&A discussions of the Fortune 500 companies than any other topic. Item 303 of Regulation S-K requires ... [a discussion of] known material events and uncertainties that would cause reported financial information not to be necessarily indicative of future operating results or of future financial conditions. ... Our comments addressed situations where companies simply recited financial statement information without analysis or presented boilerplate analysis that did not provide any insight into the companies' past performance or business prospects as understood by management.⁹

Such information is crucial for investors, because the value of securities depends on the stream of future returns and their riskiness. In many industries, future returns and risks are significantly affected by environmental exposures. Because these are inadequately disclosed and analyzed, investors often suffer sudden and significant losses when those risks materialize. In addition to the examples mentioned above, many companies have undergone sharp falls in stock value and some have been pushed into bankruptcy by environmental spills, accidents, pollution releases, clean-up requirements, and lawsuits. Most of these occurrences were the culmination of environmental exposures and risks that existed beforehand but were not disclosed and were not understood by investors, who consequently suffered serious losses.

Financial markets are now asserting a growing demand for transparency, in part because of these experiences. According to a recent *Standard and Poor's Transparency and Disclosure Study*,

Public companies around the world are increasingly under pressure from the ongoing ‘corporate governance revolution’ in which large institutional investors are intensifying the pressure on management to disclose all material information.

A corroborating study by the accounting and consulting firm Ernst and Young found, after a study of share performance in 1000 largest global companies, that poor investor relations was the third-most-frequent cause of sudden and major drops in share value. Companies that are lax on disclosure are more vulnerable to share price volatility than those that provide qualitatively good information. Moreover, investors have shown that they are willing to pay a premium for companies with superior disclosure records.¹⁰

In the United States, in the wake of corporate scandals, new requirements have been adopted requiring CEOs and CFOs to certify the accuracy and completeness of their financial statements, requiring more independence of corporate directors from management, requiring corporation lawyers to take action if accounting or reporting irregularities are discovered and not corrected, and requiring separation of auditing and advisory functions. In addition, the administration and Congress have markedly increased appropriations of funds to strengthen the enforcement capabilities of the Securities and Exchange Commission, which itself has taken steps to tighten disclosure standards.

The demand for more disclosure extends to environmental information. The SEC review of Fortune 500 company disclosures found specifically that information on environmental exposures and liabilities was frequently deficient. An increasing number of shareholder resolutions are being filed asking management for disclosure of material environmental information. In Canada, shareholders of Imperial Oil recently submitted a resolution requiring the company to spell out potential financial liabilities associated with its greenhouse gas emissions and to put in place a plan to reduce those liabilities. Worried about lawsuits against emitters of so-called greenhouse gases, Zurich-based global insurance titan Swiss Reinsurance Co. plans to start mailing out questionnaires in the next few weeks in which it will ask customers of directors-and-officers insurance what they are doing to prepare for imminent government restrictions on greenhouse gas emissions. If Swiss Re decides a client isn’t doing enough, it may consider refusing the company directors-and-officers liability coverage when, in a few years, certain countries begin implementing those rules. Directors-and-officers liability coverage, which protects a company’s directors and named officers from personal liability in lawsuits alleging they mismanaged the company’s affairs, already has grown tougher and costlier for companies to get amid the spate of corporate scandals.¹¹

In the United States, earlier this year an investor coalition that includes the State of Connecticut’s [Retirement] Plans and Trust Fund filed resolutions with five of the largest US electric power companies requesting that they disclose to shareholders the economic risks associated with emissions of carbon dioxides and other air pollutants and the business benefits associated with reducing those emissions. In an important recent development, Institutional Shareholder Services, an organization that advises pension and mutual fund managers on how to vote their proxies, endorsed these shareholder resolutions.¹² This endorsement potentially adds institutional money managers controlling hundreds of billions of dollars in assets to those demanding more environmental transparency. The Carbon Disclosure Project, an even larger initiative backed by thirty-five of the world’s largest institutional investors, has been urging companies to disclose

their greenhouse gas emissions and the risks they pose to the companies, and the extent of their emission reduction programs.

