August 4, 2004

The Honorable Jon S. Corzine
United States Senate

Subject: Environmental Disclosure: Briefing on GAO’s Findings and Recommendations

Dear Senator Corzine:

The Securities and Exchange Commission’s (SEC) primary mission is to protect investors and the integrity of securities markets. Among other things, SEC regulations require companies to file reports with SEC disclosing information that would be considered “material” to a reasonable investor. A matter is material if there is a substantial likelihood that a reasonable person would consider it important. Environmental risks and liabilities are among the conditions that, if undisclosed, could impair the public’s ability to make sound investment decisions. For example, the discovery of extensive hazardous waste contamination at company-owned facilities could expose a company to hundreds of millions of dollars in cleanup costs, while impending environmental regulations could affect a company’s future financial position if the company were required to shut down plants or invest in expensive new technology. To monitor companies’ disclosures, SEC reviews their filings and issues comment letters requesting revisions or additional information, if needed. Although the Environmental Protection Agency (EPA) does not have a direct role in monitoring environmental disclosures, the agency notifies companies of potential disclosure obligations and periodically shares relevant information with SEC.

This letter formally transmits to you the slides we used to provide a briefing on issues related to the disclosure of environmental information in SEC filings at a symposium on July 15, 2004, sponsored by you; Senators Lautenberg, Lieberman, McCain, and Nelson; and Representatives Blumenauer, Doggett, Markey, Michaud, Olver, Pallone, Payne, and Solis. (See enclosure I.) The briefing was based on our recent report, Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information (GAO-04-808, July 14, 2004). The report addresses (1) key stakeholders’ views on how well SEC has defined the requirements for environmental disclosure, (2) the extent to which companies are disclosing such information in their SEC filings, (3) the adequacy of SEC’s efforts to monitor and enforce compliance with the disclosure requirements, and (4) experts’ suggestions for increasing and improving environmental disclosure. Our review of these issues was conducted in accordance with generally accepted government auditing standards.

GAO-04-1019R  Environmental Disclosure Briefing
We are sending copies of this letter to the Chairman of SEC; the Administrator, EPA; and to other interested parties. The letter will also be available at no charge on GAO’s Web site at http://www.gao.gov.

Please call me at (202) 512-3841 if you or your staff have any questions. Major contributors are listed in enclosure II.

Sincerely yours,

John B. Stephenson
Director, Natural Resources
and Environment

Enclosures - 2
Environmental Disclosure: SEC Should Explore Ways to Improve the Tracking and Transparency of Information

Statement of John B. Stephenson Director, Natural Resources and Environment July 15, 2004
Research Objectives

Determine:

- Stakeholders’ views on how well SEC has defined the disclosure requirements
- Extent of environmental disclosure
- Adequacy of SEC’s monitoring and enforcement
- Experts’ suggestions for improving environmental disclosure
Obj. 1: Stakeholders’ Views on How Well SEC Has Defined the Requirements

What we did:

- Reviewed SEC’s disclosure regulations along with relevant standards and guidance from SEC, FASB, and AICPA
- Interviewed key stakeholders including both users and preparers of the information in SEC filings
Stakeholders Consulted by GAO

- AIG Environmental
- American Bar Association
- American Chemistry Council
- Business Roundtable
- Coalition for Environmentally Responsible Economies
- Domini Social Investments
- Edison Electric Institute
- Financial Accounting Standards Board
- Financial Reporting Advisors LLC
- Friends of the Earth
- Guida, Slavich & Flores, P.C
- Morningstar, Inc.
- Pricewaterhouse Coopers LLP
- Social Investment Forum
- The Brattle Group, Inc.
- The Calvert Group
- The Good Neighbor Project for Sustainable Industries
- The Rose Foundation
- University of Illinois School of Law
- World Business Council for Sustainable Development
- World Resources Institute
Obj. 1: Stakeholders’ Views on How Well SEC Has Defined the Requirements

What we found:
Disagreement about flexibility and scope of requirements for SEC filings.

- Some users believe the existing requirements are too flexible and too narrowly scoped
- Some preparers and other stakeholders believe the opposite
Obj. 2: Extent of Environmental Disclosure

What we did:

- Identified and analyzed 27 recently completed studies on environmental disclosure
- Examined disclosures related to impacts of potential controls on greenhouse gas emissions at selected electric utilities
Obj. 2: Extent of Environmental Disclosure

Findings:

- In general, studying the extent of disclosure is very difficult.

