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FIN 47: A Test of Sarbanes-Oxley

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Agenda

- Overview
- Selected Risks of Reporting Failure
- Public Interest Influence on Audit Risk
- Our Experiences – Common Weaknesses
- Representative Questions
- Expected Marketplace Reaction

Overview – Why are we here today?

- Recent scandals in the business world have shaken investors' confidence in corporate financial reporting
- Introduction of Sarbanes-Oxley and visibility of environmental liabilities
- Increasing perception that undisclosed environmental risks and liabilities could impair the public's ability to make sound investment decisions
- Increase in triple bottom line reporting and full disclosure due to pressure and public criticism reports issued by activists

Overview: SOX and Standards for Internal Control

- Section 404 of the Sarbanes-Oxley Act requires ongoing documentation, evaluation, and testing, and remediation of financial reporting controls

- Standard for Control: COSO – Committee of Sponsoring Organizations of the Treadway Commission
  - SEC and PCAOB both specifically state that COSO is an acceptable framework
  - Principles-based
  - Emphasizes execution of documented processes and controls

SOX Focuses on Controls for Financial Reporting

Select EMS Processes

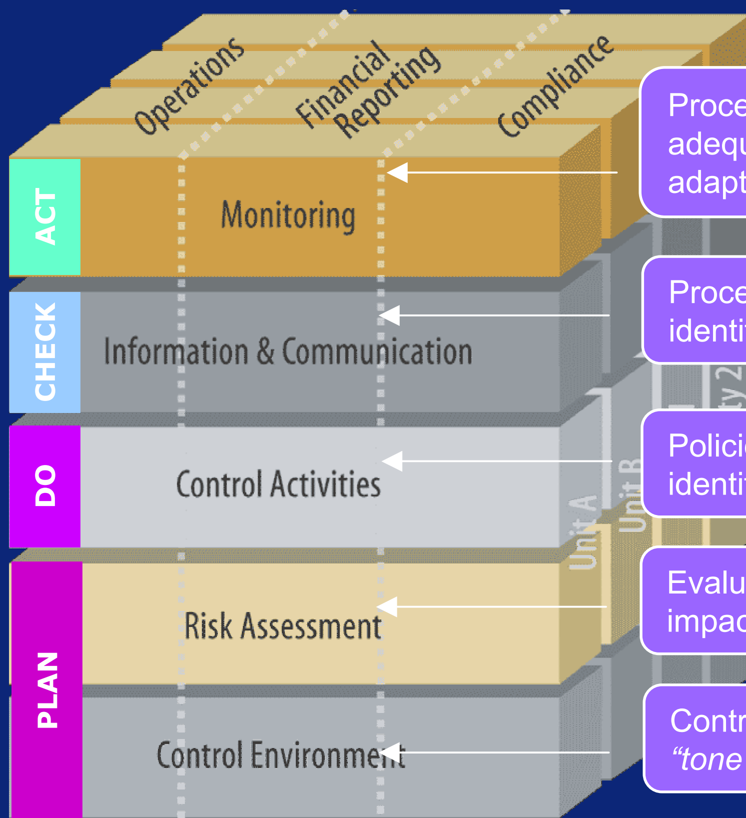
Management Review & Continual Improvement

Monitoring & Measuring, Records, Audits

Structure & Responsibility, Training, Operational Control

Aspects, Legislative, Regulatory, Objectives & Targets

EHS Policy & Commitment



COSO Principles

Process to determine whether internal control is adequately designed, executed, effective, and adaptive

Process to ensure that relevant information is identified and communicated in a timely manner

Policies and procedures to ensure that actions identified to manage risk are executed

Evaluation of internal and external factors that impact an organization’s performance

Control conscience of an organization—t*he “tone at the top”*

Processes, controls, and procedures must be comprehensive and systematic and must ensure Consistency, Accurate and timely disclosures, Relevant importance of the data is communicated

Select Risks of Reporting Failure

- Restatement
- Litigation
- Stock Price
- Loss of Brand Value

Since the passing of Sarbanes-Oxley

- Reportable Control Deficiencies

Control Deficiencies

- *Control deficiency*
  - ...design or operation of a control does not allow the prevention or detection of misstatements on a timely basis....
- *Significant deficiency*
  - A control deficiency or combination of deficiencies…such that there is *more than a remote likelihood* that a misstatement…that is more than inconsequential will not be prevented or detected.
  - *Significant Deficiencies must be disclosed to the Board*
- *Material weakness*
  - A control deficiency or combination of significant deficiencies…that results in *more than a remote likelihood* that a *material* misstatement of the annual or interim financial statements will not be prevented or detected.
  - *Material Weaknesses must be disclosed by the Company*

