

Accounting for the future, addressing the past: Understanding environmental liabilities

For many years, environmental issues were relegated down the list of corporate priorities because they had no direct link with the proverbial bottom-line. Not so any more. Environmental liabilities today can run into many millions of Rands. And yet still most South African companies are ill-prepared for the increasing financial impact of environmental issues on their business.

History catches up with us eventually

Environmental liabilities are the legacy of past actions. What society has gained from the industrial revolution in comforts and efficiency, it has generally sacrificed in the health of the ecosystem on which it depends. A recent Time Magazine Special Issue entitled Out Precious Planet summarises this collective liability succinctly in the following quote: "Our grandchildren may have access to conveniences that further reduce the drudgery of everyday life, but they will also inherit a planet with less than 20% of its original forests intact, with most of the readily available freshwater already spoken for, with most of the wetlands and reef systems destroyed or degraded, and much of the arable land under plough. They will inherit a stressed atmosphere and an unwanted legacy of toxic waste in the soil and water. Missing from the estate will be countless species, most wiped out before even being catalogued by scientists.

Gone as well will be troves of aboriginal knowledge that have disappeared as tribal people lost their lands or abandoned their traditional ways."

Environmental management comes of age

As a result of these global impacts, the 1990s has seen environmental issues come centre-stage in politics and business. The United Nations "Earth Summit" in Rio de Janeiro in 1992 witnessed one of the largest international gatherings of heads of state, business leaders and civic organisations ever. In response, the International Chamber of Commerce issued its Business Charter for Sustainable Development and in 1995, the World Business Council for Sustainable Development was formed. In December 1996, the International Standards Organisation issued the first in its series of Environmental Management standards, ISO 14001 on environmental management systems. The international trend is clear.

In South Africa, the new government has taken this global movement to heart by enshrining "the right to an environment not harmful to people's health or wellbeing" in the constitution, and initiating a comprehensive programme of reforming various key environmental legislation.

Included in this transformation process are new policies and regulations on environmental management, water, minerals, pollution control, waste management and environmental impact assessment. Business has responded by forming the Industrial Environmental Forum of Southern Africa and taking a more pro-active approach to its environmental responsibilities.

This shift in private sector attitudes is confirmed by the 1997 KPMG-IEF Top SA Companies Environmental Survey, which shows that environmental issues are already important for South Africa's top companies and are anticipated to become increasingly so, driven by a number of key forces in the market, especially government policy and legislation, public opinion, customer demand and international trade requirements. Furthermore, over half of the top companies have instituted a board member with environmental responsibilities, an environmental policy, environmental donations or sponsorship and an environmental management system. In addition, more than a third of top companies annually spend in excess of R1 million on the environment, some hundreds of millions.

What are environmental liabilities?

One of the best definitions of environmental liabilities is provided by the Institute of Chartered Accountants in England & Wales. According to their guidance document on the subject, when an entity has an obligation, or is otherwise committed, to incur future expenditure to prevent, reduce or repair environmental damage, the costs involved represent an environmental liability.

The most popular reference point for environmental liabilities is often the United States, due to its introduction of the so-called Superfund legislation. The Superfund refers mainly to the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), which Congress enacted to facilitate the remediation of facilities or waste sites that are abandoned or inactive or whose owners are insolvent, as well as some sites still in operation. This process has been further strengthened by the Securities Exchange Commission's introduction of compulsory disclosure requirements with respect to these environmental liabilities.

But there is more to understanding environmental liabilities than the Superfund approach.

Conceptually, environmental liabilities in South Africa can be considered under four broad categories: Legislative liability, rehabilitation and clean-up costs, community and public liability, and macro-economic instruments. These will first be explored in some detail before turning attention to the financial issues and requirements for accounting disclosure and treatment.

Legislative liability

There are a number of provisions in the law which can have financial implications related to environmental issues¹. The most obvious of these are fines and penalties for non-compliance with environmental legislation, such as infringing permit conditions or causing unacceptable pollution.

