

INTOSAI



Environmental Audit and Regularity Auditing

*Mehemea Kei te ora a Papatuanuku ka ora te tangata
(If we nurture Mother Earth then she will nurture us)*

INTOSAI Working Group
on Environmental Auditing

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Arabic: Egypt's Central Auditing Organization

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2004

Foreword

As people have become more aware of threats to the world's environment, an awareness of the responsibilities of industry and of all levels of government to address environmental issues has also increased. Public scrutiny, not only from individual citizens or groups but on the part of financial institutions as well, has increasingly focused on issues of accountability for environmental issues. This scrutiny has given an added impetus to efforts by government and business to incorporate environmental concerns into their planning and policy-making activities. As a result, environmental regulation by both national and local authorities has expanded significantly—resulting in new or additional compliance measures, and costs—for both the public and private sectors.

Holding government and industry to greater accountability for their actions with respect to the environment has led to a need to report on the consequences of these actions. There is also an expectation that these reports will be subject, in turn, to an independent audit. Auditors have an important part to play in responding to these concerns by virtue of their role as providers of credible and objective information, upon which performance is evaluated and decisions are based.

Environmental audits, however, do not always easily fit into the mandate of various supreme audit institutions (SAIs). The difficulties in carrying out environmental audits within a regularity mandate were first raised at the sixth meeting of INTOSAI Working Group on Environmental Auditing (WGEA), held in Cape Town, South Africa.

This paper “Environmental Audit and Regularity Auditing” provides guidance to SAIs on how to conduct environmental audits by applying regularity (financial and compliance) auditing practices. It demonstrates that SAIs do not necessarily require a performance audit mandate to conduct audit work with an environmental focus.

In 2001 the SAI of New Zealand, the Office of the Controller and Auditor-General, circulated an early draft of this paper for discussion at the seventh



meeting of the WGEA in Ottawa, Canada. An updated version was presented the following year at the WGEA Steering Committee meeting held in London, England. The Steering Committee proposed that the paper be approved by the WGEA and submitted for adoption as a formal INTOSAI document. This proposal was unanimously endorsed in Warsaw, Poland, at the June 2003 WGEA Assembly.

In October 2003, the INTOSAI Governing Board was duly informed of this intention and approved measures to distribute the paper among INTOSAI members for comment and review. In early 2004, the WGEA collected the views and opinions of INTOSAI members and introduced the appropriate changes to reflect their contribution to the paper's development. This paper is the result of these consultations. We are pleased to propose it as an INTOSAI document at the October 2004 XVIII International Congress of Supreme Audit Institutions (INCOSAI) in Budapest, Hungary.

We would like to thank Mr. Kevin Brady, Controller and Auditor-General of New Zealand for having spearheaded this project on behalf of the WGEA. We would also like to thank Martyn Pinckard, Wendy Venter, and Gareth Ellis of the New Zealand Office of the Controller and Auditor-General for their dedicated work in developing the paper and preparing it for publication. We extend our thanks to the members of the WGEA and other SAIs whose comments and views helped shape the paper's contents and contributed to its completion.

This paper is available in all INTOSAI languages and can be found on the WGEA Web site (www.environmental-auditing.org). We are sure that "Environmental Audit and Regularity Auditing" will provide useful insights and guidance for auditors, who already practice environmental audit on a regular basis, as well as those auditors who are less familiar with it.

Sincerely,



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Auditor General of Canada



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Executive Summary

1. A supreme audit institution (SAI) can undertake an audit with an environmental focus using a regularity (financial and compliance) mandate.¹ It is not necessary to have a performance audit mandate to conduct an audit with an environmental focus. An SAI may feel that their greatest skills and experience lie in the audit of financial and compliance issues. It would make sense for them to use this experience in an environmental audit. This paper illustrates the possibilities for conducting audits with an environmental focus using a financial and compliance framework.
2. The costs to governments of developing and implementing environmental policies and obligations are increasingly significant. An SAI should recognize that environmental costs, liabilities and asset impairments affect the preparation and audit of financial statements. The regularity auditor will need to assess the completeness and accuracy of the figures reported.
3. The objective of an audit of financial statements is to enable the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. Material respects can be directly linked to environmental costs, obligations, impacts, and outcomes. The audit of financial statements requires the auditor to consider environmental matters as part of the regularity audit.

¹ INTOSAI WGEA, *Guidance on Conducting Audits of Activities with an Environmental Perspective*, paragraph 124.



What is Environmental Auditing?

4. Accountants and auditors have traditionally not been associated with the conservation or environmental movement. However, as providers of information, reports, and assurance on which business and government decisions are frequently based, they have increasingly been drawn into the environmental arena. The influence of accountants and auditors comes from their access to financial and performance information. They analyze, report and communicate information on which decisions are based and performance is evaluated. They can encourage greater transparency and informed decisions about the application of resources and the impact of activities on environmental outcomes without distorting existing accounting standards.

