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Article information:
To cite this document:
Permanent link to this document:
https://doi.org/10.1108/09513570010316126

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Corporate environmental reporting
A test of legitimacy theory

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Keywords Environmental audit, Annual reports, Disclosure, Environmental impact

Abstract This paper analyses the link between the importance, as stated by reporters, of specific factors in the decision to disclose environmental information and actual reporting practices. Through a mail survey, chief finance officers (CFOs) of selected Australian companies rated the perceived importance of specific factors in the decision to disclose environmental information. Environmental disclosure within respondents’ annual reports were reviewed and an analysis was undertaken to determine if relationships existed between actual reporting practices and ratings of importance assigned to various factors. The results indicate some significant correlations between the perceived importance of a number of factors and environmental reporting practices. The results of the analysis provide limited support for legitimacy theory as an explanatory link between identified influential factors in management’s decision process and actual environmental disclosure.

Introduction
In recent years there has been increased community attention toward the identification of approaches to deal more effectively with environmental concerns. This discussion has resulted in calls for industry to become more responsive and to manage its impact on the environment better (Schmidheiny, 1992). Many corporate managements have developed environmental management systems and increasingly adopted environmental reporting within the annual report (Deegan and Gordon, 1996; Gray et al., 1995; Guthrie and Parker, 1990). Environmental reporting has remained predominantly a voluntary practice, with many of the current Australian accounting “rules” predisposed to the concealment of environmental information (see Frost and Wilmshurst, 1996b)[1].

Prior research on environmental reporting has selectively examined external factors and subsequent disclosures (Deegan and Gordon, 1996; Deegan and Rankin, 1996; Patten, 1992) failing to account for an interceding variable, that of management’s perceived importance of these factors. Evidence suggests that
environmental information within the annual report is subject to senior management intervention (O’Donovan, 1996). However, research on the factors that influence or motivate management subsequently to disclose environmental information has been limited (see, for example, Tilt, 1994).

This paper is motivated by this lack of research, and considers whether legitimacy theory provides an explanation of management’s motivation to disclose environmental information within the annual report. Two specific issues are analysed in this paper. First, the paper examines the importance placed by management on factors that focus attention on the decision to disclose environmental information. Second, the paper analyses whether the attitudes of management are consistent with actual reporting practices. This provides some support for the rationale that environmental reporting is a tool utilised by management to legitimise their activities where management attitudes are also consistent with that position. This study therefore extends prior research by directly examining management attitudes and subsequent disclosure practices.

**Legitimacy theory as an explanatory theory of environmental disclosure**

Hogner (1982) suggested corporate social disclosures were motivated by the corporate need to legitimise activities. Legitimacy theory has come to stress how corporate management will react to community expectations (e.g. Tilt, 1994; Patten, 1992; Guthrie and Parker, 1989). Underlying this notion is a view that stakeholders within the community deliberate on those activities which are acceptable, and companies, as members of that community, are expected to carry out their activities within the boundaries of what is deemed acceptable by that community[2]. When activities have an adverse impact upon the environment, management therefore will seek to re-establish its credentials through the disclosure of additional information[3].

Legitimacy theory implies, given a growth in community awareness and concern, that firms will take measures to ensure their activities and performance are acceptable to the community[4]. The annual report may therefore be used to reinforce the community’s perception of management’s responsiveness to specific environmental issues, or alternatively to divert attention from adverse environmental situations (e.g. Patten, 1992; Deegan and Rankin, 1996).

Prior research has not provided consistent support for legitimacy theory. A study by Hogner (1982) of US Steel’s corporate social reporting provided anecdotal evidence supporting legitimacy theory for social responsibility reporting. However, Guthrie and Parker (1989, p. 350) in a longitudinal study of BHP’s (an Australian mining/manufacturing company) social disclosures “failed to confirm legitimacy theory as an explanation”[5]. Patten (1992) tested legitimacy theory arguments in a study examining the effect of the Exxon Valdez oil spill on the disclosures within the annual reports of petroleum firms other than Exxon, concluding that “it appears that at least for environmental
disclosures, threats to a firm’s legitimacy do entice the firms to include more social responsibility information in its annual reports” (Patten, 1992, p. 475). A study by Deegan and Rankin (1996) found a positive correlation between those firms prosecuted by Australian state EPAs and an increase in the level of environmental disclosures (especially positive disclosures) within the annual report. The studies by Patten (1992) and Deegan and Rankin (1996) provide initial empirical evidence supporting legitimacy theory in terms of a corporate reaction to an event influencing the firm’s perceived social acceptability.

