

1.1.2 OSC Staff Notice 51-716 - Environmental Reporting

OSC STAFF NOTICE 51-716 ENVIRONMENTAL REPORTING

INTRODUCTION

National Instrument 51-102 *Continuous Disclosure Obligations* (NI 51-102) requires reporting issuers to disclose information about environmental matters in their continuous disclosure (CD) documents. This notice outlines the results of a targeted review of compliance with these requirements that staff of the Ontario Securities Commission (OSC) recently conducted. This review was announced in OSC Staff Notice 51-706 *Corporate Finance Branch Report 2007*, dated November 1, 2007.

SCOPE OF OUR REVIEW

Issuer sample

We completed a review of 35 reporting issuers for whom the OSC is the principal regulator. Twenty-two were TSX-listed issuers and 13 were venture issuers¹. Each of the issuers we reviewed operates in one of the following industries: environmental services, industrial products, mining, oil and gas, steel, transportation services, or utilities. This notice includes commentary that may be relevant to issuers operating in other industries.

Documents reviewed

We reviewed the CD documents of each issuer, which included the issuer's most recent annual financial statements, annual management's discussion and analysis (MD&A) and annual information form (AIF), if applicable.

We also reviewed each issuer's website for disclosure of information relating to environmental matters to determine if that disclosure was consistent with the disclosure in its CD documents.

Disclosure

We examined disclosure about the following matters:

- financial liabilities related to the environment (environmental liabilities)
- asset retirement obligations
- financial and operational effects of environmental protection requirements
- environmental policies fundamental to operations, and
- environmental risks

Focus on material information

As provided in Part 1(f) of Form 51-102F1 *Management's Discussion & Analysis* (Form 51-102F1) and Part 1(e) of Form 51-102F2 *Annual Information Form* (Form 51-102F2), materiality is the determining factor for including information in CD documents.

Information relating to environmental matters is likely material if a reasonable investor's decision whether or not to buy, sell or hold securities of the issuer would likely be influenced or changed if the information was omitted or misstated. As noted in Form 51-102F1 and Form 51-102F2, this concept of materiality is consistent with the financial reporting notion of materiality included in the Canadian Institute of Chartered Accountants Handbook (the Handbook).

We are of the view that issuers should consider both quantitative and qualitative factors in determining materiality generally, and particularly for disclosure relating to environmental matters.

¹ The commentary regarding disclosure obligations of TSX-listed issuers applies to all issuers that do not qualify as venture issuers. A "venture issuer" is defined in NI 51-102 as a reporting issuer that, as at the applicable time, did not have any of its securities listed or quoted on any of the Toronto Stock Exchange, a U.S. marketplace, or a marketplace outside of Canada and the United States of America other than the Alternative Investment Market of the London Stock Exchange or the PLUS markets operated by PLUS Markets Group plc.

SUMMARY OF FINDINGS AND COMMENTS

A. Environmental liabilities

Estimates reflected in financial statements

Under Section 3290 – Contingencies of the Handbook, a contingency is defined as an existing condition or situation involving uncertainty as to possible gain or loss to an issuer that will ultimately be resolved when one or more future events occur or fail to occur. For example, an issuer involved in litigation over environmental matters may include an estimated amount for a contingent environmental liability in its financial statements (including the related notes) at the date of its financial statements. The estimate may be selected from a range of possibilities. The estimate may change over time. Canadian generally accepted accounting principles (GAAP) allow the minimum estimate to be accrued if no estimate within the range is more probable than another. Prediction of the outcome of contingencies, including estimation of the financial effects, is a matter of judgment by those responsible for preparing financial statements, taking into account the particular circumstances.