5. In its paper, *Guidance on Conducting Audits of Activities with an Environmental Perspective*, the Working Group on Environmental Auditing (WGEA) identified three types of audits in which environmental issues can be addressed.² These are audits of financial statements, compliance audits and performance audits.

6. During an audit of financial statements, environmental issues may include the following:

- initiatives to prevent, abate or remedy damage to the environment;
- the conservation of renewable and non-renewable resources;
- the consequences of violating environmental laws and regulations; and
- the consequences of vicarious liability imposed by the state.

² INTOSAI WGEA, *Guidance on Conducting Audits of Activities with an Environmental Perspective*, 2000.



7. Compliance auditing with regard to environmental issues may relate to providing assurance that governmental activities are conducted in accordance with relevant environmental laws, standards and policies, both at national and international (where relevant) levels.

8. Performance auditing of environmental activities may include ensuring that:

- indicators of environmental-related performance (where contained in accountability reports) fairly reflect the performance of the audited entity; and
- environmental programs are conducted in an economical, efficient and effective manner.³

9. While this paper discusses environmental auditing and regularity auditing, it is acknowledged that audits of sustainable development may be approached in ways similar to those described here. The reader may refer to the INTOSAI WGEA's paper *Sustainable Development: The Role of Supreme Audit Institutions* for further information on this matter.⁴

Why Look at This Issue?

10. At the 6th INTOSAI WGEA meeting in Cape Town, South Africa (April 2000) the difficulties of carrying out environmental audits within a regularity mandate was raised. This was particularly the case for those SAIs

³ The INTOSAI WGEA, *Guidance on Conducting Audits of Activities with an Environmental Perspective*, 2000 describes in more detail the different types of performance audits that can be conducted (paragraph 210).

⁴ www.environmental-auditing.org.



that do not have a specific performance audit mandate, or greater skills and experience in auditing accounting or compliance matters.⁵

11. At the 7th INTOSAI WGEA meeting in Ottawa, Canada (September 2001), a discussion paper highlighted the relevance of this issue for the activities of all SAIs. The working group also felt that it was important to continue to work in this area to prepare a more detailed paper that illustrates how an environmental audit focus can be brought to the financial and compliance activities of an SAI.

12. This paper provides guidance on how to conduct environmental audits using regularity (financial and compliance) auditing practices.

The Regularity Audit

13. The INTOSAI paper, *Code of Ethics and Auditing Standards*⁶, states that the full scope of government auditing includes regularity and performance audit.

14. A regularity audit, as defined by these standards embraces:

- attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements;
- attestation of financial accountability of the government administration;

⁵ INTOSAI WGEA survey results from 1997 show that the number of SAIs working under a restricted mandate appears to be decreasing over time as SAIs develop their capacity and new mandates. The survey concluded that 94 percent of SAIs had some form of mandate to conduct environmental audits.

⁶ INTOSAI, *Auditing Standards*, June 1992.



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- audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;
 - audit of internal control and internal audit functions;
 - audit of the probity and propriety of administrative decisions taken within the audited entity; and
 - report of any other matters arising from or relating to the audit that the SAI considers should be disclosed.

15. The standards state that performance audit is concerned with the audit of economy, efficiency and effectiveness and embraces:

- audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- audit of the efficient use of human, financial and other resources that include examining information systems, performance measures, monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies; and
- audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of the activities compared with the intended impact.

16. The paper also acknowledges that there can be overlap between regularity and performance auditing, and in such cases classification of a particular audit will depend on the primary purpose of that audit.

17. The regularity audit, therefore, encompasses financial and compliance auditing. The compliance of a regularity audit may be in relation to compliance with accounting standards and/or compliance with relevant environmental laws and treaties.



Financial Audit

Purpose of financial statements

18. Financial statements should provide information on the financial position, performance, and cash flow of an entity that is useful for making and evaluating decisions about the allocation of resources. Specifically, a financial statement in the public sector should provide useful information for decision-making and demonstrate an entity's accountability of its resources.⁷

19. Generally, financial statements of governments (or their constituent entities) have tended to avoid environmental issues. However, there is a realization that there are costs, compliance, and performance issues associated with environmental policies and obligations that should be reflected in financial statements.

United Kingdom Atomic Energy Authority (UKAEA) Annual Accounts for 2002–03

The accounts of the United Kingdom Atomic Energy Authority for 2002–03 include the following disclosures:

- A performance report based on an environmental performance index—a numerical measure that promotes first class environmental management. The environmental management plans in place at UKAEA support their certification under the ISO 14001 environmental standards;
- A report on the main features of the environmental restoration for all sites for which the UKAEA is responsible; and
- Detailed disclosures on the costs of decommissioning and restoring nuclear sites and the estimates of cost are calculated.

⁷ International Public Sector Accounting Standard IPSAS1: Presentation of Financial Statements issued by the International Federation of Accountants, May 2000.