What influences the disclosure of environmental information?

Accepting the primary argument of legitimacy theory, that external factors influence corporate management to seek to legitimise activities, a number of factors may be identified to have an influence on the decision by management to disclose information about the physical environment within the corporate annual report. One of the primary factors suggested to influence a corporate response on environmental issues is the growth in awareness and concern in the general community. As argued by Hines:

...[t]here appears to be a strong demand for companies to be made accountable for the environmental impact of their actions... that firms have an implicit contract with, and should therefore be accessible to, the wider community in which they operate (Hines, 1991, p. 41).

If the members of the community are becoming more interested in the environmental impact of companies, it is likely that the senior management will be called on to explain the company’s activities affecting the environment. Such accessibility may be promoted through disclosure within the annual report.

Prominent amongst the general community are the environmental lobby or pressure groups[6]; community pressure, for example, on corporate entities to take a more proactive position on environmental issues (Bates, 1995; Bebbington et al., 1994; Elkington, 1994; Hines, 1991; Tilt, 1994). Deegan and Gordon (1996) found evidence of a correlation between corporate environmental reporting and membership of environmental lobby organisations.

Concern for environmental issues and corporate environmental performance is, however, not limited to environmental lobby organisations. Corporate management may need to be responsive to the information demands of other stakeholders. As suggested by Gilkinson (1994, p. 57) “[e]nvironmental management programs can enhance relations with a variety of stakeholders, including shareholders, lenders, insurers, underwriters, suppliers, customers, environmental activists and employees”. This “new” environment was summed up by Elkington (1994, p. 99): “the challenge facing individual companies will be to work out new ways of co-operating with their suppliers, customers, and other stakeholders – including competitors – in this key area of business activity, while ensuring that they will benefit not only in corporate citizenship terms, but also in terms of competitive advantage”. In other words, not only may management be called on to explain their actions, but also environmental disclosures may pave the way for a better relationship with their stakeholders.
A consequence of failure by management to legitimise current activities is the possible intervention of government. The government, as an elected body, could be expected to be attentive to community concerns, and responsive to community pressure groups. It would be expected that the government would be receptive to concern generated by the community about environmental issues, as evidenced by the significant growth in legal requirements and regulations, including taxation, licensing requirements, and zoning restrictions, imposed on business activities. These requirements and regulations affect the firm’s interaction with the physical environment[7]. Many of these restrict the nature of, or manner in which operations can be undertaken, and thereby impact financially upon the firm, resulting in corporate management factoring the environment into their decision process (Epstein, 1996). Collateral liability of directors has also been introduced into the legislative framework, and this has seen the transfer of responsibility for environmental performance to individual managers (Frost and Wilmshurst, 1996a). Under these conditions, corporate management may utilise the annual report to seek to satisfy “due diligence” concerns.

The management of the financial impact of a company is a double-edged sword in the sense that concern for the environment can both cost and save a company money. Zuber and Berry (1992, p. 46) suggest that a company’s impact on the environment is likely to “significantly affect a company’s financial position and its long term financial health”. These may include the potential or probable liabilities for rehabilitation or clean-up of sites that have been contaminated and the possibility of a changed regulatory environment.

In trying to define precise factors motivating corporate management to disclose social (and environmental) information, Freedman and Stagliano suggest that:

It is probable that there is no single motivation for making social disclosure. Social disclosure, for the most part, is a function of the attitude of top management toward its stakeholders. Whether there is an economic motivation for the disclosure ... a reaction to user needs ... or a political motivation ... is probably a consequence of each management’s particular perception of the world it faces (Freedman and Stagliano, 1992, p. 113).

Arguably a number of potential factors may, at a given point of time, be influential in management’s decision to disclose environmental information. The perceptions by management of the information needs of report users, tempered by the ability of factors to influence the wellbeing of the company, therefore could be expected to play a role in the level of environmental disclosure observed within the corporate annual report. This paper provides an analysis of those issues identified as influential to corporate management and the observed levels of environmental disclosure within the annual report.

**Study design**
This paper utilises data from two sources. The first source of information is a mail survey of chief financial officers (CFOs) to ascertain their opinions on the importance of specific issues motivating the decision to disclose environmental
information within the annual report. The second source is an analysis of the level of environmental disclosures within the annual reports of those companies that responded to the survey. The two data gathering processes are described below.

