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Disclosure of Liabilities in Brazil in Light of International Accounting Standards[i]

Álvaro Augusto Ricardino Filho

Universidade de São Paulo

Ivone Gonçalves Luiz

FUCAPE - Capixaba Foundation for Research in Accounting, Economy and Finance

Luciene Santana

FUCAPE - Capixaba Foundation for Research in Accounting, Economy and Finance

ABSTRACT: This article investigates the use of liability disclosure concepts, according to the standards introduced by the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting *(*UN-ISAR) in 1997. We analyzed the financial statements of the ten best Brazilian companies classified by the ANEFAC/FIPECAFI/SERASA Transparency Award for 2003, considered by a committee of specialists as having the best accounting publications for that year. By examining the content of these financial statements, we determined the level of adherence of these companies to international liability disclosure standards, i.e., the classification of liabilities into legal, constructive and equitable obligations. We found that Brazilian companies still disclose liabilities in the traditional form, only considering legal obligations, not constructive and equitable ones. This is true even when these companies published statements in other countries.

Key words: liability disclosure, international accounting standards

Álvaro Augusto Ricardino Filho
Doutorado em Controladoria e Contabilidade
Pontifícia Universidade Católica de São Paulo
Adress: Rua Monte Alegre, 984, Perdizes, 05014-901 - Sao Paulo, SP - Brazil
Email: aricardinofilho@gmail.com
Telephone: (11) 36708431

Ivone Gonçalves Luiz
Doutorado em Ciências Contábeis e Administração
Faculdade Novo Milênio
Adress: Av. Santa Leopoldina, 840, Coqueiral de Itaparica, 29075010 - Vitória, ES – Brazil
Email: ivone@fucape.br
Telephone: (27) 33995560

Luciene Santana
Mestrado Profissional em Ciências Contábeis
Faculdade do Centro Leste
Adress: Rodovia ES 010 Km 6, Manguinhos, 29703855 - Serra, ES – Brazil
Email: lu.sant1015@gmail.com
Telephone: (27) 34340100

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I. INTRODUCTION

The liability side of the balance sheet traditionally has contained a company's obligations and commitments in money, goods or services to creditors (individuals or companies). The Financial Accounting Standards Board (FASB) (2001, p. 4) defines liabilities as follows: Probable future sacrifices of economic benefits, resulting from the present obligations of a determined entity, in transferring or providing services to other entities in the future, in function of past transactions or events.

However, in recent years, due to the complexity of the financial transactions involving these obligations, a need has arisen for a more detailed conception for recognizing, measuring and disclosing liabilities.

In this context, international regulatory organs on accounting rules and standards, such as the Public Sector Committee (PSC*)* and the International Federation of Accountants (IFAC), published a study in 1995 entitled *Accounting for and Reporting Liabilities,* in which the preliminary focus was verification of the concepts and practices for recognition and disclosure of the types of obligations in the financial statements prepared by national governments and nonprofit entities. This study also made a comparison of the various ways to define liabilities used by the accounting standards organs of diverse countries (Australia, Canada, Italy, Holland, United Kingdom and United States), resulting in identifying a need for a better way of recognizing, measuring and disclosing liabilities.

Besides this, the study highlights the existence of a debate over exactly when a legal obligation causes a liability. The idea of obligations was extended beyond just legal obligations to equitable and constructive obligations, which could also be considered as liabilities from a broader perspective. These responsibilities can originate from the normal course of business or prioritize equity (or justice). For example, a business may regularly replace or repair defective products even after the warranty period.

In 1997, the United Nations, through the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (UN-ISAR), also published a report stressing the disclosure of types of liabilities in the environmental reports published by companies, in which it exposed concepts on the recognition of environmental liabilities. According to the UN-ISAR (1997), the obligations are classified as:

- **Legal:** those arising by force of legal instruments (legislation, penalties imposed by law, etc.);
- **Constructive:** those the company spontaneously proposes to honor due to ethical and moral factors, independent of the law.
- **Equitable:** the obligations the company finds itself obliged to honor due to ethical and moral factors, independent of the law.