Objectives of an audit

20. The audit of financial statements allows the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework.⁸

Environmental matters

21. Environmental matters are becoming significant to an increasing number of governments, entities, and users of financial statements. Some organizations operate in sectors where environmental matters may have material impacts on the financial statements.

22. The International Auditing Practices Committee (IAPC) defines environmental matters in a financial audit as:

- (a) “initiatives to prevent, abate or remedy damage to the environment or to deal with the conservation of renewable and non-renewable resources (such initiatives may be required by environmental laws and regulations or by contract, or they may be undertaken voluntarily);
- (b) consequences of violating environmental laws and regulations;
- (c) consequences of environmental damage done to others or to natural resources; and
- (d) consequences of vicarious liability imposed by law (for example, liability for damages caused by previous owners).”⁹

23. To date, the accounting and auditing communities have focused on environmental liabilities. While an organization’s financial statements may include land assets (valued on the same basis as other property), a recent focus has been on “environmental assets”—natural assets that do not provide

⁸ International Standard on Auditing ISA 200: Objective and General Principles Governing an Audit of Financial Statements.

⁹ International Auditing Practice Statement 1010: The Consideration of Environmental Matters in the Audit of Financial Statements, March 1998.



resource input but which provide environmental services such as habitat or flood and climate control, and other non-economic functions such as aesthetic or health values. This idea stresses that bodies are accountable not only to their shareholders but also to society for the stewardship of the natural environment. The consideration of environmental assets is still at an early stage of development, with the private sector very much taking the lead.

Cash versus accrual accounting

24. Public sector reporting is a spectrum between cash accounting and accrual accounting. Governments around the world adopt a variety of reporting practices along this spectrum.¹⁰

25. The cash basis of accounting recognizes transactions and events when cash (including cash equivalents) is received or paid. It measures the overall financial results for the period as the difference between cash received and cash paid. The primary financial statement is the cash flow statement.

26. In comparison, the accrual basis of accounting recognizes transactions and other events when they occur (not just when cash and its equivalent are received or paid). The elements in a financial statement under accrual accounting are assets, liabilities, net assets and equity, revenue and expenses.

27. This paper discusses the impact of environmental issues on financial statements prepared using both methods of accounting and what an SAI should consider when auditing financial statements.

¹⁰ International Federation of Accountants, Public Sector Committee, Governmental Financial Reporting Accounting Issues and Practices, May 2000.



How Environmental Issues Impact on Financial Statements

Cash accounting

28. Environmental issues can impact on financial statements prepared on a cash basis of accounting, but the effects are limited because a cash basis focusses on the recognition of impacts during the accounting year in question (through specific payments and, in statements of losses, through special payments). Environmental impacts are not necessarily restricted to specific periods and may need to be projected. Therefore, auditors may consider developing a methodology to examine the impacts of activities on environmental issues for periods longer than the accounting year in question.

29. Environmental issues can impact on the cash flows of an entity during the reporting period. In addition, there could be an impact where compliance reporting is included in a government financial report, for example, where the entity is required to demonstrate compliance with environmental laws and regulations. Non-compliance can be reported through specific details or special reports that use financial and compliance auditing principles.

Apollo Sea Oil Spill—Republic of South Africa

In the mid 1990s, an oil spill off the western cape shores of South Africa polluted some of the most scenic coastline of the area, a popular tourism area renowned for its natural beauty.

The responsibility for dealing with the oil spill was shared between various government agencies, but the insurance policy for recovery of the costs was vested with a government department that prepares its financial statements on the cash basis of accounting.

Additional disclosure of various items was required, including losses, incurred liabilities, and contingencies. The settlement of accounts with service providers and the finalization of the insurance claim dragged on over a number of financial periods, making the disclosure of the real cost in the cash accounts inconclusive. The effect on additional disclosures had to be considered continually. This meant the auditors had to monitor the situation over a number of financial periods until its resolution, even though it was predominantly linked to a cash basis of accounting.



The insurer offered a ZAL 15 million settlement based on the individual figures available, whereas a comprehensive analysis showed that some ZAL 25 million had been expended by the different agencies. As the responsibility was shared between various agencies, these considerations were relevant to various audits.

In this situation the SAI was able to comment in a special report on the full cost of the environmental incident and on the coordination issues between the various agencies, something that might not have been appropriate in separate audit reports on each agency.

There are other instances when an auditor may take into account the fact that while a particular issue may not be material within a single agency, it might be important across a number of agencies. For example, efficient energy management within a single agency may not be significant but across a number of agencies could lead to considerable savings.

Regularity audit and environmental issues—Poland

Regularity audits (financial and compliance) carried out by Poland's Supreme Chamber of Control have addressed a wide range of environmental issues and outcomes including:

- the implementation of a forestry planting program;
- post-mining (sulphur industry) land reclamation and environmental protection program;
- fulfillment of obligations under the provisions of the Helsinki Convention; and
- collection and use of fees and fines for salinification of surface waters.