- Despite strong limitations, studies provide tentative insights about the amount of disclosure but not its adequacy.

- Disclosures by electric utilities varied widely and did not include estimates of potential cost impacts.
### Electric Utility Disclosures Related to Potential Greenhouse Gas Controls

<table>
<thead>
<tr>
<th>Category of potential impacts</th>
<th>Number of companies making disclosures</th>
<th>Number of companies with no disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kyoto Protocol</td>
<td>14</td>
<td>6</td>
</tr>
<tr>
<td>Current policy on voluntary reductions</td>
<td>9</td>
<td>11</td>
</tr>
<tr>
<td>Other current or proposed controls</td>
<td>16</td>
<td>4</td>
</tr>
</tbody>
</table>
Obj. 3: Adequacy of SEC’s Monitoring and Enforcement

What we did:

• Reviewed procedures, studies, and statistics

• Met with SEC’s Division of Corporation Finance and Division of Enforcement

• Met with EPA’s Office of Enforcement and Compliance Assurance
Obj. 3: Adequacy of SEC’s Monitoring and Enforcement

What we found:

- SEC does not systematically track the nature of comments on filings
- SEC does not have a public database of comment letters and responses
- SEC and EPA have made efforts to coordinate, but information sharing is limited
## SEC’s Reviews of Companies’ Annual 10-K Filings

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<tr>
<td>Annual filings</td>
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<td>14,280</td>
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<td>12,830</td>
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<tr>
<td>Number reviewed</td>
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<td>2,305</td>
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<td>by SEC</td>
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<tr>
<td>Percent reviewed</td>
<td>17.4</td>
<td>8.1</td>
<td>16.4</td>
<td>19.9</td>
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<tr>
<td>by SEC</td>
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</tbody>
</table>
Obj. 4: Experts’ Suggestions for Improving Environmental Disclosure

What we did:

- Conducted a Web-based survey of 30 experts that use the filings
- Obtained perspectives of businesses that would be affected by the suggestions
## Affiliations of Experts Who Provided Views on Improving Disclosure

- GovernanceMetrix International, Inc.
- World Resources Institute
- Harvard Business School
- Friends of the Earth
- PricewaterhouseCoopers LLP
- Vanderbilt University
- Investor Responsibility Research Center
- LeBeouf, Lamb, Greene, and MacRae, LLP
- Towson University
- Calvert Funds
- National Academy of Public Administration
- Office of Connecticut State Treasurer
- The Brattle Group
- Western Michigan University
Enclosure I

Affiliations of Experts Who Provided Views on Improving Disclosure

- Office of Attorney General, State of New York
- The Rose Foundation
- Domini Social Investments LLC
- Sidley Austin Brown & Wood
- Illinois State University
- AIG Environmental
- Stratus Consulting, Inc.
- Financial Reporting Advisors LLC

- Guida, Slavich & Flores, P.C.
- Standard & Poor’s
- Ernst & Young
- Sonoma State University
- Pillsbury Winthrop LLP
- Innovest Strategic Value Advisors, Inc.
- University of Illinois College of Law
Obj. 4: Experts’ Suggestions for Improving Environmental Disclosure

What we found:

- Experts suggested:
  - modifying the requirements and guidance,
  - increasing SEC oversight,
  - pursuing nonregulatory initiatives

- Some experts commented that certain suggestions are unnecessary or unworkable

- Reporting companies said some suggestions would not improve disclosure
Key Conclusions

- Without more compelling evidence that environmental disclosure is inadequate, the need for changes to existing requirements or guidance or increased monitoring and enforcement is unclear.

- SEC should ensure that it has the information it needs to allocate its oversight resources and determine where additional guidance might be warranted.
Recommendations

We recommend that SEC

- Track key information from its reviews of company filings to facilitate analysis

- Explore the creation of a publicly accessible database of comment letters and company responses.

SEC is taking steps toward implementing these recommendations.

We also recommend improved coordination between SEC and EPA on environmental disclosure.
Enclosure II

GAO Contacts and Staff Acknowledgments

**GAO Contacts**

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**Staff Acknowledgments**

In addition to the individuals named above, Kate Bittinger, Mark Braza, Stephen Cleary, Evan Gilman, Kevin Jackson, Rich Johnson, Les Mahagan, Tom Melito, Lynn Musser, Cynthia Norris, and Judy Pagano made key contributions to this report.
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