**Sample selection**
The survey involved a selected sample from the top 500 listed Australian companies for 1994-1995, as identified by Riddells Information Services (which is based on the total revenue of trading companies). An initial sample of 105 companies was selected as a stratified random sample of companies from environmentally sensitive industries[8]. The industry groups selected were chemical, mining and resources, oil gas and petroleum, transport/tourism, manufacturing, construction, and food and household. Given the exploratory nature of the study, this bias was introduced to limit the study sample to those firms more likely to have developed a systematic response on environmental issues[9], as the study's objective was to identify what influences management considered in the decision to disclose environmental information. Environmental sensitivity of the industry has been argued to be influential on the level of environmental reporting (Deegan and Gordon, 1996), and the development of environmental management procedures (Frost and Toh, 1998). It is these firms that are more likely than firms in less environmentally sensitive industries to have considered, for example, stakeholders who utilise environmental information, in the environmental reporting decision.

The industry groups chosen were based upon the groupings used by the Australian Stock Exchange “main listings”. The groupings identified were then compared to the listing of “main activities” adopted by Deegan and Gordon (1996), with the final selection of industry groups based on the environmental sensitivity indices developed by Deegan and Gordon (1996). Deegan and Gordon (1996) ranked industries from 0 to 5 (5 being most sensitive), this study included firms that had a main activity with an adjusted mean of 3.4 or greater. While this cut-off point is arbitrary, it is felt that the selection should reflect the more environmentally sensitive groups.

**The survey process**
The questionnaire drew on sources such as work undertaken by Bebbington et al. (1994), KPMG (1993), and Coopers & Lybrand (1993) in its development. The survey instrument was developed to permit an analysis of the level of importance of specific factors on management’s decision to disclose environmental information. The factors identified from prior research[10] are:

- to provide a “true and fair” view of operations;
- to pre-empt legally imposed requirements;
- to satisfy “due diligence” requirements;
- community concern with operations;
Respondents were asked to scale the relative importance of each of these 11 possible influential factors using a rank-order Likert scale. The scale used consisted of five points ranging from unimportant to highly important[11]. The Likert scale was appropriate as the researchers wished to ascertain a level of importance attached to different influences on the decision to disclose environmental information[12].

The survey was addressed to the CFO to reflect our desire to contact a member of the management team that would typically be associated with the development of the corporate annual report and be in a position to comment on what influenced the corporate decision to disclose. While any individual within an organisation cannot speak exclusively for the entire organisation, it was felt, that the CFO was in a sufficiently senior position to provide details on the information sought.

Use of a survey instrument in gathering data is limited by the constrained scope of the questions (that is, what you ask constrains what you collect). This study aimed to explore a set of selected stated influences on the decision to disclose environmental information. Respondents were asked to indicate the title of the position they held within the company, so as to monitor who was actually completing the survey. The majority of respondents identified themselves as having a senior position in accounting or a position with comparable responsibility such as executive director – finance, company secretary, or administration manager. A limited number of respondents identified their position as relating to environmental management (for example, environmental manager, environmental/external relations). Such respondents were appropriate replacements for CFOs because they would be expected to be aware of the influences impacting on the corporate response to environmental issues.

Following the initial mail out, a reminder letter and second copy of the questionnaire were sent out four weeks after the initial request. This letter was sent to all sample companies that had not responded, or had replied but had not identified their company. There were 62 useable responses received (a response rate of 58.5 per cent). While the actual response was slightly higher, at 69 responses, there were a number of responses which were not useable, due to: return of incomplete questionnaire(s); companies indicated they were not prepared to participate; or it was not possible to identify the company.
Since the total population identified did not respond there is, as with all survey questionnaires, an issue relating to the representativeness of the sample. The issue is related to the extent of bias reflected in the respondent sample rather than the actual response rate (Babbie, 1989). A test for non-response bias was undertaken, by applying the early-late hypothesis technique which suggests that late returns are often similar to non-responses. A Mann-Whitney U test was used to assess whether bias might exist for the Likert scale questions. All factors were tested in this way. In all cases, the null hypothesis that the sample came from the same population distribution could not be rejected at the 0.05 per cent level of significance.