Implementation of a forestry planting program

After auditing this forestry program, the Supreme Chamber of Control reported to Parliament on the following shortcomings:

- lack of favourable conditions to assist the successful implementation of the program;
- lack of common forestry and spatial management policy;
- ineffective co-ordination by government departments;
- shortage of financial resources; and
- incomplete and inappropriate use of funds allocated to the program.



Drilling and maintenance of boreholes—Zimbabwe

This was an audit of a District Development Fund (DDF) that had, as one objective, to provide safe drinking water to rural people by sinking boreholes owned by and located in communities. The shortcomings reported to Parliament included:

- the financial management and control system was not favourable to provincial drilling operations;
- borehole drilling services were provided to people who were outside the DDF mandate; and
- the DDF managed to achieve only 45 percent of its planned output during the audited period.

Accrual accounting

30. Environmental issues can have an impact on financial statements prepared on an accrual basis in many ways. There are international accounting standards that address the general principles for the recognition, measurement, and disclosure of environmental matters in a financial report.¹¹ SAIs may therefore develop auditing standards in line with these international accounting standards in conjunction with their own national accounting bodies.

31. The introduction of environmental laws and regulations may involve an obligation to recognize impairment of assets and consequently a need to write-down the carrying value.

32. A failure to comply with legal requirements concerning environmental matters, such as emissions or waste disposal, may require accrual of remediation works, compensation, or legal costs. For example, a failure to comply with pollution control laws may lead to fines and penalties for an entity.

¹¹ For example, ISA 37: Provisions, Contingent Liabilities and Contingent Assets provides general considerations that apply to the recognition and disclosure of provision and contingent losses, including those arising from environmental matters. Examples of environmental liabilities are also provided.



33. Some annual operating costs are environmental in nature. For example, energy costs can be considered an environmental cost as the use of fossil fuels is a source of carbon dioxide and air pollution.

34. Some entities may need to recognize environmental obligations as liabilities in the financial statements. For example, obligations associated with solid waste landfill closure, and aftercare and restoration obligations associated with mining operations.

35. An entity may need to disclose a potential environmental obligation as a contingent liability where:

- the possible obligation depends on the possible occurrence of a future event; or
- the amount of the present obligation cannot be reasonably estimated; or
- an outflow of resources to settle the obligation is not probable.

36. In the course of meeting the relevant accounting standard requirements, some additional disclosures in the notes to the financial statements may be required. Examples might include:

- the industry in which the entity operates and the associated environmental issues;
- the accounting treatment adopted for environmental costs, i.e. what is included, when items are expensed or capitalised, how items are amortised to income, etc;
- fines and penalties which have been incurred under environmental legislation; and
- environmental restoration liabilities, including measurement uncertainties, nature, and timing.



37. Regardless of the increasing emphasis on environmental accounting, the accrual accounting regime not only recognizes environmental costs as they occur (as cash accounts, etc.) but also recognizes items such as environmental liabilities, either in the long or the short term—for instance, by establishing financial provisions in the balance sheet and by disclosing contingent liabilities elsewhere in the financial statements. The value of fixed assets can also be adjusted—through permanent diminutions in value, for example, to reflect impairments. Existing standards, therefore, can accommodate environmental issues, and auditors have a standard against which to assess the inclusion of environmental issues in the financial statements.

Accounting for key infrastructural assets in New Zealand

In New Zealand, local government is responsible for significant environmental services such as delivery of fresh water, treatment and disposal of wastewater, and solid waste disposal. Local government also administers key environmental legislation.¹²

In 1993 the New Zealand SAI tabled a report to Parliament that concluded that no assurance could be given as to local government's long-term financial security. The local government had a lack of knowledge about the condition of major infrastructural assets and no strategic plan for the maintenance and development of such assets. The Auditor-General's findings were based on the regularity audits carried out across local government.

The report resulted in a change in the *Local Government Act* requiring local authorities to assess the condition of their infrastructure and future service requirements (both customer and environment). While the prime reason for raising this was financial, the outcomes have included:

- significant increases in available information about key environmental infrastructure assets such as water and wastewater delivery and treatment systems;
- improved short-term maintenance and long-term replacement investment in environment infrastructure assets to meet customer concerns and environmental standards; and
- improved performance of infrastructure assets and the reduced risk to the environment through failure of such systems.

¹² *The Building Act 1991* and *The Resource Management Act 1991* are two examples.



Compliance Audit

38. As stated in paragraph 1, compliance auditing falls within the INTOSAI definition of regularity auditing. Compliance audits can examine an entities compliance with a range of matters. Firstly, they can examine an entity's compliance with financial authorities and accounting practices (for example, legislative controls such as appropriations of the entities spending). Secondly, they can examine compliance with environmental laws and treaties. Auditors may be interested in examining compliance with laws and treaties as non-compliance could affect the entity's financial statements. Also, auditors may be interested in examining such compliance because, apart from any effect on financial statements, it will inevitably incur expenditure and could, therefore, be relevant to the wider use of public funds.