Auditor Assessment of Environmental Risk

- In the past, auditors assessed environmental risk according to the following
  - Inherent risk (Are environmental matters inherently material given the nature of the business?)
  - Control risk (What is the likelihood that material environmental matters could go unreported?)
  - Audit risk (What is the likelihood that the audit procedures will fail to identify a material misstatement?)
- Today, Environmental Specialist expertise is requested regardless of nature of the business
- Increasing interest in Environmental Assessments due to evolving regulatory and accounting requirements and public interest

Public Interest Impact to Audit Risk

- GAO
- Rose Foundation
- Marketplace Experience

GAO Report

- **Background**
  - GAO published a report in July,2004 entitled "Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information"
- **Key Findings**
  - defining what should be disclosed can be challenging
  - reporting is inconsistent among companies (where and how)
  - difficulty exists in concluding when information is present or lacking:
    - *Does a low level of disclosure mean the company has no existing or potential environmental liabilities; has determined that such liabilities are not material; or is not adequately complying with disclosure requirements?*

Rose Foundation

- **Background**
  - Rose Foundation Published a report in July,2004 entitled "Fooling Investors & Fooling Themselves – Rose Foundation, July 2004"

- **Key Findings**
  - *Delay the quantification of liabilities*
  - Avoid meaningful qualitative disclosure
  - Hide the big issues in the footnotes
  - *Piecemeal the liability analysis*
  - *Employ artificial time horizons*
  - Mothball contaminated facilities
  - No look agreements
  - Blame non-disclosure on the government
  - Pass the buck
  - Hide insurance disclosures from investors
  - Avoid disclosure of worker health impacts
  - Deny emerging hazards

FIN 47’s Relationship to Sarbanes-Oxley

- Introduced to result in consistent recognition of liabilities with asset retirement obligations
- Serves a “test” of the adequacy of a company’s processes, procedures and controls and their ability to update existing programs
- Resulted in increased materiality of environmental liabilities
  - Inherent, control, and audit risk influenced
- Inabilities to identify, assess, measure and report FIN 47-related obligations could result in a control deficiency

Processes and Controls Should Ensure Consistency in FIN 47 Determinations

- What constitutes variances in FIN 47 accruals to date?
  - Varying determinations with respect to asset life, fair value measurements, and timing of settlement
  - Usage of Appropriate Accounting Guidance
  - Determinations with respect to “Duty to Investigate”
  - Materiality
  - “Normal” vs. “improper” operations
  - Determination of Legal obligations “associated with retirement”

Processes and controls should adequately address each of these variance areas with use of definitions, decision trees, with references to personnel and company materials

Overall Best Practices

- Ensure FIN 47-specific policies, procedures, and controls adequately identify, assess measure and report asset retirement obligations
  - Assign responsibilities and include multifunctional expertise including (legal, finance, accounting, engineering, EHS and Quality Assurance)
  - Include definitions, decision trees, timeframes for completion (allow time for Quality Assurance)
  - Provide linkages to corporate-wide guidance
  - Ensure tools for tracking, aggregating and communicating
    - Initial findings or negative confirmations
    - Questions and Answers
  - Provide Quality Assurance at all levels

Selected Reasons for Deficiency Assignments

- Use of inappropriate accounting guidance
- Lack of reliable support and cost build up for gross targets
- Manual nature of reporting
- Reliance on verbal representation
- Inadequate succession planning
- Inconsistent documentation
- Testing program is not adequate or findings are not incorporated

Common Weaknesses

- Inadequate underlying documentation
  - Internal estimates are not supported by historical experience or external scopes of work, proposals, and cost schedules are incomplete, outdated or not reconcilable to estimates accrued
- Limited justification for estimate selected given range of costs or out-dated, inadequate rationale supporting probability assignments
- Reliance on inappropriate competencies

Common Weaknesses

- Uncertainty in who owns the risk
  - Properties characterized by multiple ownership
  - "No Look" agreements
  - Acquired properties with vague transfer agreements
- Environmental Site Assessments or internal memorandums identifying or suspecting contamination in soil or groundwater

Common Weaknesses

- Inadequate or incomplete:
  - Processes and procedures for identifying risk
  - Assignment of roles and responsibilities to ensure coverage
  - Corrective Action
  - Testing

- Varying compliance to policies and procedures
  - Reports indicate Regions, Business units and Personnel interpreted guidance differently

Common Weaknesses

- Inconsistent representation
  - Ability to quantify assets but not liabilities
- Reasons for Inabilities to estimate or disclose inadequate

Expected Marketplace Response to FIN 47

- Reliance on legal counsel, and financial and technical experts to value liabilities associated with asset retirement obligations

- Increased Attention by internal and external auditors, SEC, PCAOB, and the public to Environmental Liabilities and their Materiality

- Unprecedented disclosure and accrual of asset retirement obligations associated with environmental liabilities, OR Sales of Idle Sites or “Mothballed” Facilities

- Increased Environmental Due Diligence in M&A transactions

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