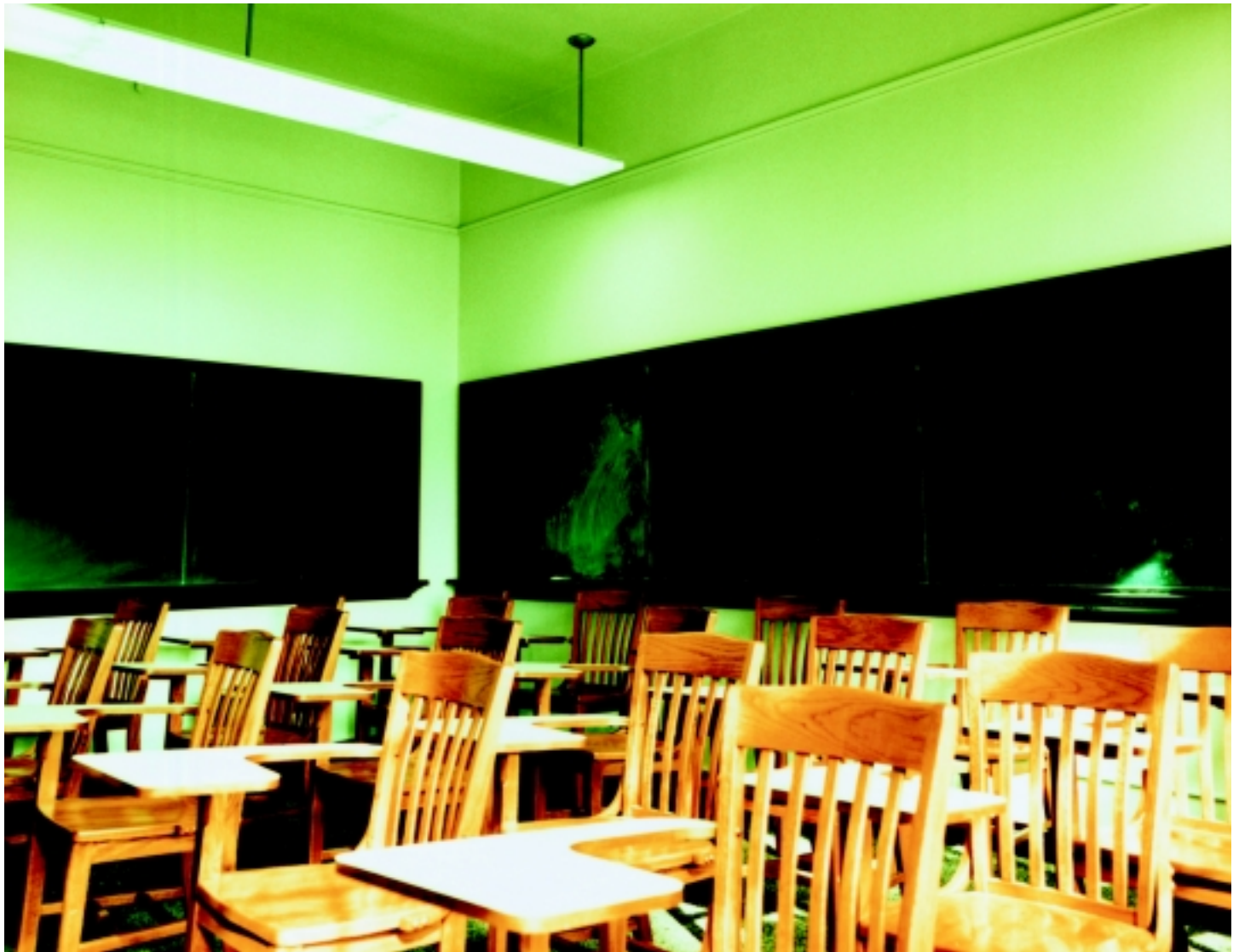




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Introduction

INTRODUCTION

As the World Summit on Sustainable Development, being held in Johannesburg this year, will testify, environmental issues are no longer merely an item of corporate social responsibility. Environmental issues today can significantly impact the business performance and financial profitability of companies. This was recently confirmed in the *2001 KPMG survey on Environmental Accounting in South Africa*, where 65% of the surveyed companies regarded the potential financial impacts of environmental issues as 'highly significant', while the remaining 35% believed them to be 'moderately significant'. One of the main drivers of this trend is the emergence of

environmental liabilities – financial obligations that companies have to provide for, incur and disclose, in order to address environmental concerns. The abovementioned survey showed that 74% of companies were already measuring environmental liabilities. Levels of disclosure, however, remain low. For example, in the *2001 KPMG Survey of Sustainability Reporting in South Africa*, only 31% of the All Share Index 100 companies were disclosing any environmentally-related financial information in their annual reports. One of the reasons for low levels of disclosure, we believe, is that there is a lack of awareness, guidance and clarity on environmental liabilities – what they are, how to measure them

and when to disclose them. The purpose of this report is to begin to fulfil that gap.

This report looks at several different perspectives on environmental liabilities in South Africa:

- the institutional perspective;
- the due diligence perspective;
- the accounting perspective;
- the financial auditing perspective; and
- the legal perspective.

The institutional perspective

THE INSTITUTIONAL PERSPECTIVE

This section gives both an international and South African institutional perspective on environmental liabilities. The South African findings are based on interviews conducted with key representatives of the government departments and sector organisations referenced below, as well as relevant documentation issued by these institutions.

International – Commission of the European Communities

One of the most far reaching declarations on environmental liabilities is the *White Paper on Environmental Liability*, published by the European Commission in 2000. The following paragraphs quote some insightful sections of

the document.

“Environmental liability aims at making the causer of environmental damage (the polluter) pay for remedying the damage that he/she has caused. Environmental regulation lays down norms and procedures aimed at preserving the environment. In the absence of allocated liability, failure to comply with existing norms and procedures may merely result in administrative or penal sanctions. However, if liability is added to regulation, potential polluters also face the prospect of having to pay for restoration or compensation of the damage they caused.