Content analysis of the annual report
The second phase of the study was an analysis of the level of environmental disclosures within the 1995 annual reports of the 62 sample companies. Environmental disclosures are defined as those disclosures that relate to the impact company activities have on the physical or natural environment in which they operate. This approach is consistent with the legislative framing of what is understood by the “environment”. For example, the Victorian Environment Protection Act (1970) Section 41 defines “environment” as:

... physical factors of the surroundings of human beings including the land, waters, atmosphere, climate, sound, odours, tastes, the biological factors of animals and plants and the social factor of aesthetics.

While care should be taken when relying on the annual report as the only source of disclosure, since companies do use a number of other reporting mediums (such as media releases, stand-alone environmental reports, Internet home pages), the annual report was the sole source adopted in this study for a number of reasons. First, it is a statutory report incorporating both statutory and voluntary disclosures, which is produced regularly, and one over which management exercises editorial control. Second, it can be easily accessed. And finally, as suggested by Wiseman (1982, p. 55) it “is widely recognised as the principal means for corporate communications of activities and intentions has been the source for virtually all previous corporate research”.

To measure the level of environmental information within the annual report a content analysis approach was adopted. This study is influenced by Bowman’s (1978, p.65) understanding of content analysis as an “inquiry process [which does] not [rely] on casual reading but on rather explicit counting and coding of particular lines of prose, of word usage and of disclosure”. The measurement of disclosure was an unweighted count of the number of words on environmental issues in the annual report[13]. Use of word counts assists in guarding against inconsistencies in calculating the quantity of disclosure (Zeghal and Ahmed, 1990). Zeghal and Ahmed (1990) indicate that words are the smallest unit of measurement for analysis and can be expected to provide the maximum robustness to the study in assessing the quantity of disclosure. Supporting this, Krippendorf (1980) noted that words are a preferred measure
when it is intended to measure the amount of total space devoted to a topic and to ascertain the importance of that topic. Environmental information in the annual reports was computer scanned, and a number word count undertaken to ensure consistency in measurement between companies.

There are a number of limitations in undertaking content analysis. There is a risk of inconsistent interpretation of what it is that is being measured. In this study the risk of arbitrariness in selection of what is environmental content was minimised by having the reports analysed independently by the two researchers for environmental content[14]. Only negligible differences in the assessment of environmental disclosures were identified, which were then subject to re-examination.

The number of words disclosed is not assumed to be representative of the quality of disclosure, although it is assumed to be representative of the overall responsiveness by corporate management in regard to legitimising environmental performance. This assumption is based on the belief that management has editorial control of content when a large number of demands for inclusion of information are likely to exist (O'Donovan, 1996). Annual reports are time consuming and costly to produce, and management must rationalise the competing demands for space. As a result space must be allocated on the basis of some perception of the importance of information to report users.

Pictures reflecting environmental activities were excluded due to measurement difficulties. Arguably pictures may be "worth a thousand words", however, to include them in a measure based upon an unweighted word count is highly subjective. Such an exclusion is a limitation as management may see this as a means to impress on users their responsible approach to the management of environmental issues. Panchapakesan and McKinnon (1992), in an analysis of social responsibility disclosures, reported a correlation between number of words and area of words and photographs at the 0.977 level, suggesting only a minor variation between the two measures.

No attempt was made to assess the quality of disclosure. Wiseman (1982) examined the quality and accuracy of environmental disclosures made in corporate annual reports, suggesting that corporate environmental disclosures were incomplete when compared to a firm’s actual environmental performance. Corporate environmental disclosures have been suggested to be insufficient and low in credibility (Tilt, 1994), and often self-laudatory in nature (Deegan and Gordon, 1996; Deegan and Rankin, 1996). Other than the work completed by Wiseman (1982) there appears to be little work which has addressed the issue of quality of disclosure or the development of benchmarks from which to measure quality. It is important therefore to exercise caution when discussing the issue of disclosure based on quantity measures.

This study is limited in that legitimisation is interpreted from the quantity of environmental information disclosed rather than from an assessment of the "quality" of what is actually being disclosed, or more importantly, not disclosed. For example, management may deliberately not disclose information
on a specific adverse situation, while increasing the level of positive disclosures on related issues. This may suggest further legitimisation of the firm, as measured by quantity of information, yet without a real increase in the quality of information being provided. Such was observed by Deegan and Rankin (1996) who reported an increase in the level of positive information disclosed by firms after being prosecuted by the EPA, without reporting on the actual prosecutions. The implication is that care must be taken in any interpretation of what is disclosed. There is likely to be a difference between the concern to be genuinely legitimate and a concern to appear to be legitimate.