Another trend sustaining the demand for more environmental disclosure is the increasing share of investor assets held in environmentally screened or “socially responsible” mutual funds and portfolios. Such portfolios now hold at least a trillion dollars in assets. Their growth has been stimulated by two factors. First, the replacement of defined-benefit pension plans with defined-contribution plans in which beneficiaries have greater control over asset allocation leading money management firms to create and offer screened portfolios or funds as an investment choice. For this reason, among others, almost all major investment houses now have staff responsible for environmental evaluation and research. Second, the demonstration in recent years that screened portfolios often provide risk-adjusted returns superior or equal to unscreened benchmarks has encouraged investors to allocate at least a portion of their assets to the environmentally screened portfolios. Both factors in combination contribute to the demand for financially relevant environmental information. First-generation screens merely eliminated companies or entire industries that were deemed socially unacceptable. They are being replaced by research carried out by such firms as IRRC, KLD, Innovest and Sustainable Asset management that seeks to understand which companies are likely to provide higher risk-adjusted returns by virtue of their superior environmental and sustainability practices. These developments have reinforced financial market demand for relevant environmental information.

II. Environmental Disclosure in Financial Reporting – An Opportunity within Reach

Such information should be forthcoming under existing general requirements in the securities laws of Mexico, Canada and the United States that companies promptly disclose all material information, since some environmental information is clearly of material financial importance. In addition, there are more detailed and specific environmental disclosure requirements in US and Canadian securities regulations that have been clarified through published accounting standards and explanatory releases by securities regulators. These detailed disclosure requirements cover such matters as the costs of compliance with environmental regulation, liabilities for remediation and restoration of contaminated property, potential damages from environmentally-related legal actions, and other known environmental risks and uncertainties.

However, concerns have been raised regarding the extent to which these requirements are being complied with or enforced, partly as the result of the sector studies and individual cases mentioned above. Last year the US Senate requested the General Accounting Office to investigate the adequacy of environmental disclosure by corporations publicly listed on US securities markets, and of the SEC’s enforcement of its own requirements. This request followed the release of a 1998 study by EPA that found that 74 percent of the companies subject to environmental legal proceedings that should have been disclosed under SEC rules had failed to do so. In Europe as well, the European Commission issued stricter non-binding guidelines in 2001 for disclosure of environmental costs and liabilities, in response to a finding that unreliable and inadequate information about environmental performance “makes it difficult for investors...to form a clear and accurate picture of the impact of environmental factors on a company’s performance or to make comparisons between companies.”¹³

Lack of enforcement: A problem

In fact, enforcement of environmental disclosure requirements in the past has been minimal. In Mexico, a search revealed no instances in which companies were disciplined for failure to disclose financially material environmental information. In Canada, only a single such case involving environmental disclosure was found within a period of twenty-five years. In the United States, only a handful of cases were found.¹⁴ Enforcement has not been vigorous in years past because environmental issues were not salient among all the securities regulatory issues that the responsible agencies were faced with. Moreover, those agencies have typically been understaffed and under-funded to the extent that they were able to deal with only the most urgent and egregious issues.¹⁵

In the absence of enforcement efforts, compliance with existing disclosure requirements by the private sector has been scanty. Many companies have not even complied with the letter of the law, failing to reveal environmental legal proceedings—as mentioned above—or failing to disclose an accurate estimate of their environmental obligations and liabilities. More conscientious companies have typically complied with the letter of the law, but have revealed as little as possible, taking refuge in uncertainties regarding future costs or financial impacts. Very few companies have complied with the spirit of existing securities law that require disclosure of all material information and material risks known to management that would significantly affect the financial conditions or results of the enterprise and make failure to disclose such information a punishable offence.¹⁶

Lack of enforcement: An opportunity

Nonetheless, experience has shown that even a relatively modest enforcement effort by government agencies can lead to a substantial improvement in disclosure practices by private corporations. Corporations are advised by legal counsel whose function is to protect the company from legal difficulties, prominent among which would be difficulties with securities regulators. If a government notification or an action taken against a single company were to signal that new emphasis is being placed on environmental disclosure, those signals would reverberate powerfully through corporate boardrooms and executive suites.