Not all forms of environmental damage can be remedied through

assigning liability, i.e. holding one or more party liable. For the latter to be effective:

- there need to be one (or more) identifiable actors (polluters)
- the damage needs to be concrete and quantifiable, and
- a causal link needs to be established between the damage and the identified polluter(s).

Therefore, liability can be applied, for instance, in cases where damage results from industrial accidents or from gradual pollution caused by hazardous substances or waste coming into the environment from identifiable sources.

However, liability is not a suitable instrument for dealing with

pollution of a widespread, diffuse character, where it is impossible to link the negative environmental effects with the activities of certain individual actors. Examples are effects of climate change brought about by CO₂ and other emissions, forests dying as a result of acid rain and air pollution caused by traffic.”

The White Paper’s scope of environmental liability is also very revealing, as it includes:

- Damage to biodiversity;
- Damage in the form of contamination of sites; and
- Traditional damage (e.g. to health or property).

South Africa – Government and Sector Associations

In the course of this research, no

clear guidance was obtained from the Department of Environmental Affairs and Tourism regarding environmental liabilities. This in itself is a cause for concern. The Department of Water Affairs and Forestry mainly deferred to the existing legislation, while the institutions directly governing the mining sector were able to provide more detailed and specific clarification.

Department of Water Affairs and Forestry

The Department of Water Affairs and Forestry (DWAF) deals with water-related liabilities in terms of the National Water Act, 36 of 1998. A liability arises when there is non-compliance with the requirements of this legislation. Industry may then be held

accountable for the costs of clean up or damages.

DWAF operates on the ‘polluter-pays’ principle in the regulation and enforcement of environmental management. Hence, when an activity results in damage, the party in control of the activity (the operator), who is regarded as the actual polluter, has to pay the costs of repair. Should the operator fail to remediate the environmental damage adequately, DWAF may implement the necessary steps and charge on the costs to the polluter.

In cases where the polluting company cannot be identified or is unable to pay the clean-up costs, the government may look to third parties who in any way benefited

from the operations, or who will benefit from the rehabilitation, to share the costs. These issues are dealt with in more detail in the Legal Perspective section of this report.

Further information is available in the 1994 DWAF publication entitled: *Operational guideline concerning financial provision for the rehabilitation of land disturbed by mining activities*.

Department of Mineral and Energy Affairs

The Department of Mineral and Energy Affairs (DME) considers environmental liability to exist when there is pollution of any element of the environment (soil, water and air, including related social impacts). Liability will be

enforced upon the holder of a prospecting permit or mining authorisation when the post-closure rehabilitation of the land involved is unsatisfactory, i.e. it is not in accordance with the approved Environmental Management Program Report and the requirements of South African environmental legislation.

The Department can issue a directive for a clean up or redress of the environmental liability and three possibilities can result – the Department can:

- Order the responsible party to address the adverse environmental situation;
- Contract a third party to do the clean up and recoup the costs thereof at a later stage; or
- Assume responsibility, if they

cannot find the responsible party or the party is not in a position to address the situation.

In order to minimise potential environmental liabilities, the DME is becoming more stringent in its requirement for financial provisions for rehabilitation to be set aside in a trust fund. The rehabilitation trust is a separate legal entity and is used as a funding mechanism subsequent to mine closure.

Chamber of Mines of South Africa

The Chamber of Mines of South Africa exists to serve the mines (its members) and promote their interests in the South African mining industry. The Chamber considers environmental liability to arise when groundwater is

polluted, tailings dams are not remediated and waste dumps are abandoned to the detriment of the environment.

The Chamber has a guideline for the administration of financial provisions for mine closure and rehabilitation, as well as guidelines for rehabilitation (for the surface coal mining industry). The financial provision for rehabilitation of land disturbed by mining activities is aimed at the following:

- (a) the *rehabilitation* of disturbances of the surface of land and the prevention and combating of pollution of air, land, sea or other water where such disturbances and pollution are due to mining;
- (b) the *protection* of the surface or land and water sources and the making safe of undermined ground and of dangerous excavations, tailings, waste dumps and structures made in the course of mining; and
- (c) the *demolition or removal* of any building or structure constructed in connection with mining.

The Chamber of Mines requires a mine to make financial provision

for rehabilitation, where the provision can either be as a provision on the financial accounts, a security instrument (e.g. a bank guaranteed cheque) or a trust fund. In addition, the Chamber has set up a central rehabilitation fund. The main object of the fund is to make financial provision for expenditure, which a member company is likely to incur.

Further information is available in the 1980 Chamber publication entitled: *Handbook of guidelines for environmental protection and rehabilitation of land disturbed by surface mining* (Volume 3).

South African Revenue Services (SARS)

In terms of the Minerals Act, 50 of 1991, a trust can be created and a trust deed drafted in order to provide for rehabilitation closure costs. The application for registering a rehabilitation trust fund must be in writing to the Director General: Mining and Energy Affairs. On receipt of the application he/she will consult with the Chief Inspector and each government department charged with the administration of any law which relates to any matter affecting the environment.

The trust – whose sole object is to receive, hold and apply moneys contributed to it in order to discharge obligations imposed in terms of a law – is exempt from

normal tax. Furthermore, for a provision to qualify for a deduction for tax purposes, there must be an actual payment before year end and it must be approved by SARS.

The Commissioner has to approve the trust on terms he considers necessary to ensure that its activities are wholly directed to the furtherance of its sole object.

In his 2nd edition of the *Mining Tax in South Africa Hand Book*, Van Blerk's method of calculating rehabilitation provisions for tax purposes is the amount determined by dividing the present value of future environmental work by the estimated remaining life of the operation. The liability calculation has to be approved by the Commissioner before it can be implemented by the mining

company. The calculated amount can rank as a deduction entry once accepted by SARS.