Results

The stated importance of factors in the environmental disclosure decision

The first objective of this study was to examine the stated importance placed by management on the factors identified in the decision to disclose environmental information. While there are a number of factors that may affect the decision to disclose environmental information, each factor is not necessarily perceived or stated to be of the same level of importance, nor ultimately influential on the level of environmental information disclosed. Table I provides a summary of the average score given to each factor.

The results reported in Table I show a narrow spread of the average level of importance placed upon the 11 factors examined. From the analysis, shareholder or investor rights to information was considered in aggregate as the most significant influence on the decision to disclose environmental information. Supportive of the primacy of the shareholders in the decision to disclose was the rating of "providing a 'true and fair' view" which, on average, was considered as important. This result is supportive of prior research that has focused on the shareholder as the primary user of the corporate annual report as a means of reducing informational uncertainty (Ullmann, 1985).

<table>
<thead>
<tr>
<th>Influences/motivating factors</th>
<th>Mean</th>
<th>Standard deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>To provide a &quot;true and fair&quot; view of operations</td>
<td>3.00</td>
<td>1.261</td>
</tr>
<tr>
<td>To pre-empt legally imposed requirements</td>
<td>2.54</td>
<td>1.032</td>
</tr>
<tr>
<td>To satisfy &quot;due diligence&quot; requirements</td>
<td>3.25</td>
<td>1.203</td>
</tr>
<tr>
<td>Community concern with operations</td>
<td>3.33</td>
<td>1.230</td>
</tr>
<tr>
<td>Financial institution concerns</td>
<td>2.55</td>
<td>1.150</td>
</tr>
<tr>
<td>To meet legal obligations</td>
<td>3.43</td>
<td>1.265</td>
</tr>
<tr>
<td>Supplier concerns</td>
<td>2.14</td>
<td>1.002</td>
</tr>
<tr>
<td>Customer concerns</td>
<td>2.64</td>
<td>1.313</td>
</tr>
<tr>
<td>Environmental lobby group concerns</td>
<td>2.57</td>
<td>1.336</td>
</tr>
<tr>
<td>Competitor response to environmental issues</td>
<td>2.16</td>
<td>1.022</td>
</tr>
<tr>
<td>Shareholder/investor rights to information</td>
<td>3.52</td>
<td>1.406</td>
</tr>
</tbody>
</table>

Notes: Levels of influence: 1 = unimportant; 2 = slightly important; 3 = important; 4 = quite important; 5 = highly important
evidence that shareholders react to the disclosure of social information (Patten, 1990), and the growth of ethical investments (Hamilton et al., 1993; Harte et al., 1991).

The second significant factor identified was the desire “to meet legal obligations”, with the “satisfaction of due diligence concerns” also ranked as one of the more important influential factors. These results were not surprising given the significant increase in environmental related legislation (Bates, 1995), and prior research indicating a relationship between prosecution and disclosure (Deegan and Rankin, 1996). It is of interest to note that a move to pre-empt legally imposed requirements, although falling between “slightly important” to “important”, was rated as ninth of the 11 factors in influencing the decision to disclose environmental information. This result, to the extent that it reflects actual as well as stated perceptions of management, may question the argument that voluntary reporting is primarily a means of defending against a more interventionist regulative approach (Gallhofer and Haslam, 1997).

Respondents also identified community concerns as important in the decision to disclose. It was, however, somewhat surprising that there were no corresponding ratings of importance associated with environmental lobby organisations. This result is of interest given that prior research has shown that these organisations do utilise the annual report (Tilt, 1994), and that a correlation existed between corporate environmental reporting and Australian membership of environmental lobby organisations (Deegan and Gordon, 1996)[15]. These results support the findings of Bebbington et al. (1994), who observed that accountants employed within organisations which disclosed environmental information were more likely to have positive attitudes toward a category referred to as “public watchdogs”, which included the general public and shareholders.

Factors such as supplier concerns and competitor response ranked as being of least importance by the respondents. Of most interest from the responses was the low ranking of importance attached to financial institutions in the decision to disclose. While it has been argued that environmental risks are of increased importance in financial evaluations (Barrett, 1994), the ranking of importance of this group suggests that meeting their information needs may not be the primary objective of annual report preparers.