Similarly, the FASB (in Ribeiro and Lisboa, 2000, p.2) stresses that the term "obligations" is not restricted to "legal obligations", but instead covers the social side and can be determined by contracts or by moral and ethical responsibilities.

Reflecting on the panorama of the evolution of accounting theory, Hendriksen (in Iudícibus, 2000) supplies a focus, determining that in the total liabilities, even if there is no legal obligation, estimates must also be included of constructive and equitable obligations.

Based on the evolution of the concept of liabilities in accounting, some multinational companies have begun to publish their financial statements mentioning legal, equitable and constructive obligations. As an example, we can cite petrochemical companies such as Cooper Energy, Lakes Oil N.L and BP Australian Group Pty Ltd, which because they conduct activities with high environmental risk (polluting potential) face greater legal and social demands to disclose their liabilities in more detail.

Since accounting is a social science, it evolves along with society, and has the objective, according to Iudícibus (2000, p.19), "(...) of furnishing to users, regardless of their nature, a set of basic information that presumably should serve all equally well (...)". The search for better disclosure of liabilities is one of the factors showing this evolution.

Since the treatment of obligations is fundamental, both to report a company's financial position and to signal new investments, the present study intends to answer the following question: ***According to international standards, what is the level of disclosure of legal, equitable and constructive obligations in the financial statements published by the ten companies receiving the Seventh ANEFAC / FIPECAFI / SERASA Transparency Award in 2003?***

This annual award seeks to recognize the Brazilian companies publishing the best accounting statements, considering among other criteria quality and level of transparency of accounting information and also adherence to accounting principles.

By analyzing this sample, the study intends to help spread knowledge of a better way to report liabilities in the financial statements of Brazilian companies, i.e., disclosure that also includes classification of liabilities into constructive and equitable obligations rather than just legal ones.

II. REVIEW OF THE LITERATURE

2.1 Concept and Types of Liabilities

In accounting theory, according to Iudícibus (2000), the concept of obligations has various currents of thought, ranging from strict to broad. The most restricted view argues that only effective debts legally owed (legal obligations) should be included as liabilities. This is the view defended, for example, by the Committee of the American Accounting Association (AAA). In contrast, there are broader visions, such as that of the FASB, which supports recognition and disclosure of legal obligations along with constructive and equitable ones.

The idea of an equitable obligation is in fact nothing new. As far back as 1929, Canning (in Iudícibus, 2000, p.146) explained what should be included in the liabilities:

> *An obligation is a service, with a monetary value, that an owner is obliged to provide by a legal or equitable rule to a second person or group of people, as long as it is not an unconditional compensation for specific services of equal or greater monetary value owed by this second person to the owner.*

Hendriksen (in Iudícibus, 2000, p.146) goes further, admitting that amounts to be paid in the future for damages, or for services rendered later, should be included in the liabilities, even if there is no legal obligation to make such payments.

For the FASB (in Hendriksen and Van Breda, 1999, p. 286), there are three essential characteristics of liabilities on the balance sheet:

- *A present obligation or responsibility to one or more entities calling for probable future transfer or by the use of assets on a specified or determinable date, in the occurrence of a predetermined event, or on demand.*
- *An obligation or responsibility that binds a given entity, giving it little or no freedom to avoid a future sacrifice.*
- *A transaction or other event that obliges the entity that has already occurred.*

For the FASB, this second characteristic is not restricted only to the obligations a company is legally subject to pay, but also includes equitable and constructive obligations, whence the FASB starts to delineate new classifications, or concepts, for liabilities.

Kam (1990) agrees with the FASB regarding recognizing and disclosing constructive and equitable obligations, not just legal ones. According to him:

> *A company can have an equitable obligation to complete and deliver a product to a customer that does not have sources of funds for payment (which would be a failed sale), and subsequently legally demand the merchandise be returned or its effective payment (...) in the form, a company can create a constructive obligation to its employees to give paid vacation or a bonus for time of service that is not contractually limited. (KAM, 1990, p. 111).*

This more inclusive approach to classifying obligations is shared with other authors, such as Hendriksen and Van Breda (1999, p.287), who in exemplifying the types of obligations include equitable and constructive ones as follows:

