REGULATORY COMPLIANCE & FINANCIAL LIABILITY STRATEGIC PLANNING

ROBERT SHERRILL, *C: 512-470-8710, ROBERT.SHERRILL@SAGEENVIRONMENTAL.COM*
 REVISED NOV. 12, 2012

BACKGROUND:

EVOLUTION OF CORPORATE LIABILITY REPORTING

A COMPREHENSIVE WEB OF ENVIRONMENTAL LAWS REGULATES THE USE, DISPOSAL, AND REMEDIATION OF HAZARDOUS MATERIALS. THIS REGULATORY SCHEME INCLUDES FEDERAL LAWS (E.G., CERCLA, SARA, RCRA, THE CLEAN AIR ACT, THE CLEAN WATER ACT AND THE NATIONAL ENVIRONMENTAL POLICY ACT) AND A WHOLE HOST OF STATE STATUTES. ALTHOUGH THE TERMINOLOGY USED IN EACH OF THESE STATUTES VARIES FROM PROGRAM TO PROGRAM, THE BASIC MESSAGES THEY CONVEY ARE THE FOLLOWING:

- Any person who participates in, exercises control over, or has responsibility for controlling a hazardous material activity may become liable for the consequences of such activity.

- The cost of remediating environmental contamination may be imposed upon all persons who 1) actively or passively participate in the activity, 2) profited from an activity that caused the contamination, or 3) will benefit economically from the remediation of the contamination.

Several recent laws (e.g., Regulation S-K and Sarbanes-Oxley) are driving mandatory corporate liability determination and reporting not only to the USEPA, but to the Security and Exchange Commission (SEC) and financial institutions. This "Corporate Liability" reporting of both existing and legacy liabilities has mandated long-range strategic planning of assets that have a direct impact on the bottom line and, for public corporations, stock values.

A corporation that uses or historically used hazardous materials or has legacy sites or purchased properties that adhere to any of the above faces a number of potential environmental issues, including the following:

BACKGROUND:

EVOLUTION OF CORPORATE LIABILITY REPORTING

- In addition to liability for contamination caused by releases, a corporation that uses or possesses property that uses such materials may face civil and criminal penalties if it fails to obtain required permits and approvals for the storage, use, transportation, discharge, and disposal of hazardous materials or if it transfers hazardous waste to an unreliable waste disposal company.
- A corporation that uses hazardous materials may also face toxic tort suits if it exposes its employees or customers to hazardous materials, fails to provide adequate employee training, lacks proper internal processes, or fails to provide required notice of hazardous materials dangers to employees, customers, neighbors or the public.
- Failure to implement all liability reporting requirements can also negate Innocent Land-Owner Applications and protections.

OUR SERVICES AND APPROACH:

SAGE'S LONG-RANGE STRATEGIC PLANNING SOLUTIONS

Reporting of liabilities and the associated potential financial effects have prompted the need for long-range strategic planning. This long-range strategic planning, although differing somewhat depending on the corporation, includes the following activities:

ASSET RETIREMENT OBLIGATIONS

A corporate policy for Asset Retirement Obligations that spells out the corporate approach to liability asset disposal and the financial assurance to meet those obligations is imperative. Sage assists corporate management, financial, and environmental teams in developing long-term asset retirements and develops both short and long-term resource commitment plans based on the advantages of short and long-term pattern of asset removal.

IMPAIRMENT OF LONG-LIVED ASSETS

In August 2002, the Financial Accounting Standards Board (FASB) issued SFAS 143, Accounting for Obligations Associated with the Retirement of Long-Lived Assets. This statement requires that (a) an existing legal obligation associated with the retirement of a tangible long-lived asset must be recognized as a liability when incurred and the amount of the liability be initially measured at fair value, (b) an entity must recognize subsequent changes in the liability that result from the passage of time and revisions in either the timing or amount of estimated cash flows, and (c) upon initially recognizing a liability for an asset retirement obligation, an entity must capitalize the cost by recognizing an increase in the carrying amount of the related long-lived asset. SFAS 143 became effective for financial statements issued for fiscal years on June 15, 2002.

Key estimates related to long-lived assets include useful lives, recoverability of carrying values, existence of any retirement obligations, and how such estimates can

SAGE'S LONG-RANGE STRATEGIC PLANNING SOLUTIONS

be significantly modified. The carrying values of long-lived assets can be impaired by new technological developments, new industry entrants with significant raw material or other cost advantages, uncertainties associated with the U.S. and world economies, any cyclical nature of the overall industry and uncertainties associated with governmental actions.

Corporations must periodically evaluate long-lived assets for potential impairment indicators. Judgments regarding the existence of impairment indicators are based on legal factors, market conditions, and the operational performance of the business. Actual impairment losses incurred could vary significantly from amounts estimated. Additionally, future events could cause the corporation to conclude that impairment indicators exist and that associated long-lived assets of their business are impaired. Any resulting impairment loss could have a material adverse impact on the corporation's financial condition and results of operations. Depreciation and amortization of these assets, including amortization of deferred turnaround costs, under the straight-line method over their estimated useful lives are determined, usually out to 10 or 20 years depending on the asset (i.e., if the useful lives of the assets were found to be shorter than originally estimated, depreciation charges would be accelerated).