The descriptive data provides some evidence toward the role of legitimacy theory in providing an explanation of management’s decision to disclose environmental information. The results suggest management weighs influences differently when considering the decision to disclose environmental information. Respondents identified community concern, shareholder/investor rights to information, due diligence and legal obligations as most important, with the least important influences being competitor response to environmental issues and suppliers’ concerns. The identified importance of a factor does not necessarily equate to actual disclosure within the annual report. Actual responses by management to these factors may be driven by the ability of the factor to influence the wellbeing of the company, or what management
perceives to be important, or management’s desire to be “economical with the truth”. However, it is possible to suggest from the results that these factors may play a differential role in the decision to disclose based on the attached importance as indicated by the survey respondents.

**Issues of stated importance versus disclosure of environmental information**

Once respondents rated the factors in terms of relative importance in the environmental reporting decision, the next step was to assess whether these factors were then associated with the level of disclosure (number of words) on environmental issues observed within the annual report. Correlations were run between the ostensible influences on the disclosure decision and actual disclosure in the annual reports to assess whether different influences identified as significant are related to actual disclosure. Table II reports the results of the correlation analysis.

Table II identifies significant associations between influences on the decision to disclose environmental information and actual disclosure in annual reports for shareholders’ right to information ($p = 0.031 < 0.05$), customer concerns ($p = 0.005, < 0.01$), community concern with operations ($p = 0.009, < 0.01$), supplier concerns ($p = 0.005, < 0.01$), and financial institution concerns ($p = 0.021, < 0.05$). These significant correlations indicate a varied group of influences perceived to have been important in the decision to disclose environmental information and resultant levels of environmental disclosures.

Table II indicates no significant correlation between actual disclosures and associated importance of the environmental lobby on the decision to disclose. This result is of interest considering prior research which has found a correlation between environmental reporting practices and the membership numbers of environmental lobby organisations (Deegan and Gordon, 1996).

Of note is the lack of a significant correlation between the importance attached to legal requirements and the level of disclosures observed. The results may suggest that although legal issues are considered important in the

<table>
<thead>
<tr>
<th>Influence variables</th>
<th>Pearson</th>
<th>$p$</th>
<th>Spearman</th>
<th>Significance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Shareholders’ right to information</td>
<td>0.3706</td>
<td>0.031</td>
<td>0.4704</td>
<td>0.008</td>
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<tr>
<td>Response to competitions</td>
<td>0.0982</td>
<td>0.320</td>
<td>0.0656</td>
<td>0.378</td>
</tr>
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<td>Environmental lobby group</td>
<td>-0.0103</td>
<td>0.480</td>
<td>0.0359</td>
<td>0.432</td>
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<td>Customer concerns</td>
<td>0.5042</td>
<td>0.005</td>
<td>0.4021</td>
<td>0.023</td>
</tr>
<tr>
<td>Supplier concerns</td>
<td>0.4392</td>
<td>0.014</td>
<td>0.3859</td>
<td>0.028</td>
</tr>
<tr>
<td>To meet legal obligations</td>
<td>0.0889</td>
<td>0.336</td>
<td>-0.0412</td>
<td>0.422</td>
</tr>
<tr>
<td>Financial institution concerns</td>
<td>0.4083</td>
<td>0.021</td>
<td>0.3009</td>
<td>0.072</td>
</tr>
<tr>
<td>Community concerns with operations</td>
<td>0.4580</td>
<td>0.009</td>
<td>0.4795</td>
<td>0.007</td>
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<tr>
<td>To meet “due diligence” requirements</td>
<td>0.2303</td>
<td>0.134</td>
<td>0.2389</td>
<td>0.125</td>
</tr>
<tr>
<td>To pre-empt legal imposition</td>
<td>-0.0109</td>
<td>0.479</td>
<td>-0.1017</td>
<td>0.314</td>
</tr>
<tr>
<td>To provide a “true and fair” view</td>
<td>0.2862</td>
<td>0.078</td>
<td>0.3388</td>
<td>0.045</td>
</tr>
</tbody>
</table>

Table II: Association between actual disclosure in the annual reports and influence on the decision to disclose

*Note: One-tailed probabilities*
decision process, management may not be prepared to respond to this factor until the firm is directly affected. For example, prior research has shown management responding through environmental reporting to specific events that directly influence the firm, or the industry in which the firm operates, that result in an increased focus of community or regulatory attention upon environmental performance (Deegan and Rankin, 1996; Patten, 1992). On the other hand, such a result may suggest that the level of disclosure does not capture the response by management on legal obligations. It may therefore be more appropriate to analyse the issues being discussed within the annual report. Further, the level of disclosure may be seen as a direct response to specific stakeholders rather than a means of meeting specific disclosure requirements.