The due diligence perspective

THE DUE DILIGENCE PERSPECTIVE

Business transactions today must include consideration of environmental issues. Complex laws can impose significant environmental liabilities on purchasers, sellers, and lenders involved in a financial transaction, whether or not they caused the environmental impacts or own the assets. Environmental liabilities associated with mergers, acquisitions, and similar business transactions can present substantial financial risks.

For example, acquiring a firm can expose the acquirer to liabilities hidden in its target assets, such as contaminated land, or significant capital costs to upgrade processes and equipment to meet

environmental legislation. Failure to identify the environmental risks and liabilities of a target entity can significantly affect the investment's return, and create ongoing compliance and operational costs for the acquiring firm. Lack of a complete understanding of the true value of the target assets can in turn lead an acquiring firm to pay more for the target entity than might be appropriate.

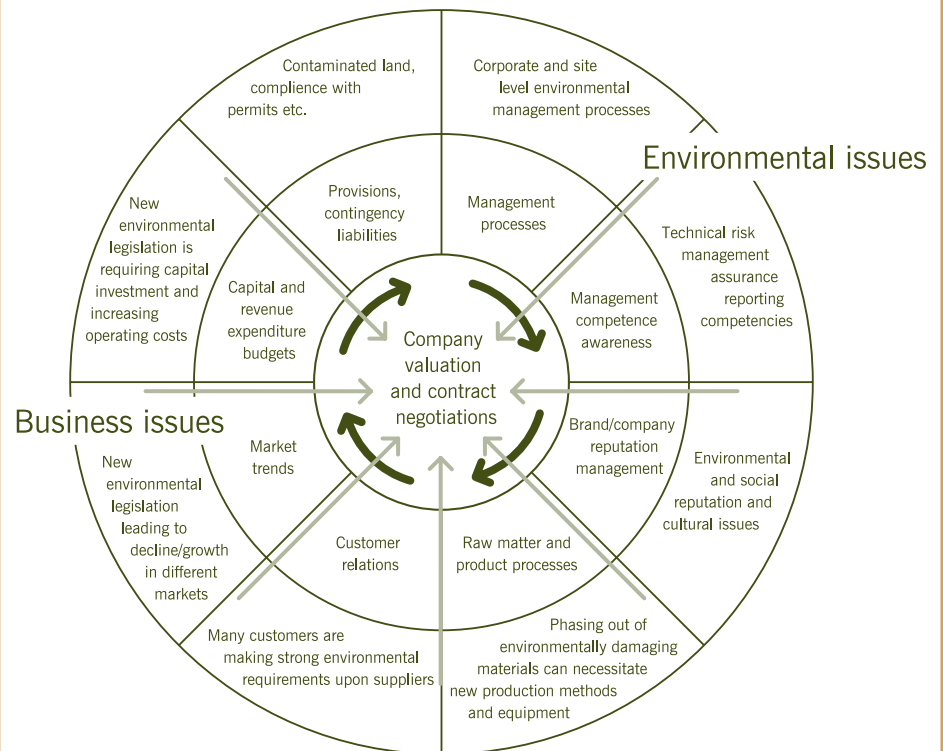
For these reasons, it is essential to use Environmental Due Diligence as a tool for determining environmental liabilities when financial transactions are being negotiated. This not only provides greater management assurance over the transaction, but also enhances the organisation's credibility in the eyes of often skeptical stakeholders.

The ISO 14015 standard on environmental assessment of sites and organizations gives some useful guidance that is relevant to due diligence investigations. In addition, recognising that environmental liabilities can arise from a variety of physical and business-related factors, the following diagram reflect's KPMG's holistic approach to environmental due diligence.

Typically, the physical assessment aspect of an environmental due diligence will take place in two phases. Phase I will use the method of site inspection, management interviews and documentation review to identify the potential existence of environmental liabilities related to historical or ongoing pollution or

lack of adequate controls. Should the risk be judged significant, a second phase is conducted to quantify the air, soil and water pollution impacts, through scientific sampling, testing and analysis.

KPMG'S HOLISTIC APPROACH TO ENVIRONMENTAL DUE DILIGENCE



The accounting perspective

THE ACCOUNTING PERSPECTIVE

Environmental matters are becoming significant to an increasing number of organisations and may, in certain circumstances, have a material impact on their financial statements. This is particularly true for environmental liabilities. These issues are of growing interest to the users of financial statements and other stakeholders. Hence, the recognition, measurement, and disclosure of these matters is the responsibility of management. This section details some of the guidance on environmental liabilities that has emerged from the accounting profession, through the International Accounting Standards, as well as other practice statements and guidelines.

INTERNATIONAL ACCOUNTING STANDARDS (IAS)

IAS 37 on Provisions, Contingent Liabilities and Contingent Assets

IAS 37 became operative for annual financial statements covering periods beginning on or after 1 July 1999. It includes guidelines on the creation of environmentally related provisions, such as for environmentally related rehabilitation.

The following definitions can be directly applied to environmental issues. IAS 37 defines a 'contingent liability' as:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future

- events not wholly within the control of the enterprise; or
- (b) a present obligation that arises from past events but is not recognised because:
 - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
 - (ii) the amount of the obligation cannot be measured with sufficient reliability.

The Standard defines 'provisions' as liabilities of uncertain timing or amount. It requires a provision to be raised when the following criteria are met:

- (a) an enterprise has a present obligation (legal or constructive) as a result of a past event;

- (b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and
- (c) a reliable estimate can be made of the amount of the obligation. The Standard notes that it is only in extremely rare cases that a reliable estimate will not be possible.

Highly relevant to environmental issues, the Standard defines a 'constructive obligation' as an obligation that derives from an enterprise's actions where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the enterprise has indicated to other parties that it will accept

- certain responsibilities; and
- (b) as a result, the enterprise has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

In terms of IAS 37, gains from the expected disposal of assets should not be taken into account in measuring the provision.