> *(...) equitable obligations result from ethical or moral limitations instead of legal restrictions. For example, a company may feel ethically obligated to satisfactorily finish the repairs on a customer's car, even though the legal obligation only covers refunding the customer's money.*
> *(...) constructive obligations result from customs, for example, if a company typically gives vacation to its employees once a year, it can be inferred that this practice represents an obligation of the company.*

International entities for accounting research and standards cover this new classification of liabilities. For example, the Canadian Institute of Chartered Accountants (CICA) (2003, p. 1) makes the following observations:

> *Liabilities are current obligations arising from past transactions or events and cause an expectation of future sacrifice of economic*

> *benefits. Liabilities include those arising from contractual or legislative, constructive and equitable obligations;*
> *For liabilities that cannot be recognized, because a reasonable estimate of the amount involved cannot be made, the information on the nature and possible amounts should be disclosed in notes;*
> *Where there is a measurement uncertainty related to a recognized amount, the nature and extent of this uncertainty should be disclosed unless the disclosure of the amount would have an adverse effect on the entity.*

According to another accounting standards organ, the Australian Accounting Standards Board *(*AASB, 2001), an example of an equitable obligation would be where an entity makes a public announcement that it will give financial help to the victims of a recent natural disaster, because of customs and moral considerations, even though there is no legal obligation to do this.

The main difference between legal and constructive obligations according to the International Accounting Standards Board (IASB) can be explained by considering the consequences of inadequate behavior by the company. A legal obligation requires suitable behavior or results in a fine that should be at least economically equivalent to the failure to do what is adequate. Constructive obligations are always based on an expectation of continuing past behavior, or of future behavior where an expectation of this has been created.

The IASB exemplifies, in International Accounting Standard (IAS 19), also regarding constructive obligations, that a company may have no obligation to pay any bonus to its employees (profit sharing, for instance). Nevertheless, in some cases the company has this practice. This being so, in such cases it will have a constructive obligation, since although there is no legal obligation, it will pay the bonus due to custom.

2.2 Recognition of Liabilities

The question of when to recognize a liability is another controversial point, because there are some that are not easy to recognize or measure. However, even if this is not possible, the fact of recognition does not change the nature of this element, since it continues to be a liability, albeit not recognized.

The Canadian Institute of Chartered Accountants (CICA, 2003) states that liabilities should be recognized in the financial statements when:

a) there is an appropriate basis for measurement;
b) a reasonable estimate can be made of the amount involved.

As a rule, equitable obligations (environmental, for example) should be subject to a probability of demandability that can be reliably measured (or reasonably calculated). The words “probability” and “reliably” (or “reasonably calculated”) are important in interpreting the main accounting standards.

In IAS F91, the IASB (in Schaltegger and Burrit, 2000, p.184), this is expressed:

> *An obligation is recognized on the balance sheet when it is probable that the resources used result in economic benefits and result in the determination of a present obligation that can be reliably measured.*

Reliability is a very important characteristic in decisions, since it ensures that the information is reasonably free of errors (HENDRIKSEN and VAN BREDA, 1999).

So, there needs to be some reliability, even if not certainty, to the recognition and measurement of a liability. But it is also necessary for there to be a balance with relevance, which, according to the FASB, is the capacity that the information would have to make a difference in a decision, because then this information will be useful to the various users of information (which is the objective of accounting).

2.3 Disclosure

Regarding disclosure, Schaltegger and Burrit (2000, p.190) state that:

> *Disclosure is the process of incorporating countable financial elements (resources, obligations, expenses and revenues) on the balance sheet, in the statement of income, in notes and the other financial statements.*

International standards organizations have devoted much time and effort to discussing the best ways to disclose liabilities. For example, the IASB, in IAS 10 (in Schaltegger and Burrit (2000, p.190), requires that events of loss and contingencies be disclosed, and that furthermore, unrecognized obligations that are pertinent to a company's financial position should be reported in notes, environmental reports (when related to environmental liabilities) or the annual report.

For the CICA (2003), an obligation can be defined as a responsibility, but may not be recognized in the financial statements because it is impossible to make a reasonable estimate of the amount involved. The information on the nature and worth of obligations that cannot be recognized should be reported in notes by means of a reasonable estimate of the amounts involved. The CICA and the IASB agree here in determining that the information should be reported in notes to the financial statements.