Issues as explanatory variables
Regression analysis is used to assess whether the influence factors identified by the CFOs have explanatory power in determining the actual level of disclosure in annual reports. A significant model resulted from stepwise regression (F significance 0.0029, <0.01). The model, summarised in Table III, indicates that two independent variables in the equation (influence of competitor response to the environment and customer concerns) are significant, with an adjusted R² of 0.37. This model is a significant explanation of the actual disclosure of environmental information found in annual reports with a positive contribution by customer concerns (Beta 96 per cent), and a negative contribution by the influence of competitors’ response to environmental issues (Beta –61.5 per cent).

The results suggests that actual environmental reporting is in part explained as a reaction by management to the perceived importance of external factors considered in the decision to disclose environmental information. Such a result provides some support to the argument that environmental reporting is

<table>
<thead>
<tr>
<th>Multiple R</th>
<th>R square</th>
<th>Adjusted R square</th>
<th>Standard error</th>
</tr>
</thead>
<tbody>
<tr>
<td>0.65263</td>
<td>0.42592</td>
<td>0.37125</td>
<td>388.81694</td>
</tr>
</tbody>
</table>

**Analysis of variance**

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<th>DF</th>
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<th>Mean square</th>
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<tr>
<td>Residual</td>
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<tr>
<td>F = 7.79017</td>
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</table>

**Variable**

<table>
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<tr>
<th>Competitors’ responses to environmental issues</th>
<th>B</th>
<th>SE B</th>
<th>Beta</th>
<th>T</th>
<th>Sig T*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Competitors’ responses to environmental issues</td>
<td>-316.059606</td>
<td>126.804053</td>
<td>-0.615288</td>
<td>-2.493</td>
<td>0.0105</td>
</tr>
<tr>
<td>Customer concerns (Constant)</td>
<td>358.044538</td>
<td>91.787071</td>
<td>0.962937</td>
<td>3.901</td>
<td>0.0004</td>
</tr>
<tr>
<td>(Constant)</td>
<td>205.713716</td>
<td>189.721140</td>
<td>1.084</td>
<td>0.1452</td>
<td></td>
</tr>
</tbody>
</table>

**Note:** a One-tailed significance

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Table III.
Least squares regression: stepwise regression influence variables as an explanation for actual disclosure
used as a means of legitimising corporate activities by indicating a link between the importance of certain factors in the decision process and observed reporting practices.

**Conclusion**

Prior research has tested legitimacy theory by observing disclosure as a reaction to external issues (Deegan and Gordon, 1996; Deegan and Rankin, 1996; Guthrie and Parker, 1989). This study sought to examine for a relationship between factors perceived as important by CFOs in the decision to disclose and the observed disclosure of environmental information within the annual report.

The results of the survey indicated that the factors identified were given differing levels of consideration in the decision to disclose environmental information. Factors considered of most importance were shareholders’ or investors’ right to information (also ostensibly to provide a “true and fair” view of operations), legal obligations and “due diligence” requirements, and community concerns. Results suggest that in the decision process, management gives most consideration to shareholders’ information needs and legal issues.

The study then sought to test if the level of importance given to these factors correlated with environmental reporting practices. Testing of CFO responses against the environmental disclosures within their company’s annual report identified positive associations with shareholders’ right to information, customer concerns, supplier concerns, financial institution concerns, community concerns and the provision of a “true and fair” view of the operations of the firm. Of note was the observation that although legal related factors were rated important as a consideration in the decision to disclose, this consideration did not appear to translate in actual disclosure quantity.

The regression analysis of influences on the decision to disclose environmental information to actual disclosures of environmental information identified the influences of the competitor response to environmental issues and customer concerns to have predictive power. The stepwise regression suggested that 37 per cent of actual disclosure could be attributed to these two influences.