Penalties often include incarceration (jail sentences) for the offending parties.

For example, in terms of various sections of the Water Act, 54 of 1956, persons convicted of a criminal offence (which includes water pollution) are, in the case of a first conviction, liable to a fine not exceeding R50 000 or imprisonment not exceeding two years, or both such fine and imprisonment. In this case, the amount of the fine can also include “the monetary value of any advantage gained or likely to be gained by such person in consequence of that offence”, as assessed by the court.

At present, the maximum stipulations for fines and penalties are set out in clause 159(2) of the draft National Water Bill, 1998. This provides that any person who is convicted of contravening any provision of subclause 159(1) is liable, in the case of a second or subsequent conviction, to a fine (presently calculated at R200 000) and imprisonment not exceeding ten years.

Rehabilitation / clean-up costs

The costs related to clean-up and/or rehabilitation can run into hundreds of millions of Rands, and can either be undertaken voluntarily, or enforced under certain conditions by legislation. The expenditure may be related to clean-up of pollution incidents, contaminated land, past waste disposal sites or the rehabilitation of existing operating or waste disposal sites in the future.

Examples of the provisions in the law which can enforce clean-up and the recovery of associated costs by government include sections 22A and 22B of the Water Act, 54 of 1956, sections 29(7) and (8) and 31A(2), (3) and (4) of the Environment Conservation Act, 73 of 1989, and sections 38 to 42 of the Minerals Act, 50 of 1991.

The key point here is that, although companies may have been in full legal compliance in the past or operating within industry norms, this does not preclude the recovery of costs from them for the clean-up or rehabilitation of what is regarded as unacceptable practice or pollution in terms of current-day law.

For example, in terms of section 22A of the Water Act, such costs can be recovered “from any person who at any time did any thing on the land concerned which caused or contributed to the ... pollution”. And section 22B provides that such costs can be recovered “from any person who, at the time of the occurrence of the pollution incident, was the owner of any substance involved therein and from any person who through his negligent handling of that substance, caused or contributed to the occurrence of the pollution incident.” Section 22A also provides for the recovery of the costs referred to in

that section from any person who, directly or indirectly, has gained or is likely to gain any advantage from any thing done through the pollution of the water.

Such advantage may include or consist of the enhancement of the value of any land.

Furthermore, there has been unofficial talk in government circles about the compilation of a national register of contaminated land.

Community / public liability

An area which is currently less significant, but which is likely to grow, is that of community or public liability. One form this can take is civil damage claims, which have the backing of the law in terms of section 24 of the Constitution and various sections of the environmental Acts. For example, section 171 of the Water Act provides for the convicted person to be ordered by the court to pay for the loss or damage caused by the offence.

South Africa's most infamous case is that of Thor Chemicals which was related to the deaths of two workers from mercury poisoning. The case involved several government investigations, a hearing before the International Water Tribunal, a criminal case in South Africa resulting in three of Thor's top management officials being charged with culpable homicide and 42 other charges, a civil case in the UK against the English-based Thor companies, and an eventual combined settlement in excess of R9 million. Of course, there are other less dramatic and less public cases as well, particularly in the mining and chemical industries.

The costs include the legal expenses of companies defending themselves against claims by individuals or environmental groups, as well as delays in scheduled production processes which these legal battles may cause. An example of this is the recent High Court decision to set aside the mining permit for the new Sasol R500 million Vaal strip coal mine, due to inadequate consultation with interested and affected parties, represented by the Save the Vaal Environment (SAVE) action group.

Another liability which is more difficult to quantify but no less important is the amount which is spent by companies to promote or restore public "goodwill", especially after a negative environmental incident. These marketing and public relations costs can be fairly significant in size.

Macro-economic instruments

The last kind of environmental liability, in the sense that it entails significant future expenditures, has to do with macro-economic instruments. The most topical of these in South Africa at present is the substantial proposed changes to water pricing, as implied in the new Water Bill, 1998. For many large industrial companies who are high-volume users of water, this additional cost may run into a few hundred million Rands.