Also on the matter of disclosure, the AASB (2001, p. 6) specifies a minimum disclosure required in relation to provisions, contingent obligations and contingent resources. The specific disclosure will include information regarding:

- the nature of the provision or contingency;
- changes in recognized amounts;

and regarding contingencies:

- indications of the uncertainty relating to the amount or timing of the sacrifice or the inflow of future economic benefits;
- an estimate of the amount of the financial effect, if practicable;
- the existence and amount of any potential recoveries.

In Brazil, authors have an approach to disclosure of liabilities that is restricted mainly to the environmental area, specifically regarding equitable and constructive obligations. Ribeiro (2000, p.3) relates that environmental liabilities should be recognized, in the period in which they occur, in notes to the financial statements. She goes on to state that:

> *The notes to the financial statements should be used to report the contingencies and events occurring after the balance sheet closing date, as well as expected losses whose amounts may be greater than provisioned.*

Hendriksen and Van Breda (1999, p.410) affirm that "(...) simultaneous to the growing awareness of the need to recognize more obligations on balance sheets, there has been an explosion of different types of liabilities."

Faced with what has been described in the previous citations, we can observe that the complex circumstances of companies' financial transactions has been forcing a change of attitude among regulatory organs and authors on accounting theory regarding the classification, recognition and disclosure of liabilities.

Observing this phenomenon, we propose to verify the level of disclosure of legal, equitable and constructive obligations (according to international standards) in the financial statements of the ten Brazilian companies that received the Seventh ANEFAC / FIPECAFI / SERASA Transparency Award in 2003.

Through this award, we analyze the balance sheet of the companies selected from among the 500 biggest and best private Brazilian firms in the area of commerce, industry and services, except financial services, and the 50 largest government-owned companies.

The ANEFAC took the initiative of creating this award to encourage companies to endeavor to produce numbers, balance sheets and other financial statements that are clear, accurate and transparent to the various users of accounting information.

III. HYPOTHESIS OF THE WORK

In Brazil, studies and research available classifying obligations as legal, equitable and constructive focus basically on the environmental area, and the Brazilian bibliography is still scanty even in this respect. In contrast, the evolution of disclosure of liabilities in countries like the United Kingdom, Canada, the United States and Australia, where the subject is still controversial, has been widely discussed by their regulatory and accounting research organs. Based on this, we pose the following null hypothesis:

H_0: *Brazilian companies still disclose liabilities in the traditional form, i.e., only considering those referring to legal obligations and not including equitable and constructive obligations*.

IV. METHODOLOGY FOR RESEARCH, SELECTION AND TREATMENT OF THE DATA

In conducting this study, we used the technique of content analysis, which is defined by Bardin (1997, p.42) as:

> A set of analytical techniques seeking to obtain, by means of systematic and objective procedures, to describe the content of messages, using quantitative or non-quantitative indicators to permit inferring awareness of the conditions of production/reception (inferred variables) of messages.

The general objective of this work is to verify, ***according to international standards, the level of disclosing legal, equitable and constructive obligations in the liabilities of the 10 companies receiving the Seventh ANEFAC / FIPECAFI / SERASA Transparency Award in 2003***, using content analysis of their respective financial statements.

We obtained the information on these companies from their sites and analyzed the text (sentences) of the published accounting reports, identifying the characteristics of obligations, i.e., observing the concepts of legal, equitable and constructive obligations. By means of these financial statements and accompanying reports, we sought to identify all references to liabilities, which we subsequently classified considering the following categories defined for analysis of the data:

- Declarative Information – when the information was presented in qualitative form and expressed in purely descriptive terms.
- Quantitative Non-monetary Information – when the information was presented in quantitative form and expressed in numbers of a non-financial nature.
- Quantitative Monetary Information – when the information was presented in quantitative form and expressed in numbers of a financial nature.

We limited the study to the notes to the financial statements and annual reports, in which the concentration of information was perceptively significant.

From analysis of the sentences, we prepared tables and graphs to demonstrate the disclosure of obligations.