To conclude, this study provides limited support for the applicability of legitimacy theory as an explanation for the decision to disclose environmental information. Results offer some support for the contention that management is responding to the perceived importance of stakeholders, for example, the greater the perceived importance of shareholders’ information needs and community concerns, the higher the level of environmental disclosures that were observed within the annual report. However, the analysis failed to find associations between those factors more generally associated with the restriction of activities with respect to the environment, such as the environmental lobby or legal related issues, and the level of environmental disclosures observed.
Arguably, management may legitimise its environmental performance in response to general changes in the perceived importance of environmental issues; hence it may be seeking to meet the information needs of the general community and stakeholders financially reliant on the firm. The failure to provide evidence of a link between the perceived importance of specific environment related stakeholders or legal issues might be explained in the results of prior research. For example, Deegan and Rankin (1996) found a prosecution relating to an environmental issue significantly influenced the level of disclosure observed. In this case the importance of legal issues in general had not changed, but a specific event resulted in a change in reporting practices. Patten (1992) also observed significant increases in environmental reporting subsequent to the Exxon Valdez oil spill which resulted in an increase in social exposure of the oil industry. Therefore further research on event-driven changes in the social environment may prove useful in providing additional explanatory power on what influences management in the decision to disclose environmental information.

A further avenue of inquiry would be case study based research to gain an understanding of the trade-off that occurs between the competing requirements for information to be included in the annual report. Such observations of interaction cannot be observed through passive survey research. Additionally, the analysis of responsiveness did not encompass issues of information quality and alternate means of information dissemination. Further research in these areas would provide additional insight into the motivations for management’s response to the environmental reporting process in terms of the type, and quantity of environmental information to disclose, and in what format to disclose this information.

Notes
1. Prescriptive guidelines on environmental reporting have been limited to Urgent Issues Group Abstract 4: Disclosure of Accounting Policies for Restoration Obligations in the Extractive Industries which requires extractive industry companies to disclose information on the amount of restoration liability (see also Australian Accounting Standards Board 1022 Accounting for the Extractive Industries) and the accounting method adopted in determining the liability.

2. The argument underlying legitimacy theory is the idea that management is able to influence the perceptions of the public toward it. It is argued that a firm will seek to somehow satisfy the social values of the community in which it operates and to, at least ostensibly, meet the norms of acceptable behaviour. Lindblom (1994) has described 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” (p. 2).

3. An example of such an action occurred in 1995 when the Iron Barron ran aground in Northern Tasmania. Within 12 hours of the incident, BHP issued its first press release assuming all responsibility for the incident, and thereby averted much public criticism for the accident (Salmons, 1995).

4. Where firms are not able to show they have remained within acceptable boundaries, the members of a community may express dissatisfaction in a number of ways, as either
individuals, or as groups of individuals, or through the elected representatives of the community. For example, political and lobby groups may direct their activities specifically against an industry or a firm, or customers may boycott the products or services of firms that are felt to be acting against the best interests of the community.

5. A major limitation of both Hogner’s (1982) and Guthrie and Parker’s (1989) work was that only one company was analysed.

6. Beaucamp and Girgensohn (1992) suggest that the public have become more sensitive, and are now better informed on environmental issues. This has enhanced the development of professional environmental pressure groups.

7. Within Australia there exists a large number of environment related pieces of legislation, for example Barbera (1994) cites almost 500 pieces of legislation that existed as at 30 September 1992. Much of the environmental legislation has been developed within the last 25 years (Bates, 1995).

8. A random sample of public companies was selected from within the selected industry groups. As such the sample is not random from the top 500 companies, but is random from within the selected industry groups. Since the number of firms in each industry group was not the same, the sample size randomly selected from each was based on the relative importance of each group to the total firms number in the sample included in the study. This approach was felt to be necessary to ensure representativeness from each group.

9. It may also be argued that such a sample selection would result in an increased response rate. Bebbington et al. (1994) found that a bias towards environmentally sensitive industries was more likely to increase the response to a survey on environmental issues.

10. The initial draft of the questionnaire was presented to a seminar at The University of New England. At various stages the structure of the questionnaire and the questions were refined after discussions with colleagues at the University of New England and Victoria University of Technology.

11. The Likert scale used was composed of the following categories: 1 = unimportant; 2 = slightly important; 3 = important; 4 = quite important; 5 = highly important.

12. The Likert scale is not an interval scale and no conclusions can be drawn about the interval between each scale position (Moser and Kalton, 1975).

13. Other studies using word counts in content analysis include Deegan and Gordon (1996) and Deegan and Ranking (1996).


15. It may, however, be suggested that membership of environmental lobby organizations is a reflection of community concerns, and that the company responds to community concerns rather than directly to the environmental lobby. This result may suggest that while the membership of environmental lobby organizations may be an appropriate proxy for community concerns, corporate management does not react to the lobby organizations on general issues. Comments from respondents also included the suggestion that they believe the environmental lobby to be “over emotional”. This type of position could explain the apparent discrepancy.

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