Evidence is available from US experience with the disclosure of site remediation obligations. Early experience in implementing CERCLA (Superfund) revealed that there were very many sites requiring remediation and that the costs of cleaning up a site could be large. The gap between those estimated costs and the liabilities recorded in corporate financial statements was conspicuously large. Subsequently, very few SEC actions against companies and some explanatory releases clarifying disclosure obligations led to further actions by accounting standards bodies, a host of articles in journals and periodicals serving corporate lawyers, and a very pronounced improvement in the disclosure of site remediation liabilities in company financial reports throughout the American industry. A relatively small enforcement effort led to a large improvement in disclosure practice for this particular category of environmental issues.

Moreover, increased transparency has led to significant capital market developments in handling site remediation risks more efficiently. Property and casualty insurance companies that withdrew pollution coverage after being saddled with unexpected remediation costs now offer insurance

against remediation liabilities and cost overruns in cleaning up contaminated sites. Banks now routinely consider contamination risks in lending against industrial and commercial property. Because of greater transparency these environmental risks are now priced and allocated more efficiently by capital markets.

However, in the absence of effective government or regulatory action, neither transparency nor capital market efficiency has yet spread beyond disclosures about site remediation to other environmental risks. An opportunity still beckons to use existing securities regulations to stimulate fuller disclosure of material environmental information to financial markets and investors, thereby simultaneously promoting improved environmental performance by the private sector while protecting investors, promoting capital investment and increasing capital market efficiency. Taking advantage of this opportunity does not require new legislation or regulation but merely more vigorous application of existing rules.

The chances for this opportunity to be acted upon beneficially can be further enhanced by two other courses of action that are certainly available in Canada. The first would be to increase awareness of financial executives of the potential advantages of better evaluation of their companies' prospects by investors and analysts arising from more complete, timely and relevant environmental disclosures about matters beyond just site remediation costs and liabilities. Projects planned under a loose partnership by the National Round Table on the Environment and the Economy, the Conference Board of Canada, the Canadian Institute of Chartered Accountants, Environment Canada, US EPA and the CEC all aim to engage business and capital market participants in ways likely to foster this greater understanding and its implications for finance and disclosure.

The second course of action, flowing from the first, would be better use of the Management's Discussion and Analysis report as a communication vehicle that can include disclosures beyond the minimum required by the present rules of securities regulators. The MD&A Guidance (2002) issued by the Canadian Institute of Chartered Accountants (CICA) recommends that companies use the MD&A to present and discuss matters such as strategy, key performance drivers and principle business risks of all types that are necessary for investors to obtain a clear understanding of a company's performance and prospects beyond what it is possible to express in financial statements alone. Specifically, this MD&A Guidance calls for disclosures about environmental responsibility that are key to success in strategy and performance—presumably topics of special significance for companies in certain sectors. This Guidance is voluntary, but companies that are progressive in their investor relations and dealings with capital markets are expected to give serious consideration to implementing the recommended broader disclosures. And, as previously noted, securities regulators in Canada and the US are now paying a great deal more attention both to the adequacy of company MD&A reports and of the disclosure requirements.

III. The Potential Role of Environmental Ministries and Agencies in Stimulating Greater Disclosure

Of course, the primary responsibility for enforcing financial disclosure requirements rests with securities regulators, stock exchanges, accounting standards bodies, and auditors. Recent developments, particularly in the United States, have strengthened the capabilities and the resolve of these institutions to ensure adequate disclosure of material financial information in general, though not of material environmental information particularly.

There are relatively simple and low-cost initiatives that environmental ministries and agencies might take to make sure that this increased attention to disclosure issues extends to financially significant environmental information. Some such steps have already been taken. In October 2001, the US EPA issued an enforcement alert emphasizing the obligation of publicly listed companies to disclose environmental legal proceedings and other material environmental information.¹⁷ In that document the EPA revealed that it had begun notifying companies subject to certain enforcement actions of their potential duty to disclose, and had established informational links to the SEC's enforcement division. Strengthened liaison with securities regulators could be taken.

