



Operationalizing Internal Controls – From Project to Process

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Environmental Compliance and Financial Disclosure:
Managing Internal Controls and Information Flow

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Presentation Overview



- Financial Reporting Requirements and Internal Controls
- Observed Best Practices
- Stages of Program Maturity
- Methods and Tools
- Applying Management Systems for reliable financial reporting and business management of environmental liabilities



The Sarbanes-Oxley Act of 2002



- Enacted to improve the accuracy and reliability of corporate financial disclosures
- Requires the CEO and CFO to certify the content of financial reports and that that internal controls are in place to ensure that material information...is made known to the corporate officers



One result of Sarbanes Oxley



- More attention is now focused on sources of risk that may not have previously been considered material
- Especially true for environmental liabilities
 - Cost of Compliance
 - Legal Proceedings
 - Remediation Liabilities
 - Asset Retirement Obligations (FAS 143, FIN 47)

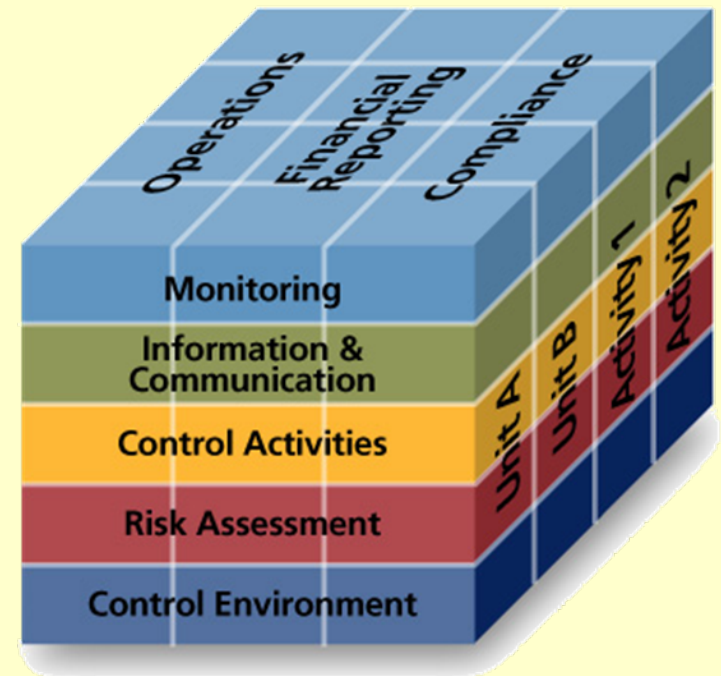


The COSO Framework



What is an internal control?

- A process designed to provide reasonable assurance regarding the achievement of objectives in the following categories:
 - Effectiveness and efficiency of operations
 - Reliability of financial reporting
 - Compliance with applicable laws and regulations



Internal Controls



- Defined by the policy, procedures, roles, responsibilities and accountabilities of a Management System
 - Auditing critical to verify they're in place and working
- Can be readily integrated into an EMS (or EHS MS)
- Should be linked with other business processes
 - Legal, Financial, Business Development and Acquisition, Risk Management, Supply Chain, Quality, HR, Operations, Maintenance, Security, etc.



FIN 47



- Introduced to result in consistent recognition of material environmental liabilities
- Serves as a “test” of a company’s processes, procedures and controls and their ability to update existing programs
- Resulted in increased recognition of material environmental liabilities
- Relation to Sarbanes Oxley:
 - Inability to identify, assess, measure and report conditional asset retirement obligations could result in a control deficiency



GAO Report



- GAO published “*Environmental Disclosure: SEC Should Explore Ways to Improve Tracking and Transparency of Information*” in July 2004
- Key Findings
 - Defining what should be disclosed can be challenging
 - Reporting is inconsistent among companies
 - Difficulty exists in concluding when information is present or lacking



Financial Reporting – Process Requirements



- SEC, FAS 5, FAS 143, FIN 47 – What are the Business Objectives?
- Cross-Disciplinary (legal, finance and accounting, EHS/technical, risk management, IT/IS, real estate, operations)
- Reliability and Defensibility of Process (documented to deliver accurate financial reports)
- Consistent Application
- Internal Controls – integrated into the management system for sustaining the process



The Management System Cycle



Management System Structures



- ISO 14001
- ISO 9001
- OHSAS 18001/ANSI Z10
- RC 14001 and RCMS
- ISO/IEC 27001



Common Elements



- Planning
- Document/Data Control
- Legal & Other Requirements
- Corrective & Preventive Action
- Non-Conformances
- Records
- Training & Awareness
- Auditing
- Structure & Responsibility
- Operational Control
- Monitoring & Measurement
- Management Review



Non-Environmental Functions Affecting Environmental Liabilities



- Risk Management – logical next step
- Safety and Security
- Strategic and Tactical Business Planning
- Sales and Marketing
- Procurement and Supply Chain Management
- Operations and Maintenance
- Finance and Accounting
- And more...