TABLE 1
Disclosure by Type of Obligation, Type of Report and Type of Information
(in number of sentences)

Disclosure by type of obligation, type of report and type of information (in number of sentences)	Annual Report			Notes to Financial Statements			Total sentences from all reports			Was there conformity with international disclosure standards? (*)	
Type of information -------------------------------->	***D***	***Q***	***M***	***D***	***Q***	***M***	***D***	***Q***	***M***	Yes	No
Legal Obligations											
Loans and financing contracted				27	7	19	27	7	19		x
Insurance	1			4		13	5		13		x
Contracts with third parties	1			3		2	4		2		x
Tax obligations	2			10	1	5	12	1	5		x
Labor obligations	4			7	1	6	11	1	6		x
Environmental obligations				4		2	4		2		x
Legal provisions and contingencies				3			3				x
Constructive Obligations											
Sponsored complementary pension plan	2		6	10	2	14	12	2	20		x
Sponsored health plan											x
Profit sharing	1			3	2		4	2			x
Provision for product warranty claims				1			1				x
Provision for product improvement				1			1				x
											x
Equitable Obligations											
Enviornmental and social responsibility and commitments				4			4				x
Total sentences analyzed											168

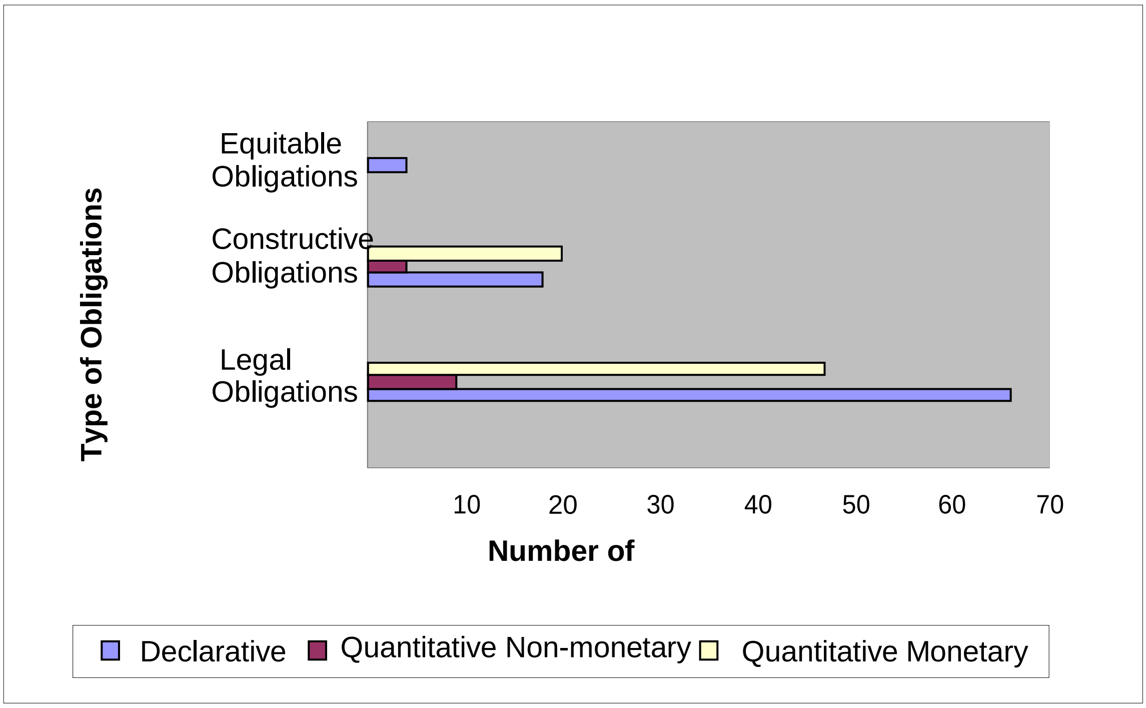
Type D - Declarative Information - when the information was presented in qualitative form and expressed in purely descriptive terms
Type *Q* - Quantitative Non-monetary Information - when the information was presented in a quantitative form and expressed in numbers of a non-financial nature.
Type M - Quantitative Monetary Information - when the information was presented in quantitative form and expressed in numbers of a financial nature.
(*) - Disclosure of legal, fair and constructive obligations.