Where some or all of the expenditure required to settle the provision is expected to be reimbursed by another party, the reimbursement should be recognised when, and only when, it is virtually certain that reimbursement will be received if the enterprise settles the obligation. The reimbursement should be treated as a separate asset. The amount recognised for the reimbursement

should not exceed the amount of the provision.

IAS 2 on Inventories

It is often the case that companies, especially in the mining industry, regard their infrastructure and waste materials as assets with a residual value; for example, mineral content that can be retrieved, or recycled materials that can be sold. The result of this approach is that there will often be a reduced rehabilitation liability provided in respect of the site, since the potential asset sales have been netted off. This, however, is not an acceptable approach in terms of international accounting standards.

IAS 2 defines inventories as assets that are:

- (a) held for sale in the ordinary

- course of business;
- (b) in the process of production for such sale; or
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

In terms of IAS 2, a waste site should not be accounted for as an asset, unless additional costs were incurred to convert the waste into a commercial item. If the latter is the case, the waste should then be valued at the lower of the cost and net realisable value. Alternatively, no account should be taken of current recovery operations, since offsetting the liability against future recoveries is not allowed by the accounting standards. To the extent that the waste site or infrastructure meets the definition

of an asset, it should be accounted for in accordance with IAS 2 on Inventories or IAS 16 on Property, Plant and Equipment. These standards requires that an item should be recognised as an asset when:

- (a) it is probable that future economic benefits associated with the asset will flow to the enterprise; and
- (b) the cost of the asset to the enterprise can be measured reliably.

IAS 16 on Property, Plant and Equipment

One of the most significant areas of environmental liability is rehabilitation. IAS 16 addresses this issue, stating that the cost of an item of property, plant and equipment includes “the estimated

cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision under the statement on provisions, contingent liabilities and contingent assets.”

A provision should therefore be recognised for the estimated rehabilitation costs that will be incurred during or at the end of the life of the asset, as soon as there is an obligation to incur the expenditure. Rehabilitation costs include the cost of rehabilitating damage incurred on the initial acquisition and set-up of an asset, as well as damage incurred over the life of the asset through its use. The rehabilitation liability should not be reduced by the possible revenue that will be generated from the sale of assets,

for example sale of scrap materials or reworking of a waste site. This is according to IAS 37 and it is in line with the requirements of IAS 18 on *Revenue*.

To the extent an obligation to decommission the asset and restore the site arises at the time the asset is first acquired, a provision should be recognised. These estimated costs should be included in the cost of the asset. Therefore, to the extent that damage is incurred in the initial set up of an asset, the anticipated cost of restoring the site and removing the asset should be recognised as a provision and as part of the cost of the asset. A provision for environmental rehabilitation costs resulting from damage caused during the period

of operating the asset should be raised as the damage is incurred.

The corresponding debit should, however, be recognised as an expense in the period in which the obligation arises, and should not be included in the cost of the asset, since these costs do not extend the life of the asset beyond its originally envisaged term. At each reporting date, the provision recognised should be the present value of the estimated cost of site restoration and clean up based on damage incurred at the balance sheet date.

IAS 10 on Events after the Balance Sheet Date

Subsequent events may also be relevant to environmental issues. IAS 10 states that subsequent

events are those events, both favourable and unfavourable, that occur between the balance sheet date and the date when the financial statements are authorised for issue. Two types of events can be identified:

- (a) those that provide evidence of conditions that existed at the balance sheet date (adjusting events after the balance sheet date). For example, the resolution after the balance sheet date of an environmentally-related court case which, because it confirms that an enterprise already had a present obligation at the balance sheet date, requires the enterprise to adjust a provision already recognised, or to recognise a provision instead of merely

- disclosing a contingent liability; and
- (b) those that are indicative of conditions that arose after the balance sheet date (non-adjusting events after the balance sheet date). For example, an environmental spill subsequent to year-end would not require the financial statements to be adjusted; however, should it be significant, it will require additional disclosure in the financial statements as follows:
- the nature of the event; and
 - an estimate of its financial effect, or a statement that such an estimate cannot be made.

OTHER ISSUES

IAS 36 on Impairment of Assets

Where initial set up and dismantling costs are included as part of the cost of an asset and there is an indication that the asset may be impaired, the recoverable amount of the asset should be calculated in terms of IAS 36 on *Impairment of Assets*. If the carrying amount of the asset exceeds its recoverable amount, the carrying amount of the asset should be written down.

Rehabilitation Trust Funds

South African legislation requires mining companies to set funds aside for rehabilitation. Usually, separate trust funds are established and amounts are contributed to these funds to be used for rehabilitation. The amounts contributed to the funds

do not necessarily bear any relation to the actual expenditure that will be incurred, although they are an attempt to estimate this future expenditure.

In addition, the contributions to the trust do not extinguish the entity's obligation for the rehabilitation costs should there be a shortfall; the trust is merely used as a funding mechanism subsequent to mine closure. Where an entity has made a contribution to a trust fund, the expected cost of environmental rehabilitation, based on the damage incurred at the balance sheet date, should be calculated. An environmental rehabilitation provision should be recognised for this full amount. A separate asset should be recognised for the

funded portion of the future liability.

These amounts should not be set off. The relationship between the asset and the liability should be disclosed in the notes.

IAS 27 on *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*, and especially SIC 12 on *Consolidation - Special Purpose Entities (SPEs)* should be considered to determine whether rehabilitation trust funds should be consolidated by the entity. An enterprise should consider whether it, in substance, controls the rehabilitation trust fund and should therefore consolidate it.

In most cases, it is likely that the trust fund is set up to fund an

entities rehabilitation liability and is thus seen to be operating on behalf of an enterprise in accordance with its specific business needs.

Accounting Policies

An entity should disclose the accounting policy adopted in respect of provisions for site restoration and environmental rehabilitation. The following *illustrative* accounting policy note in the financial statements may be provided in respect of environmental liabilities:

“Provisions are recognised when the entity has a present legal or constructive obligation as a result of past events, for which it is probable that an outflow of economic benefits will occur, and where a reliable estimate can be made of the amount

of the obligation. Where the effect of discounting is material, provisions are discounted. The discount rate used is a pre-tax rate that reflects current market assessments of the time value of money and, where appropriate, the risks specific to the liability.