Another focus area at present is the regulation of greenhouse gas emissions to reduce global warming effects, recently discussed at the international Kyoto Summit. The ensuing agreement, the Kyoto Protocol, has committed to employing tradable emissions permits once the mechanism has been refined. Essentially, companies will be given a pollution quota, over an above which they will have to purchase emissions credits from companies who have performed below their quotas. The effect of this could be significant for companies responsible for large volumes of greenhouse gases such as carbon dioxide, methane, HCFCs and SF₆.

There has also been considerable international debate recently about the introduction of ecological taxes. These would tax resource consumption inputs and pollution/waste outputs, in order to encourage conservation and cleaner production. There are limited examples of this approach in other countries already, such as the landfill tax in the UK. Were similar policies to be implemented in South Africa, these would again have the effect of a liability for many companies.

Financial implications of environmental liabilities

The identification of environmental liabilities raises several questions for the financial and accounting profession. For example: n Are companies making financial assessments of potential environmental liabilities, based on a rigorous environmental risk assessment process? n Are financial managers recognising and making financial provision for these environmental liabilities in anticipation of significant future costs? n Are financial auditors aware enough of the possible impacts of environmental liabilities to assess whether the company's financial position is being accurately reflected? n Is there sufficient professional accounting guidance on how companies should recognise, disclose and account for environmental liabilities? n And are the attitudes of government and the public mature enough to encourage proactive identification and disclosure of environmental liabilities by companies, without fear of undue recrimination or judgement?

These and other related questions will all need to be addressed by the profession in due course.

For the time being, it is worth considering what the international bodies are proposing with respect to disclosure and treatment of environmental liabilities.

Accounting disclosure and treatment

Several of the international organisations have detailed guidance on environmental liabilities, among them the American Institute of Certified Public Accountants, Canadian Institute of Chartered Accountants, Institute of Chartered Accountants in England & Wales, International Accounting Standards Committee, International Federation of Accountants and the United Nations Economic and Social Council. The University of Pretoria's Department of Accounting also makes recommendations in this area, as part of its research programme into Environmental Reporting in South Africa.

Some of the common recommendations of these bodies, together with KPMG's professional opinion, are summarised as follows: 1. A liability is a present obligation resulting from past transactions or other past events, the settlement of which will lead to an outflow of resources embodying economic benefits in order to satisfy a third party claim. 2. Liabilities should be recognised in the financial statements when the following criteria have been met: ■ It is probable that any future economic benefit associated with the liability will flow from the enterprise; and ■ The liability has a cost that can be measured with reliability. 1. Environmental liabilities should be disclosed separately in the financial statements.

Disclosure should include:

- A description of the nature of the liabilities;
- An indication of the timing and terms of their settlement; and
- Rand amounts of environmental liabilities, contingent liabilities and reserves established in the current period. 1. In the case where environmental liabilities are not recognised due to fact that no estimate can be made of them, the following should be disclosed: ■ The nature or the future expenditure or loss as well as the probability that it will realise; ■ A statement that an estimate of expected expenditure or loss cannot be made; and ■ The timing of the expected future expenditure or loss.

Concluding remarks

Environmental liabilities are a complex issue which will increasingly impact on financial and accounting practices. A clearer understanding of the nature and extent of these liabilities needs to be gained by professionals in both the environmental and financial disciplines. This will be aided by the emergence of international environmental accounting standards, such as the one due for release by the International Accounting Standards Committee later this year. Companies with significant potential environmental liabilities which are not being assessed or provided for will have to begin this practice. In addition, companies should look towards establishing an integrated environmental accounting system which can encourage effective environmental management decisions, accurate assessment of business risk, and more transparent public disclosure.

The time has come for society to begin counting the costs of environmental degradation. Is the financial and accounting professional ready to play a leading role?

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Notes

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