Table 1 shows the content of the annual reports of management and the notes to the financial statements of the 10 companies. The data disclosed were grouped according to the nature of the liabilities, i.e., legal, equitable and constructive obligations.

We classified the data by inference of the type of liability in each sentence found, since none of these companies made specific mention of classifying obligations as legal, equitable and constructive. Hence, none of these firms can be said to be in conformity with international liability disclosure standards.

Subsequently, the sentences found were classified according to the information categories (Declarative, Quantitative Non-monetary, Quantitative Monetary), and Graph 1 was prepared based on Table 1.

GRAPH 1
Disclosure by Type of Obligation and Information



Graph 1 shows the preponderance of Declarative information, which leads to the supposition of a difficulty of measuring obligations classified as equitable and constructive.

By analyzing Table 1 and Graph 1 together, it can be seen that the greatest concentration of information was found in the notes, and that legal obligations were preponderantly disclosed, such as under *Loans and financing contracted*. There is also disclosure of obligations that, by their nature, arise from customs, such as under *Sponsored complementary pension plan.* Equitable obligations, which in the case under analysis refer to environmental liabilities, were sparse in comparison with the total of other obligations.

We then prepared Table 2 to show the disclosure pattern for each company analyzed and the distribution of obligations by types.

According to Table 2 and Graph 2, the majority of companies disclosed, as seen previously, only legal obligations in their reports and notes.

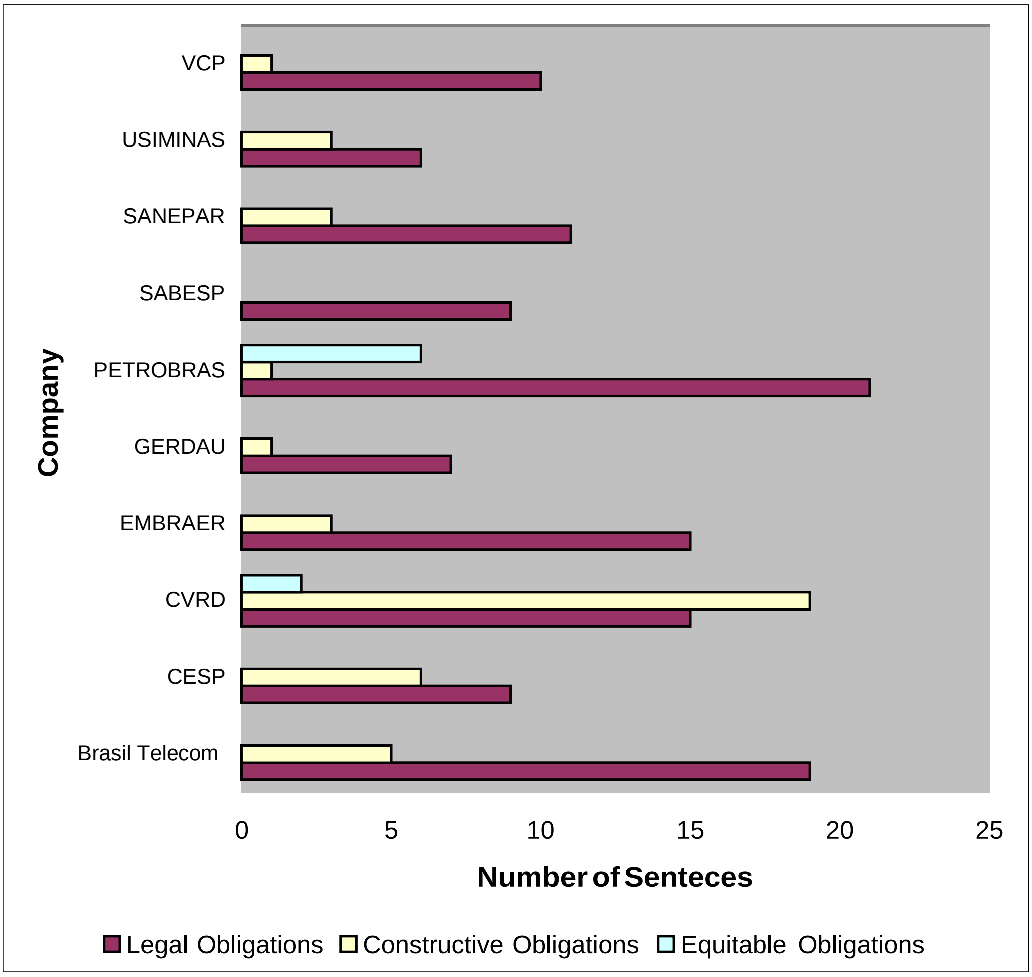
TABLE 2
Disclosure by Type of Obligation and Company (in number of sentences)