A provision is raised for the present value of environmental damage incurred on the initial set up of assets and other long-term capital projects. These costs are included in the cost of the related asset.

The obligation to restore environmental damage caused through operations is raised as the relevant operations take place.”

Other Accounting Guidelines

Due to the relatively recent

introduction of IAS 37 and the progress of environmental legislation over the last few years there was a need identified to give guidance and clarity on environmental liabilities.

As a result of the complexity and significance of the environmental liabilities numerous initiatives by both accounting institutes and environmental agencies have produced legislation, standards and guidelines on environmental liabilities. The following list is included for reference:

- United States – *Comprehensive Environmental Response Compensation and Liability Act* or ‘Superfund’ (1980);
- Canadian Institute of Chartered Accountants – *Environmental Costs and Liabilities: Accounting and Financial*

Reporting Issues (1993);

- Institute of Chartered Accountants in England and Wales – *Financial Reporting of Environmental Liabilities: A Discussion Paper* (1995);
- American Institute of Certified Public Accountants’ *Statement of Practice (SOP) 96-1 – Environmental Remediation Liabilities* (1996);
- United Nations Conference on Trade and Development (UNCTAD) – *Accounting and Financial Reporting for Environmental Costs and Liabilities* (1999);
- International Federation of Accountants – *Environmental Management in Organisations: The role of Management Accounting* (1999);
- Japanese Environment Agency –

Grasping Environment Cost Accounting (1999);

- Commission of the European Communities – *White Paper on Environmental Liabilities* (2000); and
- Commission of the European Communities – *Recommendation on the Recognition, Measurement and Disclosure of Environmental Issues in the Annual Accounts and Annual Reports of Companies* (2001).

The auditing perspective

THE AUDITING PERSPECTIVE

Due to the significant financial impacts that environmental issues may have, the International Auditing Practice Standard (IAPS) 1010 on *'The consideration of environmental matters in the audit of financial statements'* was introduced in 1998. This is equivalent to South African Auditing Standard (SAAS) 2501, adopted in 1999. This section quotes some of the guidelines on environmental liabilities included in this standard, as well as giving some additional comments of relevance.

The extent to which any of the audit procedures described in this Statement may be appropriate in a particular case requires the exercise of the auditor's judgment in the light of the requirements of

the International Standards on Auditing (ISA) and the circumstances of the entity.

IAPS 1010 – REQUIREMENTS OF THE STANDARD

Guidance on the Application of ISA 310 – Knowledge of the Business

The auditor considers the industry in which the entity operates, as it may be indicative of the possible existence of environmental liabilities and contingencies. Certain industries, by their nature, tend to be exposed to significant environmental risk. These include the chemical, oil and gas, pharmaceutical, metallurgical, mining, and utility industries. (Par. 15)

Audit Materiality of ISA 320 – The Relationship between Materiality and Audit Risk

When planning the audit, the auditor considers what would make the financial statements materially misstated. The auditor's assessment of materiality, related to specific account balances and classes of transactions, helps the auditor decide such questions as what items to examine and whether to use sampling and analytical procedures. This enables the auditor to select audit procedures that, in combination, can be expected to reduce audit risk to an acceptably low level.

GUIDANCE ON THE APPLICATION OF ISA 250 – Consideration of Laws and Regulations in an Audit of Financial Statements

Changes in environmental legislation could have significant consequences for the operations of the entity and may even result in liabilities that relate to past events which, at the time, were not governed by legislation.

An example of the first category is a change in noise regulations that could curtail future use of plant or machinery. An example of the latter is an increase in standards that could render a waste generator liable for waste disposed of in previous years, even though disposal of the waste was in compliance with the then existing practice. (Par. 31)

Substantive Procedures

The use of professional judgment may become even more important because of a number of difficulties with respect to the recognition and measurement of the consequences of environmental matters in the financial statements, for example: often there is a considerable time delay between the activity that basically causes an environmental issue, and the identification of it by the entity or regulators; naccounting estimates may not have an established historical pattern or may have wide ranges of reasonableness because of the number and nature of assumptions underlying the determination of these estimates;

- environmental laws or regulations are evolving, and interpretation may be difficult or

ambiguous. Consultation of an expert may be necessary to assess the impact of these laws and regulations on the valuation of certain assets (for example, assets that contain asbestos). Making a reasonable estimate of liabilities for known obligations may also appear to be difficult in practice; or

- liabilities may arise other than as a result of legal or contractual obligations. (Par. 39)

Environmental Experts

Management is responsible for accounting estimates included in the financial statements.

Management may require technical advice from specialists such as lawyers, engineers or other environmental experts to assist in developing accounting estimates

and disclosures related to environmental matters. Such experts may be involved in many stages in the process of developing accounting estimates and disclosures, including assisting management in:

- identifying situations where the recognition of liabilities and related estimates is required (for example, an environmental engineer may make a preliminary investigation of a site to determine if contamination has occurred, or a lawyer may be used to determine the entity's legal responsibility to restore the site);
- gathering the necessary data on which to base estimates and providing details of information that needs to be disclosed in

the financial statements (for example, an environmental expert may test a site in order to assist in quantifying the nature and extent of contamination and considering acceptable alternative methods of site restoration); and

- designing the appropriate remedial action plan and calculating related financial consequences. (Par. 41)

Management Representations

ISA 580 "Management Representations" requires that the auditor obtain written representations from management on matters material to the financial statements when other sufficient appropriate audit evidence cannot reasonably be expected to exist.