A strategy of liability cost reduction is developed. For example, amortizing costs of major turnaround maintenance and repair activities over the period until the next expected major turnaround of the affected unit, as opposed to expensing turnaround costs, which would likely result in greater variability of corporate quarterly operating results and potentially adversely affect corporate financial position and results of operations.

Sage assists in preparing a long-term "plan of action" that encompasses both long-term and key-point costs over the anticipated future life of the asset up to and including potential asset retirement.

CONTINGENCIES AND ENVIRONMENTAL LIABILITIES

Corporations consult with various professionals to estimate environmental costs and legal proceedings. Corporations accrue expenses when determining that it is probable that a liability has been incurred and the amount is reasonably estimable. The required accompanying consolidated financial statements related to these contingencies and liabilities are based on the best estimates and judgments available, although it is recognized that actual outcomes may differ. Sage develops current and projected liability costs of both process and environmental liabilities.

EXIT COSTS

Adoption of Financial Accounting Standards No 146 supersedes EITE Issue No. 94-3, Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring), and changed accounting for the costs related to closing and restructuring activities. SFAS 146

SAGE'S LONG-RANGE STRATEGIC PLANNING SOLUTIONS

requires that a liability for a cost associated with an exit or disposal activity be recognized when the liability is incurred, not at the date of an entity's commitment to an exit plan. Sage develops the framework costs of unit or facility "decommissioning" to ensure the removal or mitigation of long-term liability costs.

ENVIRONMENTAL EXPENDITURES

Environmental expenditures that increase the life or capacity or result in improved safety or efficiency of a facility are capitalized. Expenditures that relate to an existing condition caused by past operations are expensed. Liabilities are recorded when environmental assessments or cleanups are probable, and the cost can be reasonably estimated. Sage develops both plans for and costs of short- and long-term expenditures, including an evaluation of time-sensitive, cost-sensitive, and ongoing operations-sensitive factors that govern projected expenditures. In addition, Sage develops a timeline of resource allocations associated with the environmental expenditure.

RISK ASSESSMENT

Corporations must regularly conduct SWOT (Strengths, Weaknesses, Opportunities and Threats) assessments that incorporate elements of internal control and environmental financial reporting. Sage provides a third-party evaluation of SWOT assessments and the resulting recommendations concerning potential risks to the corporation, short- and long-term costs, and control activity evaluation, improvements, and/or implementations.

CONTROL ACTIVITIES

Based on the results of the SWOT, the corporation must modify existing systems and procedures that define tasks and responsibilities, including resources allocated to control these activities. This may include environmental operational controls, such as the budgeting process currently used to estimate and manage environmental transactions, a third-party assessment of what is actually happening in comparison to the corporate policies, etc.

INFORMATION AND COMMUNICATIONS

The corporation evaluates its current means of internal information and communication, such as the use of an environmental audit module/task manager and incident tracker, employee training and awareness, etc. Sage provides a third-party evaluation of the current linear and multi-directional communication and information flow and develops recommendations based on the client's needs and State and Federal requirements.

MONITORING

Are there existing parameters that are used for performance monitoring on some frequent basis? If so, what are these and are they aligned with the corporation's overall objectives in terms of planning? What measurement tools are in place to assure accurate monitoring? Is there audit planning targeted on known problem areas, such as the audit module described in the previous section?

SAGE'S LONG-RANGE STRATEGIC PLANNING SOLUTIONS

Sage conducts a third-party review of all in-place monitoring and audit activities and provides recommendations for the addition and/or improvement of processes based on client needs, State and/or Federal permits and rule requirements.

SARBANES-OXLEY

Additional requirements under Sarbanes-Oxley (SOX) for addressing internal planning, transactional, and review controls for the above discussed categories are also required for public corporations. Sage identifies, evaluates, and improves these additional processes. These processes include the following:

Environmental	• Top management commitment • Defined policies (FAS 5, 143, 144, etc) • Definition of key process (10K, Due Diligence, Rights of Recovery) • Procedures and work instructions define authority, responsibility, controls and accountability. • Management review assesses overall performance, including effectiveness of controls
Risk Assessment	• Business-level planning • Product-level planning • Environmental aspects • Corrective and preventative actions to address deficiencies and potential weaknesses • Management assesses risks in determining appropriate resources and preventive actions
Control Activities	• Systems and procedures define tasks and responsibilities, including resources allocated to control these activities • Environmental operational systems and system maintenance • Transactional data reviewed for compliance (e.g., approvals and verifications vs. procedure) • Environmental controls put into actual practice • Other supporting controls (e.g., document control) • Established management review schedules, agenda, and records reflect the review of controls and related data, including complaints and audit findings • Environmental controls periodically verified and results reviewed by management
Information and Communications	• Resources provided for employee training and awareness • Required competencies defined and training provided with associated records • Performance results shared, including audit deficiencies and corrective actions
Monitoring	• Performance monitoring and measurement tools identified • Objectives identified • Audit planning targeted on problem areas, as needed • Required competencies defined and training provided with associated records • Ongoing monitoring of routine business activities, key business processes, and specific environmental controls • Internal system(s) audits • Performance results shared, including audit deficiencies and corrective actions • Management review activity, including the monitoring of both business performance results and systems compliance