Where the environmental liability involves a critical accounting estimate (as defined in Form 51-102F1), certain disclosure is required. Specifically, item 1.12 of Form 51-102F1 requires management of TSX-listed issuers to include an analysis of critical accounting estimates in their MD&A. This analysis should:

- identify and describe each critical accounting estimate, including:
 - a description of the accounting estimate
 - the methodology used in determining the critical accounting estimate
 - the assumptions underlying the accounting estimate that relate to matters highly uncertain at the time the estimate was made
 - any known trends, commitments, events or uncertainties that management reasonably believes will materially affect the methodology or assumptions described, and
 - if applicable, why the estimate is reasonably likely to change from period to period and have a material impact on the financial presentation
- explain the significance of the estimate to the issuer's financial condition, changes in financial condition and results of operations and identify the financial statement line items affected by the accounting estimate
- discuss changes made to critical accounting estimates during the past two financial years, including the reasons for the change and the quantitative effect on the issuer's overall financial performance and financial statement line items, and
- identify the segments of the issuer's business that the accounting estimate affects and discuss the accounting estimate on a segment basis, if the issuer operates in more than one segment

Findings

The MD&A of some of the TSX-listed issuers we reviewed included a detailed analysis of the issuer's environmental estimates. For example, in discussing reclamation costs, one issuer stated that its operations are subject to environmental laws in the various countries where it has closed mines and open mines. The issuer then stated that technical issues made the reclamation of closed mines uncertain, which, together with any future changes in environmental laws, made estimating reclamation costs difficult. Nevertheless, the issuer provided a breakdown of its estimated reclamation costs for its closed mines and its open mines, and provided the basis and methodology for making these estimates. The issuer concluded its analysis by noting that it recognized changes in its estimated reclamation costs immediately for closed mines and amortized any changes in its estimated reclamation costs over the life of its open mines.

In contrast, many of the other TSX-listed issuers we reviewed included boilerplate discussion of environmental estimates in their MD&A with minimal or no analysis, or did not discuss the environmental estimates at all. For example, in its MD&A, one issuer simply stated that it is responsible for its share of environmental costs and maintains insurance for environmental risks, but that there is no guarantee that the insurance will cover all environmental claims brought against the issuer.

Comments

We are of the view that in order for a TSX-listed issuer to meet the requirements of item 1.12 of Form 51-102F1, the issuer should quantify the accounting estimate where quantitative information is reasonably available and would provide material

information to investors. They should also identify and explain that the estimate was highly uncertain at the time it was made and provide a detailed discussion of the estimate, which may include a sensitivity analysis or disclosure of the upper and lower ends of the range of estimates from which the recorded estimate was selected.

We are of the view that boilerplate disclosure is insufficient because it does not specifically identify how the estimate relates to that issuer, and therefore does not provide meaningful information to investors.

Potential environmental liabilities not reflected in financial statements

Findings

Many of the issuers we reviewed only discussed potential environmental liabilities in their MD&A if they had included these potential liabilities in their financial statements.

Eight issuers mentioned environmental contingencies and commitments in the notes to their financial statements. These included chemical spills, litigation resulting from a variety of environmental matters, arbitration in foreign jurisdictions concerning licences and permits, and soil remediation. However, only six of these issuers discussed these environmental contingencies and commitments in their MD&A.

Comments

Some issuers may have potential liabilities that are not reflected in the financial statements because their long-term or contingent nature can make them particularly difficult to quantify.

Some issuers may have several contingent environmental liabilities that have not been recognized because they are not individually material, but it is possible that together they may indicate an underlying risk or trend that could be material to the issuer in the long-term.

We are of the view that a discussion of material contingent environmental liabilities should be included in an issuer's MD&A and/or AIF whether or not the liability has been accrued in the financial statements or has been disclosed in the notes to the financial statements.

B. Asset retirement obligations

In accordance with Section 3110 – Asset Retirement Obligations of the Handbook, issuers are required to include certain disclosure about asset retirement obligations (AROs) in their financial statements, if applicable.

Item 1.2 of Form 51-102F1 requires an analysis of an issuer's financial condition, results of operations and cash flows, which includes a discussion of commitments, events or uncertainties that are reasonably likely to have an effect on the issuer's business. In addition, item 1.6 of Form 51-102F1, and the corresponding instructions for item 1.6 included in Form 51-102F1, require TSX-listed issuers to provide a summary, in a table, of contractual obligations for the issuer's balance sheet conditions or income or cash flow, including payments due for each of the next five years and thereafter. Among other things, TSX-listed issuers must list other long-term obligations, which may include AROs.

Findings

Thirteen issuers, including two venture issuers, included AROs in their financial statements. Seven of these issuers also included AROs in the summary contractual obligations table in their MD&A.

Five issuers discussed the AROs in both their MD&A and their AIF, seven issuers discussed the AROs only in their MD&A and one issuer did not discuss the AROs in their MD&A or AIF.