39. Some SAIs may conduct the second type of compliance audits under a performance audit mandate—compliance can therefore fall within both regularity and performance audit mandates.

40. Compliance auditing also allows the SAI to assess the compliance performance of an entity. It can help the government (and its agencies) close the gap between promises and the results achieved by its policies and programs. For example, a department may be funded to regulate environmental activities such as permits for the logging of trees. Does it have the systems in place to do the job? Are its activities being fairly and accurately reported?

41. This type of environmental audit can:

- promote compliance or provide increased assurance about compliance with existing and impending environmental policy and legislation;
- reduce the risks and costs associated with non-compliance with regulations;
- save costs by minimizing waste and preventing pollution; and
- identify liabilities and risks.



Payments for motorway construction and water quality monitoring—Greek Court of Audit

The Greek Court of Audit only carries out financial audit—it has no direct powers to conduct “green audits.” It can examine whether

- (a) public money is going to be spent or has been spent against environmental rules (compliance); and
- (b) public money scheduled to be spent for the protection of the environment is effectively spent for this purpose.

The Court has stated that *the audit of the public expenditure is not limited to the application of financial regulations but also comprises the implementation of the regulations on protection of the environment.*

The Court conducted such an audit on payments made for the construction of a motorway and concluded that the approach adopted for the enlargement of the motorway was the most economic. However, funding for the project was not approved as the coastal area where the motorway was to be built was protected by the Constitution as an environmental public good.

The Court has also conducted an audit on the implementation of a program for the protection of bathing waters. The program was designed to establish a monitoring mechanism for testing the quality of bathing waters. The Court observed that public money had been spent not on the basis of a permanent establishment, but for the payment of private entities or individuals, occasionally collaborating with the public service. The court raised queries regarding the eligibility of this kind of expenditure. It considered that the aim of the program was to create a relevant monitoring network with highly qualified personnel. An infrastructure was thus necessary to be provided in order to make possible the installation of a new public service.

What Can a Regularity Auditor Do?

Obtain knowledge of environmental matters

42. In all audits, a sufficient knowledge of the business is needed to enable the auditor to identify and understand matters that may have a



significant effect on the financial statements, the audit process, and the audit report (ISA 310, paragraph 2).

43. The auditor is not expected to know more than management or the environmental experts.

44. The regularity auditor should consider the industry in which the entity operates, as it could indicate the possible existence of environmental liabilities and contingencies. Certain industries are more exposed to environmental risks—for example, chemical, oil and gas, pharmaceutical, and mining industries, or government agencies with responsibilities for environmental management or regulation.

Assess inherent risk, internal control systems, and the control environment

45. Having acquired a sufficient knowledge of the business, the auditor assesses the risk of material misstatement in the financial statements. This would include the risk of misstatement due to environmental matters, namely environmental risk.

46. Examples of environmental risk include:

- compliance costs arising from legislation; and
- impact of non-compliance with environmental laws and regulations.

47. The audited entity can adopt different approaches to achieve control over environmental matters. Small entities or entities with low exposure to environmental risk may include environmental control systems in their normal internal control systems. Entities with high exposure to environmental



risk may design and operate a separate internal control sub-system—for example, an environmental management system (EMS).¹³

48. The auditor should also obtain an understanding of the control environment for environmental matters. For example, areas to examine could include a governing body's and its management's attitude, awareness, and actions toward internal control.

49. If the auditor considers there is a risk of material misstatement of the financial statements, specific procedures would need to be designed and performed to ensure that there is no material misstatement.

Water and Wastewater Management—Austria

The Austrian Court of Audit recently conducted a study of grants given by the federal ministry of agriculture, forestry, environment, and water management. The study included an examination of the organization and its financing of the system. Fundraising and distribution of money was seen as important—the more efficient the system, the more projects could be funded and the more potential environmental benefits could be achieved.

Consider laws and regulations

50. When planning and performing an audit, a regularity auditor may evaluate compliance with applicable laws and regulations, where non-compliance may materially affect the financial statements, or where compliance incurs expenditure of public funds. However, an audit cannot be expected to detect non-compliance with all laws and regulations.¹⁴

51. The regularity auditor obtains a general understanding of environmental laws and regulations that could result in the material

¹³ Standards for an EMS have been issued by the International Organization for Standardisation ISO 14001: *Environmental Management System—Specification with Guidance for Use*.

¹⁴ ISA 250: Consideration of Laws and Regulations in an Audit of Financial Statements.



misstatement of the financial statements or which may have a fundamental impact on the operations of an entity.

52. The auditor is not expected to possess the expertise or professional competence to determine if an entity is in compliance with the environmental laws and regulations. The auditor, however, can use his training, experience and understanding of the entity and industry to recognize non-compliance issues and seek expert advice.

Perform substantive procedures

53. The regularity auditor also obtains evidence to support the environmental disclosures made in the financial statements through enquiries of management—those responsible for preparing the financial statements and those responsible for environmental matters.