Observed Best Practices



- Structured Environmental Management Systems
 - Basic “blocking and tackling”
 - Defines “what, who, and how”
 - Provides a baseline to continually improve
 - Integrated throughout organization
 - Linked to Enterprise Risk Management



Observed Best Practices (continued)



- Reliable “Assurance” Program
 - Includes standards, training, consistency, data for measurement, corrective actions, issues closure
 - Relies on independent or 3rd-party verification
 - Includes internal operational reviews by management



Observed Best Practices (continued)



- Planned and disciplined approach to M&A due diligence and post M&A integration
 - Liabilities identified prior to “the deal”?
 - Compliance issues?
 - Operational/Maintenance issues?
 - Management System compatibility?
 - Integration challenges?
 - Improvement opportunities?



Observed Best Practices (continued)



- Systematic process for legacy sites and asset retirement obligations (“Impaired Properties”)
 - Identify and assess liabilities
 - Take a business-based approach (What are the “win points”?)
 - Assure defensible, consistent and reliable financial reporting



Impaired Properties Program – Stages of Maturity



- Shift in approach for companies with a large portfolio of impaired properties
- Moving from projects to a process—several stages
 - Projects dealt with one by one
 - Projects addressed programmatically
 - Standardized processes applied to program
 - Improvement of processes and program
 - Up and out to other business activities that can lead to liabilities (Real Estate, M&A, R&D, Oper/Maint)



What does this yield?



- **Sustainable Liability Estimating Process**
 - Standardized and used every day in business management to produce accurate, reliable, defensible, reproducible estimates, rather than “one-off” calculations
- **Reporting comes from the standardized process, becoming an outcome/update of the way liabilities are managed routinely**
 - Should be able to generate the estimate anytime



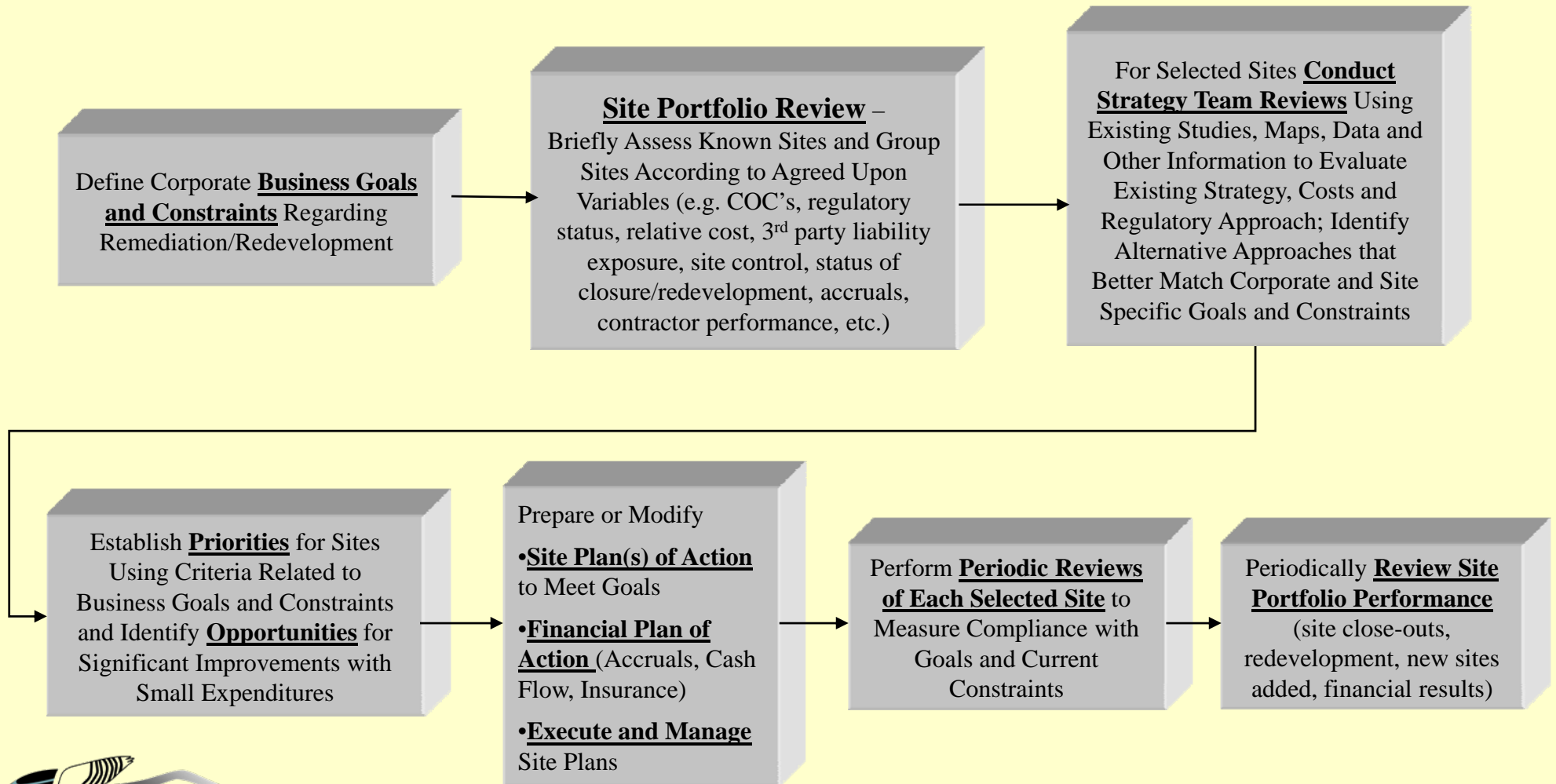
What does this yield? (continued)