Disclosure of AROs varied among issuers. For example, some issuers recognized, measured and disclosed liabilities for AROs associated with the retirement of long-lived assets in accordance with GAAP, but did not include a discussion of these liabilities in their MD&A and/or AIF.

Other issuers provided more useful information regarding AROs to investors. For example, one issuer accrued environmental remediation costs relating to certain mines in its annual financial statements in accordance with GAAP. The issuer also included a comprehensive discussion of these costs in its MD&A and AIF, separating the costs into categories such as the costs of compliance with environmental legislation and the costs associated with the disposal of hazardous materials, and also divided the costs among open mines, closed mines and development projects. The issuer then identified the current and future impact of the costs on financial results and noted that it would record a loss accrual if a contingent loss arose due to the improper use of an asset and the loss was probable and could be reasonably estimated.

Comments

A liability for an ARO should be recognized in the period when a reasonable estimate of fair value can be made. Once this estimate can be made, GAAP requires that the estimate be included in the issuer's financial statements.

We are of the view that if an ARO is material to an issuer, in addition to providing the required financial statement disclosure, the issuer should strive to enhance a reader's understanding by providing supplemental disclosure in its MD&A. Specifically, issuers should include in their MD&A a comprehensive discussion of material commitments, events or uncertainties, including AROs, that are reasonably likely to have an effect on the issuer's business.

Issuers should also evaluate whether AROs are material long-term obligations. If so, we are of the view that TSX-listed issuers should include these AROs in the summary contractual obligations table in their MD&A as required under item 1.6 of Form 51-102F1.

C. Financial and operational effects of environmental protection requirements

Item 5.1(1)(k) of Form 51-102F2 requires issuers to disclose the financial and operational effects of environmental protection requirements on the issuer's capital expenditures, earnings and competitive position in the current financial year and the expected effect in future years.

Findings

Twenty-two of the issuers we reviewed were required to file an AIF. Fourteen of these issuers included disclosure about environmental protection requirements in their AIF. Eight issuers did not include any disclosure in their AIF about environmental protection requirements.

Most of the issuers that included disclosure in their AIF about environmental protection requirements provided only a qualitative discussion of environmental protection requirements. They did not quantify the costs or the impact or potential impact on financial and operational results. This qualitative disclosure was typically discussed in the context of a risk factor.

In addition, many of these issuers provided only a limited discussion of these requirements, again with no quantification on the results of the issuer's operations. For example, one issuer simply stated that future environmental changes could affect any aspect of its activities.

Some issuers did include a detailed discussion of the financial and operational effects of environmental protection requirements on their capital expenditures, earnings and competitive position in the current financial year and the expected effect in future years. For example, one issuer stated that it designs and operates in compliance with all applicable environmental requirements relating to the protection of the environment. The issuer also stated that it cannot predict the changes that could be made to environmental requirements in the future. The issuer concluded its discussion by stating that its capital and operating costs for environmental controls would likely increase in the future, but these increases were not expected to have a material effect on the earnings or competitive position of the issuer.

Comments

We are of the view that in order to meet the requirements of item 5.1(1)(k) of Form 51-102F2, the AIF should, where reasonably available, include a quantification of the costs associated with environmental protection requirements, and the impact or potential impact of these costs on financial and operational results. Boilerplate disclosure is insufficient to properly meet these requirements.

D. Environmental policies fundamental to operations

If an issuer has implemented environmental policies that are fundamental to its operations (such as policies on the issuer's relationship with the environment), item 5.1(4) of Form 51-102F2 requires the issuer to describe these policies and the steps it has taken to implement them.

Findings

Disclosure of environmental policies varied significantly in the AIFs that we reviewed. Some issuers provided meaningful information to investors. For example, one issuer discussed its various programs to prevent and control spills and protect water quality, reuse and conserve water, and mitigate the dust produced by its operations for each of its properties. The issuer also addressed how harmful materials generated by its operations are removed and destroyed, and described its policy of performing regular environmental audits on all of its properties.

A number of issuers did not provide a meaningful discussion of their environmental policies and the actions they have taken to implement these policies, or they only provided generic boilerplate discussion of their environmental policies.