54. If the entity has an internal auditing function, which examines environmental aspects of the entity's operations, the auditor should consider using that work. In certain situations, an environmental expert may be involved in an outcome recognized or disclosed in the financial statements, for example, in quantifying the nature and extent of a contamination, considering alternative methods of site restoration, etc. In such cases, the auditor should consider the impact of the expert's work on the financial statements and the professional competence and objectivity of the environmental expert.

55. Another aspect the regularity auditor may consider is the use of any income that an entity may be responsible for collecting, such as funds collected under the "polluter pays" model. The auditor may examine the financial systems and controls around the collection of such funds, and also whether the funds are being used for the purposes they were intended.



Reporting

Service performance reporting

56. Some governments either report information on service performance in financial statements or separately. In such cases, SAIs may further the accountability and reporting aspects of their regularity audit role.

57. “With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a greater need for the accountability processes to be in place and operating effectively.”¹⁵

58. This suggestion concerns all entities that have an impact on the environment and can be categorized into three groups:

- entities whose operations directly or indirectly affect the environment, whether positively or negatively—such as by rehabilitation or utilization and pollution;
- entities with powers to make or influence environmental policy and regulations—whether internationally, nationally, or locally; and
- entities with the power to monitor and control the environmental actions of others.¹⁶

59. “Development of adequate information, control, evaluation and reporting systems within the government will facilitate the accountability

¹⁵ INTOSAI, *Auditing Standards*, Revised Edition 1992, paragraphs 20–22.

¹⁶ INTOSAI, *Guidance on Conducting Audits of Activities with an Environmental Perspective*, 2000.



process. Management is responsible for the correctness and sufficiency of the form and content of the financial reports and other information.”¹⁷

60. If key environmental departments or agencies are required to produce a statement of what they intend to achieve (a statement of service performance for environmental outputs or outcomes), SAIs could encourage governments to make such statements a part of the entity’s request for a budget. Each year the achievement of the previous year’s statements could be reviewed as part of the financial audit.

61. This could form that basis of an annual checkpoint for monitoring the progress toward the desired environmental outcomes. Each SAI should consider how appropriate this approach might be, bearing in mind its own mandate.

Sea fisheries management and development—Republic of South Africa

In 1997 the SAI of South Africa carried out an examination of the activities of the Department of Environmental Affairs and Tourism: Sea Fisheries Management and Development. The examination was to enhance the accountability process for environmental affairs by:

- auditing the financial statements;
- auditing compliance; and
- auditing performance.

The audit examined, amongst other things:

- the use and custody of assets;
- inefficient or ineffective management measures;
- matters which, in the public interest, should be brought to the attention of the legislature concerned; and
- non-compliance with legislation and other requirements that could influence the reasonable presentation in the financial statements.

¹⁷ INTOSAI, *Auditing Standards*, Revised Edition 1992, paragraphs 23–24.



The examination of the department's financial and compliance activities were central to the environmental audit and allowed the SAI to, amongst other things, report that:

- financial reporting, performance reporting, and the implementation of environmental management systems have been impeded by a lack of legislation;
- capacity constraints impede the rendering of effective law enforcement services; and
- policy formulation and implementation were impeded by the unavailability of analytical environmental performance information, the absence of full cost accounting, and accurate information of the resource.

Other forms of reporting

62. Organizations in the public sector are making progress in developing corporate governance and arrangements for risk management. There has been a move away from a singular focus on financial risk toward giving attention to all major risks that will impact on the public. The management of all significant risks to a body's fulfillment of its objectives has led to changes in corporate responsibilities and reporting.

63. Environmental reports have been developed as a method for companies to communicate their environmental performance and impact to stakeholders: they can be seen as a new and important aspect of corporate governance. Such reports could include an organizational profile, an environmental policy statement, details of targets and achievements, and details of performance and compliance.

64. In the United Kingdom's public sector, a number of bodies have started to produce environmental reports. For example, English Nature, a public agency, published its first environmental report in 2000–01. Among other things, the report outlined the agency's environmental policy and reported on key environmental performance and impacts.

Conclusion

65. The environmental problems of the world will not be solved overnight nor will they be solved solely by the actions of SAIs. However, much trust is placed in the role of the SAIs and they can be part of the solution.

66. The role of a SAI is to respond to the expectations of citizens by providing independent, credible, and objective verification of the information provided by government agencies with respect to their activities and their impact on the environment.

67. As this paper illustrates, the audit of financial statements enables the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an identified financial reporting framework. It also shows how “material respects” can be directly linked to environmental costs, obligations, impacts and outcomes. In this context the audit of financial statements requires the auditor to consider environmental matters as part of the regularity audit.

68. In addition, auditors need to be aware of ongoing developments—such as recognizing environmental assets. They should seek out opportunities to encourage their clients to adopt regimes that may be considered good practice but are not currently mandatory—for instance, the production of environmental reports. As standards—in both financial reporting and corporate governance—move toward fuller reporting and disclosure of environmental, social, and ethical reporting, auditors will need to reappraise their approach.