Much of the evidence available to the auditor with respect to the impact of environmental matters on the financial statements will be persuasive in nature rather than conclusive. The auditor may therefore wish to obtain specific representation that management:

- (a) is not aware of any material liabilities or contingencies arising from environmental matters, including those resulting from illegal or possibly illegal acts;
- (b) is not aware of any other environmental matters that may have a material impact on the financial statements; or
- (c) if aware of such matters, has disclosed them properly in the financial statements."

IAPS 1010 - ILLUSTRATIVE AUDIT QUESTIONS

Control environment and control procedures

Is management aware of the existence, and the potential impact on the entity's financial statements, of:

- any risk of liabilities arising as a result of contamination of soil, groundwater, or surface water;
- any risk of liabilities arising as a result of air pollution; or
- unresolved complaints about environmental matters from employees or third parties? (Par. 20)

Substantive Procedures to Detect a Material Misstatement due to Environmental Matters Completeness of Liabilities, Provisions and Contingencies

Enquire about policies and procedures implemented to help identify liabilities, provisions or contingencies arising from environmental matters. (Par. 18)
Enquire about events or conditions that may give rise to liabilities, provisions or contingencies arising from environmental matters, for example,

- Violations of environmental laws and regulations;
- Citations or penalties arising from violations of environmental laws and regulations; or
- Claims and possible claims for environmental damage. (Par. 19)

If site clean-up costs, future removal or site restoration costs or penalties arising from non-compliance with environmental laws and regulations have been identified, enquire about any related claims or possible claims. (Par. 20)

Enquire about, read, and evaluate correspondence from regulatory authorities relating to matters dealing with environmental matters and consider whether such correspondence indicates liabilities, provisions or contingencies. (Par. 21)

For property abandoned, purchased, or closed during the period, enquire about requirements for site clean-up or intentions for future removal and site restoration. (Par. 22)

For property sold during the period (and in prior periods), enquire about any liabilities relating to environmental matters retained by contract or by law. (Par. 23)

Perform analytical procedures and consider, as far as practicable, the relationships between financial information and quantitative information included in the entity's environmental records (for example, the relationship between raw materials consumed or energy used, and waste production or emissions, taking into account the entity's liabilities for proper waste disposal or maximum emission levels). (Par. 24)

Accounting estimates

For liabilities, provisions, or contingencies related to environmental matters consider

whether the assumptions underlying the estimates continue to be appropriate. (Par. 27)

Compare estimates of liabilities relating to one location (for example, estimates for site restoration or future removal and site restoration costs at a specific location) with:

- (a) estimates of liabilities for other locations with similar environmental problems;
- (b) actual costs incurred for other similar locations; or
- (c) estimates of costs of environmental liabilities reflected in the sales price for similar locations sold during the period. (Par. 28)

OTHER AUDITING ISSUES

Environmental managers

Environmental managers at organisations are normally well informed of environmental legal requirements and the likely costs associated with rehabilitating environmentally damaged areas to acceptable standards. Therefore the auditor can often obtain a good indication of the possible rehabilitation costs through discussions with these managers, as well as reference to the technical reports that they have undertaken or commissioned.

However, it is sometimes the case that there will be a conflict of interest between environmental management and financial management. Financial management's aim is to ensure

maximum profits and shareholder value, whereas the environmental management will try to ensure optimal environmental responsibility.

Should there be a lack of knowledge or awareness of environmental obligations and the requirements of the international accounting standards, the danger exists that financial management can inappropriately overrule environmental management when assessing the liability for disclosure in the financial statements. Financial auditors should therefore take care to ensure that this does not occur.

Environmental Management Programme Reports

Mining companies in South Africa are required to have an approved Environmental Management Programme Report (EMPR), which serves as the legal basis for estimating and providing for environmental liabilities for mines in terms of closure cost. Part Six of the EMPR, which focuses on mine closure, requires the mine to indicate its closure activities, which would normally include costs, and activities to comply with the environmental legislation. The EMPR seldom contains all relevant information on environmental liabilities, but remains a useful reference point.

ISO 14001

There is generally a misconception that, when an entity has been certified to the ISO 14001 Environmental Management Systems standard, there is no environmental liability or that the liability has been properly quantified. ISO 14001 is only an environmental management tool and in no way serves as a guarantee that environmental liabilities have been identified, quantified and are being adequately addressed. Nevertheless, a good environmental management system will provide a useful basis for addressing environmental liabilities, through elements like the complaints register, legal register, aspects and impacts register and external audits.

Foreign entities

A number of South African companies have subsidiaries or joint venture in other countries. The environmental legislation in many of these countries, especially in Africa, may not require any environmental rehabilitation. However, the existence of a corporate environmental policy at a holding company level creates a constructive obligation to ensure that the policy commitments are adhered to in all subsidiaries, irrespective of the country in which the operations occur.

The South African legal perspective

THE SOUTH AFRICAN LEGAL PERSPECTIVE

Legal developments

With the coming into being of the Constitution of South Africa Act 108 of 1996 (the Constitution), the legal landscape of South Africa was profoundly altered. From being essentially state-centred in orientation, our law is now firmly human rights based. Significantly, South Africa's Constitution is one of only a few constitutions in the world that entrenches a right to a healthy environment in its Bill of Rights.

To give effect to this right, the Constitution places an obligation on government to enact legislation that prevents pollution, promotes conservation, and secures ecologically sustainable

development and use of natural resources.¹ Not only do recently enacted environmental laws reflect these changes, but constitutional provisions have enhanced the ability of affected persons to seek redress from the courts should non-compliance with these environmental enactments be shown to have occurred.

Thus, for example, the common law requirements pertaining to legal standing upon which an aggrieved person may approach a competent court to seek relief have been relaxed significantly.² Traditionally, one had legal standing or *locus standi*, if he or she were able to show a personal interest in the matter before court. This represented a major obstacle for non-government organizations

and other concerned citizens wishing to take court action in respect of environmental transgressions. Section 38 of the constitution has significantly widened the ambit of persons who may seek redress in respect of an infringement of any right in the Bill of Rights, including their environmental rights.