A useful first step to strengthen this liaison might be a consultation at management level between environmental and securities regulatory agencies in the US, and between counterpart agencies in Canada and Mexico, to explore useful avenues for further cooperation. Securities regulators are often handicapped by a lack of information about environmental matters that are not disclosed but perhaps should be. They have scant resources with which to deal with their growing and increasingly complex responsibilities. Without assistance, they often experience difficulty in finding out what regulated companies are not disclosing. Environmental ministries and agencies can help in providing this needed information. As a start, they could *establish a small liaison office to facilitate contacts with securities regulatory agencies*. This liaison office can be responsible for facilitating the flow of information from the environmental agency to the securities regulator and for redirecting questions from the former to the appropriate branches of the latter. Certain kinds of information could be shared between the two agencies on an ongoing and regular basis. Such information might include:

- 1) texts of proposed major new regulations, and timetables for finalization, promulgation and compliance;
- 2) accompanying regulatory impact analyses, including analyses submitted by industry groups, estimating compliance costs and economic impacts on significantly affected industries and sub-sectors;
- 3) emissions and waste generation inventories organized by company;
- 4) nonconfidential information regarding ongoing litigation, enforcement actions, etc.

Information of this kind would be helpful to securities regulators in enabling them to form judgements regarding the kinds of disclosures that should be expected from companies within an industry.

Support to securities

In addition to inter-agency cooperation of this kind, environmental agencies can greatly enhance their role as an information resource to investors and investment analysts. At present, investors and analysts typically do not see the environmental agency as a potentially useful source of information, and most within these groups lack any knowledge of how information from the environmental agency might be accessed.

To some extent, analysts' perceptions regarding the paucity of useful information available from environmental agencies has been justified. Many databases maintained by these agencies, though ostensibly public, have been difficult to access and to manipulate. On some, the data can be outdated or of questionable accuracy. On some, the data are formatted in ways that are not useful to investors or analysts. For example, emissions data should be readily aggregated by company but often cannot be. To remedy this situation, the environmental agency could **review their publicly available databases and attempt to make them more accessible and more useful**. This effort, of course, would be of benefit to many users, not only to the investment community.

More specifically, to facilitate access, the environmental agency could **provide a telephone service for analysts** directing their questions to relevant branches and sources of expertise within the agency. This service could be publicized by presentations to financial sector professional associations, announcements in the financial press and other means. Once established, such a service would help in breaking down the lack of communication between the environmental agency and the investment community.

A further step in this direction would be to **establish within the agency an Internet web site containing links and directories to potentially useful information**. Such information would likely include materials in the categories 1) through 4) above. Direct Internet access to relevant information would be a valuable resource for investors and analysts, who often must make decisions under time pressure. A web site would be even more useful if it contained a search engine capability that enabled users to search for information by industry, company, or environmental issue.

Steps such as these merely illustrate the possibilities of closer cooperation between environmental agencies and securities regulators and the investment community. Others might be developed through consultations among these groups. Potentially useful to initiate these consultations might be a **high-level meeting between environmental agency senior management, securities and accounting bodies, and senior executives from within the financial and investment sector**. One focus of such a meeting might be the need for improved transparency with respect to financially material environmental information and steps needed to achieve it. This meeting would be in line with and help foster corporate sustainability activities ongoing in the three countries.

In Canada, aside from the provincial securities regulators, four main governmental bodies are at play in the environment and finance arena. These are: The Department of Finance, the Financial Consumer Agency of Canada (FCAC), Environment Canada, and the National Round Table on the Environment and the Economy. These four bodies each have individual strengths that together could serve to develop one of the most progressive and efficient systems for addressing materiality and disclosure issues in the world. Already, innovative Canadian responses to this challenge, in which Environment Canada could play a role, include the Public Accountability Statements and the FCAC Act. In Canada, banks and federally incorporated or registered trust and insurance firms with more than \$1 billion in equity are now mandated to publish information in the form of yearly Public Accountability Statements, describing their contribution to the Canadian economy and society. These statements, conceived and implemented by the Department of Finance, have the potential to encourage innovation and best practice in the financial sector. For example, the Canadian Imperial Bank of Commerce went beyond the mandated PAS requirements to publish a 15-page section on their environmental efforts.