Department of Trade and Industry, consolidated departmental resource accounts for 2002–03 United Kingdom

The annual consolidated departmental resource accounts for the Department of Trade and Industry include the following disclosures:

- a provision to meet some of the costs of restoring the heavily contaminated land at a coke works—the minimum costs required to meet standard environmental standards;
- a provision, through an arrangement with the United Kingdom Atomic Energy Authority, to cover the costs of liabilities from programs associated with, among other things, the decommissioning of radioactive plant and facilities; and
- provisions for health-related liabilities to cover damage to workers caused by exposure to environmental hazards such as coal mine dust and fumes, and prolonged use of vibratory tools.

69. With acknowledgement to the work of:

- Bruce Gilkison and his book *Accounting for a Clean Green Environment*.¹⁸
- The International Auditing Practices Committee (IAPC), International Federation of Accountants, ISA 1010: The Consideration of Environmental Matters in the Audit of Financial Statements.

¹⁸ First published 1999 Bruce Gilkison and KPMG, Anchor Press Limited, Nelson New Zealand, ISBN 0-473-06106-6.



Appendix—Guidance Notes

Questions that might prompt possible dimensions of an environmental audit

National and local government environmental legislation or policy

Does the government have any stated **national environmental goals**?

- Who developed them?
- What do they aim to achieve?
- Do they establish standards or guidelines that must be complied with?

Does the government have any **entities or departments** that are responsible for the protection, restoration, and management of the environment?

- What are the departments and their responsibilities?
- How do they achieve the results (by regulation, policy, or management programs)?

Does the government have relevant accounting standards?

Has the government developed **legislation** designed to protect, restore, and manage the environment?

- Are there laws that government departments are responsible for enforcing?
- Are government departments required to comply with the environmental legislation or regulations?

Government programs or activities

Does the government have any **programs** designed to protect, restore, and manage the environment?

Is the government involved in **funding** programs that are designed to achieve environmental objectives?

Such programs might include maintaining soils in croplands; providing irrigation for agriculture; protecting watersheds; supporting forestry; supporting agriculture; protecting water bodies; conserving bio-diversity; improving energy efficiency; preventing pollution; managing urban waste; or protecting and preserving cultural heritage, national parks, heritage buildings, or places of special cultural or scientific value.

- What resources are the departments using to achieve the required outcomes?
- Are the resources accurately accounted for and the results accurately reported?



- What responsibilities does the SAI have with respect to the accounting and reporting of the performance of these programs?

Knowledge of the department or industry

Does the government have any department/industry or agencies with activities that have an environmental impact?

Does the government department/industry or agencies operate in an industry that is exposed to significant environmental risk that may adversely affect the financial results and reports of the entity?

Which environmental laws and regulations are applicable to the entity?

Are there any substances used in the entity's products or production process that are subject to particular law or regulations?

Do enforcement agencies monitor the entity's compliance with the requirements of environmental laws, regulations, or licenses?

Have any regulatory actions been taken or reports been issued by enforcement agencies that might have a material impact on the entity and its financial results and/or report?

Is there a history of penalties and legal proceedings against the entity or its directors in connection with environmental matters? If so, what were the reasons for such actions?

Are any legal proceedings pending with regard to compliance with environmental laws and regulations?

Are environmental risks/impacts covered by insurance?

Control environment and control procedures

What is management's philosophy and operating style with respect to environmental control in general?

Does the entity's operating structure include assigning responsibility, including segregation of duties, to specified individuals for environmental control?

Does the entity maintain an environmental information system, based on requirements by regulators or the entity's own evaluation of environmental risk?

Does the entity operate an environmental management system (EMS)?

- This system may provide, for example, information about physical quantities of emissions and hazardous waste, environmental characteristics of the products and services, or the results of inspections or incidents.
- Examples of recognized standards for an EMS are the international standard ISO 14001 and the European Commission's Eco-management and Audit Scheme (EMAS).



Has the entity (voluntarily) published an environmental performance report? If so has it been verified by an independent third party?

Are control procedures in place to identify and assess environmental risk, to monitor compliance with environmental laws and regulations, and to monitor possible changes in environmental legislation likely to have an impact on the entity?

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

- any risk of groundwater 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?

Does the entity have operating and control procedures for the disposal of waste and hazardous waste in compliance with legal regulations?