- Enables use of experiential model for estimating rather than probability models or forecasts
 - Easier to work with and communicate internally and with auditors
- Provides the solid basis for periodic review, updating, and continual improvement



Risk Management Business Model for Legacy Sites and AROs



Impaired Properties Program – Business Goals Examples



- Set Business Goals
 - Remediation and liability cost avoidance and reduction,
 - Revenue generation through cost recovery and the sale of property, and
 - Reduction of environmental book reserves



Impaired Properties Program – Focus on Top Priorities



- Participate in Strategic Site/Asset Review:
 - Processes to identify and prioritize impaired sites and retirement obligations
 - Understand and track “Drivers and Triggers”
 - Address the highest risk properties (material significance, cash flow impact)
 - Review and manage work performed by consultants/contractors at selected sites with known or suspected environmental liabilities.
 - Conduct facilitated cross-functional review of selected candidate sites—goals, strategies, regulatory issues, technical-financial-property use alternatives



Impaired Properties Program – Methods and Support Tools



- Program Building Blocks
 - Inventories, risk assessment process, multi-site business plans, policies, sourcing process, cost recovery, risk transfer, policies
- Sarbanes Oxley compliant internal controls
 - Standard definitions, flow charts, processes and procedures, forms and templates
 - Project management, liability cost-estimating and reporting
 - Definition of “who, what, when, how”, approval authority; data management, metrics, checks and reviews
- Regulatory strategy review for cost reduction opportunities



Impaired Properties Program – Supply Chain Management



- Process for Sourcing and Consultant/Contractor Continuous Improvement:
 - Consultant training
 - Standardized processes (project development steps, data reporting, cost estimating)
 - Peer review validation
 - Consultant evaluations and contract renewals



Impaired Properties Program – Proactive Support to Real Estate



- Environmental Review of Real Estate Sites
- Define, improve and accelerate processes to evaluate the salability of properties
 - Risk screening checklists and Decision trees
 - Environmental profiles and maps; Surrounding land-use information
 - Remediation and long term care cost estimates
 - Regulatory strategy alternatives and cost recovery programs
 - Insurance options
 - Define pre-purchase due diligence processes (assure “all appropriate inquiries”)



Integrating Acquisitions



- A disciplined process and procedures
 - Criteria and checklists for due diligence
 - Timelines, defined roles, responsibilities, authorities
 - Compliance Analysis (material deficiencies?)
 - Operational/facility analysis (deferred maintenance issues?)
 - Legacy issues (sites, PRPs, AROs)
 - Standardized due diligence reporting formats
 - Cost estimating standards
 - Deal Strategies, including insurance
- Post Acquisition integration and management of liabilities



Review



- Financial Reporting Requirements and Internal Controls
- Observed Best Practices – The Basics
- Stages of Program Maturity
- Methods and Tools
- Applying Management Systems for reliable financial reporting and business management of environmental liabilities