The Financial Consumer Agency of Canada may also support good governance in two ways. First, the FCAC strives to protect consumer rights and access to information through actively fielding consumer complaints and developing consumer education programmes. Through these programmes the Commission fosters a culture of transparency and good governance that may help prevent governance scandals before they occur. Second, the FCAC, through the FCAC Act, strives to:

1. Improve the availability, accessibility and clarity of financial information for consumers.
2. Monitor and ensure adherence to voluntary codes and public commitments that federally regulated financial institutions put in place to protect consumers.

Clearly the FCAC has an opportunity under these points of FCAC Act to support and encourage the development of the PAS statements. The FCAC can also develop consumer awareness and the capacity for consumers to critically evaluate the PAS statements via its mandate to educate financial consumers. Together these features of Canadian legislation provide both the incentive to show industry leadership as well as a means of ensuring a baseline of service provision.

While the Department of Finance may be better suited to direct regulation of the financial sector, Environment Canada has a comparative advantage in environmental background knowledge that it could offer to the Department of Finance in order to strengthen or make the case for this aspect of the PAS. Environment Canada could also support this process in several other ways:

1. Make the case for the FCAC to recognize that material environmental information is relevant to consumers (especially those consumers of investment products) and that the availability of this information to the consumer should be improved.
2. Support and develop consumer education campaigns that stimulate the demand for environmental information from the financial sector by explaining the effects of financial sector actions on the society and the environment.
3. Highlight for the FCAC as well as monitoring and encouraging compliance with, (in accordance with the FCAC Act) voluntary codes of practice adopted by the financial sector

(e.g., the Global Reporting Initiative, commitments to the United Nations Environment Programme Finance Initiatives, and the World Bank-International Financial Corporation's "Equator Principles").

As both the Canadian and US examples illustrate, there is tremendous potential for cross-ministry cooperation that could lead to a more inclusive and accurate policy framework in this area: one that is easier for consumers to understand, for governments to implement, for industry to comply with, and for society to benefit from.

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⁴ World Bank, *Greening Industry: New Roles for Communities, Markets, and Governments*, New York, 2000

⁵ Robert Repetto & Duncan Austin, "Quantifying the Financial Implications of Corporate Environmental Performance," *Journal of Investing*, Fall, 2002; Robert Repetto, "The Complexities of Strategic Environmental Management in the Electric Utility Industry", *Corporate Environmental Strategy*, March, 2003; Duncan Austin, *Changing Oil*, World Resources Institute, Washington, DC, 2002

⁶ Commission for Environmental Cooperation. 2003. Environmental Disclosures in Financial Statements: New Developments and Emerging Issues Event Report – 26 February 2003 The Second Finance and the Environment Meeting held by the CEC with the Financial Sector, New York, March 2003.

⁷ Robert C. Eccles et al., *The Value Reporting Revolution*, Wiley, NY, 2001; ch.7.

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¹⁰ "Going with the Flow," *Investor Relations on the Net*, 15 October 2002.

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¹² Jeffrey Ball, "Global Warming is a Threat to Health of Corporations," *Wall St. Journal*, 16 April 2003.

¹³ Donald Sutherland, "Europe Tightens Corporate Environmental Accounting Rules," *Environmental News Service*, Brussels, October 5, 2001.

¹⁴ Commission on Environmental Cooperation, *Environmental Disclosure Requirements in the Securities Regulations and Financial Accounting Standards of Mexico, Canada and the United States*, Montreal, 2002

¹⁵ U.S. Government Accounting Office, *SEC Operations: Increased Workload Creates Challenges*, Washington, Govt. Printing Office, March, 2002.

¹⁶ Robert Repetto & Duncan Austin, *Coming Clean: Corporate Disclosure of Financially Significant Environmental Risks*, World Resources Institute, Washington, DC, 2000.

¹⁷ U.S. EPA, “U.S. EPA Notifying Defendants of Securities and Exchange Commission’s Environmental Disclosure Requirements”, *Enforcement Alert*, Volume 4, number 3; October, 2001.