Appendix—Members of the INTOSAI Working Group on Environmental Auditing

(Of June 2003)

Chair Mrs. Sheila Fraser, Canada			
Associate Chair Mrs. Johanne Gélinas, Canada			
Country	Audit office	Auditor General	Title
Algeria	Cour des Comptes	Mr. Abdelkader Benmarouf	President
Austria	Austrian Court of Audit	Dr. Fanz Fiedler	President
Bangladesh	Office of the Comptroller and Auditor General of Bangladesh	Mr. Muhammad Ahsan Ali Sarkar	Comptroller and Auditor General
Brazil	Brazilian Court of Audit	Mr. Valmir Campelo	President
Cameroon	Supreme State Audit Office	Mr. Njiemoun Mama	Auditor General
Canada	Office of the Auditor General	Mrs. Sheila Fraser	Auditor General
Chile	Contraloría General de la República de Chile	Mr. Gustavo Sciolla Avendano	Sr. Contralor General de la República
China (People's Republic of)	National Audit Office of the People's Republic of China (CNAO)	Mr. Li Jinhua	Auditor General
Colombia	Contraloría General de la República de Colombia	Dr. Antonio Hernandez Gamarra	Contralor General de la República



Country	Audit office	Auditor General	Title
Costa Rica	Contraloría General de la República	Lic. Luis Fernando Vargas Benavides	Contralor General de la República
Cyprus	Audit Office of the Republic	Mrs. Chrystalla Georghadji	Auditor General
Czech Republic	Supreme Audit Office	Mr. Lubomír Voleník	President
Denmark	National Audit Office of Denmark	Mr. Henrik Otbo	Auditor General
Egypt	Central Auditing Organization	Mr. Mohammed Gawdat Ahmet El-Malt	President
El Salvador	Corte de Cuentas de la República	Mr. Rafael Hernán Contreras	Presidente de la Corte de Cuentas
Estonia	State Audit Office	Mr. Mihkel Oviir	Auditor General
Ethiopia	Office of the Auditor General	Mr. Lemma Argaw	Auditor General
Georgia	Chamber of Control of Georgia	Mr. Sul Khan Molashvili	Chairman of Control of Georgia
Guyana	Office of the Auditor General	Mr. Swatantra Anand Goolsarran	Auditor General
Iceland	National Audit Office	Mr. Sigurdur Thordarson	Auditor General
India	Office of the Comptroller and Auditor General	Mr. Vijayendra Nath Kaul	Comptroller and Auditor General
Indonesia	Audit Board of the Republic of Indonesia	Mr. Satrio Budihardjo Joedono	Chairman
Iran	Supreme Court of Audit	Mr. Seyed Kazem Mirvalad	President
Jordan	Audit Bureau	Mr. Abed Kharabsheh	President
Kazakhstan	Estimation Committee for Control over Implementation of the Republican Budget	Mr. Zhaksybek Kulekeyev	Chairman



Country	Audit office	Auditor General	Title
Korea (Republic of)	Board of Audit and Inspection	Mr. Jong-Nam Lee	Chairman
Kuwait	State Audit Bureau	Mr. Abdulaziz Sulaiman Al- Roumi	Acting President
Latvia	The State Audit Office	Mr. Raits Cernajs	Auditor General
Libya	General People's Committee for Popular Control	Mr. Hosni Sadeg Wahishi	Secretary
Lithuania	State Control of the Republic of Lithuania	Mr. Jonas Liaucius	Controller General of the Republic of Lithuania
Macedonia (Republic of)	State Audit Office	Mr. Metodija Toshevski	General State Auditor
Malta	National Audit Office	Mr. Joseph G. Galea	Auditor General
Netherlands	Netherlands Court of Audit	Mrs. Saskia J. Stuiveling	President
New Zealand	Office of the Controller and Auditor-General	Mr. Kevin Brady	Controller and Auditor- General of New Zealand
Norway	Office of the Auditor General of Norway	Mr. Bjarne Mork Eidem	Auditor General
Pakistan	Office of the Auditor General of Pakistan	Mr. Muhammad Yunis Khan	Auditor General
Paraguay	Contraloría General de la República de Paraguay	Mr. Francisco Javier Galiano Morán	Contralor General de la República
Peru	Contraloría General de la República	Dr. Genaro Matute Mejía	Contralor General de la República
Poland	Supreme Chamber of Control	Mr. Mirosław Sekuła	President
Romania	Court of Accounts	Mr. Dan Drosu Saguna	President



Country	Audit office	Auditor General	Title
Russia	Accounts Chamber of the Russian Federation	Mr. Sergey Vadimovich Stepashin	Chairman of the Accounts Chamber
Saudi Arabia	General Auditing Bureau	Mr. H.E. Tawfik Ibrahim Tawfik	President
South Africa	Office of the Auditor-General	Mr. Shauket A. Fakie	Auditor-General
Sri Lanka	Auditor General's Department	Mr. S.C. Mayadunne	Auditor General of Sri Lanka
Turkey	Turkish Court of Accounts	Mr. Mehmet Damar	President
Ukraine	Accounting Chamber	Mr. Valentyn Kostiantynovych Symonenko	The Head of Accounting Chamber
United Kingdom	National Audit Office	Sir John Bourn KCB	Comptroller and Auditor General
United States	U.S. General Accounting Office	Mr. David M. Walker	Comptroller General of the United States
Zimbabwe	Office of the Comptroller and Auditor-General	Mr. Abdulman Eric Harid	Comptroller and Auditor-General