Comments

We are of the view that when discussing environmental policies fundamental to their operations, issuers should evaluate and describe the impact or potential impact these policies may have on their operations. This discussion may include a quantification of the costs associated with these environmental policies, where quantitative information is reasonably available and would provide meaningful information to investors. Boilerplate disclosure is insufficient to properly meet these requirements.

E. Environmental risks

Item 5.2 of Form 51-102F2 requires an issuer to disclose risk factors relating to the issuer and its business. This includes environmental risks and any other matter that would be most likely to influence an investor's decision to buy the issuer's securities. The AIF should provide insight into what the issuer believes are the risks relating to the issuer and its business so that investors can assess the effect of these risks on the issuer's operations and/or financial performance.

Findings

Eighteen of the 22 issuers we reviewed that were required to file an AIF, provided disclosure about environmental risks. Four of the 22 issuers did not address environmental risks as a risk factor, despite being in an industry where environmental risks appear to be relevant.

Disclosure about environmental risks varied among issuers. For example, one issuer provided a detailed discussion of the foreign environmental laws and regulations that apply to it and quantified the costs of compliance with these laws and regulations in both the short- and long-term. The issuer also discussed how significant changes to these laws or regulations could materially impact its expenditures, which in turn could affect its business, financial results and financial condition.

In contrast, other issuers used boilerplate language, simply disclosing that they are subject to environmental laws and regulations, and that they have established general provisions for expenses associated with environmental obligations. There was no quantification of these expenses. For example, one issuer stated that it was subject to the risk of penalties if it did not comply with applicable environmental laws and indicated that there was no assurance that it could comply with these laws.

Comments

An issuer should assess whether, due to the nature of its operations, it should address environmental risks in its CD documents. If so, those risks should be disclosed in the issuer's AIF, if required to be filed. If the issuer is not required to file an AIF, those risks should be disclosed in the issuer's MD&A.

We are of the view that if any risks relating to environmental laws are material to an issuer's operations, whether national or international, the issuer should include a detailed discussion of these laws. This discussion should provide meaningful information to investors. For example, it may include whether or not the issuer is in compliance with these laws and any costs of compliance. Boilerplate disclosure is insufficient to properly meet these requirements.

CONCLUSION

General

Existing CD obligations require issuers to disclose material information, including material information about environmental matters. Issuers should consider the guidance in this notice when preparing their financial statements, MD&A and AIFs to ensure that the disclosure of environmental matters complies with securities legislation and provides investors with meaningful information for making investment decisions.

Website disclosure

All of the issuers we reviewed disclosed environmental information on their website that was consistent with their CD documents. We remind issuers that disclosure of material environmental matters should be set out in their CD documents filed with the securities regulatory authorities as required by GAAP and applicable securities legislation, and that it is insufficient to discuss environmental matters required by securities legislation solely on their website.

Certification and audit committee responsibilities

Multilateral Instrument 52-109 *Certification of Disclosure in Issuers' Annual and Interim Filings* requires that certifying officers certify, among other things, that an issuer's financial statements, together with the other financial information included in the issuer's MD&A and AIF, if applicable, fairly present, in all material respects, the issuer's financial condition. We are of the view that meaningful discussion of material environmental matters, where applicable, in an issuer's MD&A and AIF is important to achieve fair presentation of the issuer's financial condition in all material respects.

In addition, under Multilateral Instrument 52-110 *Audit Committees*, an audit committee is required to review an issuer's financial statements and MD&A before the issuer publicly discloses this information. The audit committee must also be satisfied that adequate procedures are in place for the review of the issuer's public disclosure of financial information extracted or derived from the issuer's financial statements, and must periodically assess the adequacy of these procedures. We are of the view that the audit committee's oversight of financial reporting related to material environmental matters, where applicable, in CD documents is an important aspect of meeting these responsibilities.

We will continue to monitor disclosure of environmental matters as part of our ongoing CD reviews.

QUESTIONS OR COMMENTS

We encourage issuers or their representatives to contact us with any questions or comments on these matters.

Jo-Anne Matear
Assistant Manager, Corporate Finance
(416) 593-2323
jmatear@osc.gov.on.ca

Neeti Varma, CA
Accountant, Corporate Finance
(416) 593-8067
nvarma@osc.gov.on.ca

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