This now includes: anyone acting as a member of, or in the interests of, a group of persons; anyone acting in the public interest; and an associate acting in the interests of its members. The National Environmental Management Act 107 of 1998 (NEMA) has further extended legal standing to enforce environmental laws to include, *inter alia*, any person or group of persons acting in the interests of

protecting the environment.³ In the past another factor that has tended to inhibit persons instituting legal proceedings against financially powerful institutions has been the question of the legal costs, not only in respect of launching civil proceedings, but also in respect of a possible negative cost order being awarded against one should the application or action fail, which is customary in civil litigation.

Again, recent legislative intervention has radically redefined the issue of costs in respect of environmental litigation: In situations where any person or group of persons, acting in the interest of protecting the environment, institutes legal

proceedings but fails to secure the relief sought, a court may decide not to award costs against such a person or group of persons if, in the opinion of the court, the persons or group of persons acted reasonably and out of due concern for the public interest or in the interests of protecting the environment.⁴

NEMA further allows for attorneys and advocates providing free legal assistance to such litigants to make application to be awarded legal costs in instances where the relief sought has been successful.⁵ What this means is that legal assistance can be elicited from experts and professionals by poor or indigent persons to pursue litigation for environmental degradation through the highest

courts in the land, if need be, free from financial constraints. Another important constitutional right is the right to access to information, which applies to anyone wishing to gain access to information held by the state or private person, for the exercise or protection of any right, including the environmental right.⁶ The right of access to information has been given effect in NEMA⁷ and in the coming into operation of the

Promotion of Access to Information Act 2 of 2000. It is now possible for anyone who can show that their right to a healthy environment is being, or may be, infringed upon, to apply to a private company for records of information which would otherwise be considered privileged.

Companies may now be compelled to divulge information which might confirm poor environmental practices. Hence they may be exposed to financial risk not only in so far as the embarrassment that would be caused by disclosure and the accompanying loss of image in the market place, but also by way of confirming legal liability.

These statutory developments reflect a growing public awareness regarding the impacts that human and industrial activity is having on the environment and communities. For this reason companies are increasingly coming under public scrutiny to comply with the law. It is thus crucial that corporate entities become aware of their legally defined responsibility

towards the environment and the potential legal liabilities they expose themselves to should they fail to act in accordance with this responsibility.

Legal Liabilities

The body of law in South Africa referred to as environmental law is fairly extensive and complex. For this reason, liability can arise in different ways. It has been cogently argued that it is useful to group environmental liability into three categories: criminal liability, civil liability and ecological liability.⁸

Criminal Liability

Criminal liability may arise in common law as a result of a commission of a common law offence. However, criminal liability

pertaining to environmental transgressions are created under statute. Statutory provisions may require that authority be obtained before an activity may commence. For example, the provisions of Section 22 of the Environment Conservation Act 73 of 1989, states that no person shall undertake an activity identified in terms of the Act without the written authority of the Minister.

A failure to comply with this administrative requirement is an offence. On the other hand, liability may arise as a result of a violation of a statutory duty not to cause degradation or pollution. For example Section 151 (1) of the National Water Act 36 of 1998, makes it an offence to intentionally or negligently perform an act or

omission which pollutes a water resource.

The penalties for contraventions of these statutory offences were once considered by many not to be sufficiently severe to warrant serious consideration. However, this is certainly no longer true, if indeed it ever was. It is not only the prescribed penalty that must be considered, but also the further financial ramifications that may possibly flow on conviction.

For example a contravention of Section 151(1) under the National Water Act may not only result in the penalties set out in the subsection, but entitles the court on written request from a person who suffered harm as a result of the contravention, or from

the Minister in respect of the damage caused to a water resource, to enquire into the harm or damage, make a determination in respect thereof, and award damages or order the accused to pay for the cost of any remedial action.

Company directors, employers and employees are subject to personal liability under South Africa's environmental laws. In terms of NEMA, any person who is or was a director of a firm at the time of the commission by that firm of any offence under any provision listed in Schedule 3 of the Act, is guilty of the offence, if the offence in question resulted from the failure of the director to take all reasonable steps that were necessary under the circumstances

to prevent the commission of the offence. Similar provisions apply to employers, managers, agents or employees.

Furthermore, a court hearing the criminal matter may enquire into the assessment of loss and award damages in accordance thereto. The offences listed in Schedule 3 include those created in terms of most of the country's important environmental statutes. Similarly, in terms of the Company Act 16 of 1973, a director can be removed from office in situations where the company has been found guilty of an offence and in addition, be sentenced to pay a fine or undergo imprisonment.

Civil Liability

Civil liability arises out of duties and obligations created under the common law but, unlike criminal liability, falls into the realm of private law. In essence, there are no separate duties and obligations specific to the environment in private law.

Instead, there is the principle that all persons owe a duty of care not to perform an act, or omit to act, the consequence of which would be the creation of a nuisance, or harm to another. The most important remedies one has in civil law, in so far as corporate environmental liabilities are concerned, are the application for an interdict, and the invitation of civil action for damages. One can make application for an interdict

either by asking the court to compel a respondent company to do something, or to refrain from an activity that is likely to cause harm to the applicant. In environmental terms, an interdict could be applied to stop a polluting activity causing a nuisance.⁹

An action for damages is instituted when the defendant company has caused the plaintiff damage, whether to his or her person or property. Thus the action for damages remedy would cover instances where a person has suffered disease or injury, or damage to property, or has suffered damages due to the death of a relative caused by the wrongful actions of the defendant. Although there are set requirements that must generally

be proved to succeed in an action for damages, including fault in the form of intention or negligence on the part of defendant, the law has moved in the direction of holding persons strictly liable for environmental harm.

Thus a plaintiff may not be required to show that the defendant acted with intent or was negligent in causing the environmental harm complained of. In other words, fault becomes irrelevant and one only need prove that a wrongful act caused the loss.¹⁰ This issue is further discussed below in terms of ecological liability.