Disclosure by type of obligation and company (in number of sentences)	Brasil Telecom S.A[1]							EMBRAER[4]	GERDAU S.A[5]	PETROBRAS[6]
Legal Obligations										
Loans and financings contracted	13	5	5	4	2	11	5	2	2	4
Insurance	2	2		5		5		3		1
Contracts with third parties	1					1		3		1
Tax obligations	2	1	5	1	3	1	3		2	
Labor obligations	1	1	5	1	2	1		2	2	3
Environmental obligations				4		1	1			
Legal provisions and contingencies						1		1		1
Constructive Obligations										
Sponsored complementary pension plan	4	5	17	1	1	1		2	3	
Sponsored health plan										
Profit sharing	1	1	2					1		1
Provision for product warranty claims				1						
Provision for product improement				1						
Equitable Obligations										
Environmental and social responsibility and commitments			1			3				
Total sentences analyzed	**24**	**15**	**35**	**18**	**8**	**25**	**9**	**14**	**9**	**11**

1 – Brasil Telecom S. A.
2 – Companhia Energética de São Paulo. 3 – Companhia Vale do Rio Doce.
4 – Empresa Brasileira de Aeronáutica.
5 – Petróleo Brasileiro S.A.
6 – Gerdau S.A.
7 – Cia. Saneamento Básico do Estado de São Paulo.
8 – Companhia de Saneamento do Paraná.
9 – Usinas Siderúrgicas de Minas Gerais S.A.

Based on Table 2, we prepared Graph 2.

GRAPH 2
Disclosure by Type of Obligation by Company



It was also possible to discern that the companies that in some form disclosed obligations that can be classified as "equitable", in this case referring to Social and Environmental Responsibility, are those that have high polluting potential, such as oil company Petrobras and mining company CVRD.

V. CONCLUSION

The information contained in the annual reports and financial statements of the companies in the sample studied leads to the confirmation of the study's hypothesis that Brazilian companies still disclose liabilities in the traditional way, i.e., mainly considering those referring to legal obligations. This corroborates the opinion of Hendriksen and Van Breda (1999, p.287) that "(...) the strictest position has been that only obligations or debts of a legal character should be included as accounting liabilities," since according to these authors, the broader approach to concepts of liabilities can create difficulties for accountants as to the moment of their recognition. Equitable and constructive obligations are derived from social or moral sanctions or customs. This makes it hard to find a reliable base to measure such obligations.

Kam (1990) also considers that the classification of obligations into equitable and constructive ones is inconsistent in practice, since social and moral responsibilities are difficult to classify. This also occurs for companies that operate internationally, which forces accountants to make moral judgments. Exactly because of the lack of a clear legal basis for recognition of constructive and equitable obligations, such classification can cause a company to assume a future liability that it might otherwise not have had to do.

Companies that offer bonuses to employees at career end (considered a constructive obligation because it arises from custom), for example, may in the future not be willing to bear such obligations. However, according to Hendriksen and Van Breda (1999, p. 410), in characterizing liabilities, "(...) there can be no freedom to avoid future sacrifice", which leads to a conflict with the example cited. Hence, such situations generate difficulties for classifying obligations as equitable and constructive.

Therefore, there needs to be greater harmonization regarding the use of the concepts of legal, constructive and equitable obligations, both in Brazil and internationally, because it is still a polemic point, so that accounting and financial professionals can have a clearer guide and thus supply more information on companies' liabilities that can be useful to users in making their decisions.

We hope the information in this study has contributed to increase knowledge about the disclosure of the liabilities of Brazilian companies according to international standards. Since this is still a little-investigated subject, we suggest further research on the theme.

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