Recent developments in the law flowing from provisions in the Constitution discussed previously,

such as the extension of standing to institute actions, the question of legal costs, and access to information provisions, have significantly increased the likelihood of civil action being instituted against companies in respect of environmental degradation causing harm.

Ecological liability

Ecological liability will not, as pointed out by Sampson, be found in legal textbooks, but it is a category of liability that fits somewhere between criminal and civil liability and has features common to both.¹¹ It is a useful category because of the fact that environmental liability often extends further than to direct harm to humans. Environmental degradation may well have a direct

bearing on a person's health, but may also result in the deterioration of the general quality of the environment, damage to ecosystems, and loss of flora and fauna.¹² In essence, the distinction can be made that ecological liability would pertain to costs of clean up and rehabilitation of the environment.

NEMA imposes a duty on persons who cause, have caused or who may cause significant pollution or degradation of the environment to take reasonable measures to prevent such pollution or degradation from occurring, continuing or recurring. If such harm to the environment is authorised by law or cannot reasonably be avoided or stopped, one is then obligated to minimise

such harm and to rectify such pollution or degradation to the environment.¹³ Where harm has been caused, it is likely that 'reasonable measures' referred to would include clean up and rehabilitation.

The Act further provides that the Director General may issue a directive to persons or parties responsible for pollution or degradation to remediate the pollution or degradation. Should no action be taken, the Director General has the authority to carry out all necessary measures and to claim costs from various categories of persons, including the landowner and successors-in-title.¹⁴

The list of responsible parties include several people who would

not necessary have caused the pollution. Thus, for example, a person may have bought a property, and hence become a successor in title after the pollution had occurred. It may also include parent companies of subsidiaries.

This would obviously have a direct bearing on a financial institution, which has security over a contaminated property in terms of a loan. If on default the financial institution forecloses on the property, the financial institution becomes the owner and a 'responsible party', which the Director General may hold responsible for clean up.

Both NEMA and the National Water Act provide for historical liability, which is another unique

feature of ecological liability. In other words, a landowner, for example, may be held liable for costs of remediation or clean up in respect of pollution, which was caused many years before the landowner took possession of the property. Obviously, the financial ramifications for a company finding itself in this position could be significant, considering the potential scope of the liability and the associated costs. This makes environmental due diligence, as discussed in another section of this report, critical.

Conclusion

CONCLUSION

Government departments have their own requirements and objectives in considering environmental liabilities. These requirements are all unique to the various departments but the main objective is the same, namely to promote and regulate responsible care of the environment. Due diligence studies relating to environmental liabilities are very similar to the approach of financial audits.

In both cases, the objective is to obtain a fair presentation of the financial position of an organisation, where environmental issues may have a material impact.

IAS 37 on *Provisions, Contingent Liabilities and Contingent Assets*

is one of the most significant drivers in requiring environmental liabilities to be disclosed in the financial statements of organisations.

This is supported by various other statements, like IAS 16 and IAS 2, that should be considered in assessing environmental liabilities. IAPS 1010 on *The Consideration of Environmental Matters in the Audit of Financial Statements* can assist auditors, and the development of good practice, by providing guidance when environmental matters are significant to the financial statements of the entity. The extent to which any of the audit procedures described in this Statement may be appropriate in a particular case requires the

exercise of the auditor's judgment in the light of the requirements of the ISAs and the circumstances of the entity.

Over the past few years environmental legislation has become more stringent in South Africa and has introduced the scope for considerable environmental liabilities to be imposed on industry. A clear understanding of these risks is therefore essential for ensuring responsible business practice in the future.

Annexure A

Annexure A – The Association of Chartered Certified Accountants (ACCA)

ACCA is the largest, fastest growing, global professional accountancy body, with nearly 300,000 members and students in 160 countries. ACCA headquarters is in London and it has 34 staffed offices and 34 active centres around the world.

ACCA's mission is to provide quality professional opportunities to people of ability and application, to be a leader in the development of the global accountancy profession, to promote the highest ethical and governance standards and to work in the public interest.

ACCA launched the world's first environmental reporting award scheme in 1990. Since then ACCA has continued to raise awareness of environmental and social reporting amongst the finance and business communities, and has contributed to the CSR debate through its involvement with the Global Sustainability Reporting Initiative, the UN UNCTAD environmental accounting programme and the Sustainability working party of the European Federation of Accountants. Further information on ACCA is available on ACCA's website, www.accaglobal.com/sustainability

Annexure B

Annexure B – KPMG Sustainability Services

KPMG Sustainability Services is a network of professionals specialising in the areas of environment, health, safety, ethics, social accountability and certification, within KPMG's global framework of advisory and assurances services.

The Global Sustainability Network contains over 300 professionals in 27 countries. This extensive and multi-skilled resource provides our clients with a spectrum of advisory and assurance services. Through the network the various KPMG offices are able to provide support, share, compare and enhance the communication within KPMG. Our emphasis is on embedding sustainability criteria into

organisations' existing strategic processes, management systems, performance measurement and reporting practices. The benefits of this approach are a reduction in organisational risks and potential liabilities, enhancement of management effectiveness and business performance, and improvement in stakeholder relations and public reputation.

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¹ S 24 (b).

² S 38.

³ S 32.

⁴ S 32 (2).

⁵ S 32 (3).

⁶ S 32.

⁷ S 31.

⁸ 'Environmental legal compliance audit' by Ian Sampson in Ian Sampson *The Guide to Environmental Auditing in South Africa* (2000) p2-8.

⁹ See *Minister of Health and Welfare v Woodcarb (Pty) Ltd and Another* 1996 (3) SA 155 (N).

¹⁰ See *Lascon Properties (Pty) Ltd v Wadeville Investments Co (Pty) Ltd and Another* 1997 (4) SA 578 (W).

¹¹ Op sit note 8 at p2-10.

¹² Ibid.

¹³ S28.

¹⁴ S28(5) to (12).

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