



Standard Guide for Disclosure of Environmental Liabilities¹

This standard is issued under the fixed designation E 2173; the number immediately following the designation indicates the year of original adoption or, in the case of revision, the year of last revision. A number in parentheses indicates the year of last reapproval. A superscript epsilon (ϵ) indicates an editorial change since the last revision or reapproval.

1. Scope

1.1 *Purpose*—The purpose of this guide is to provide a series of options or instructions consistent with good commercial and customary practice in the United States for environmental liability disclosures accompanying audited and unaudited financial statements. This guide is intended to supplement and be consistent with Generally Accepted Accounting Principles (GAAP).²

1.2 *Objectives*—The objectives of this guide are to determine the conditions warranting disclosure and the content of appropriate disclosure.

2. Referenced Documents

2.1 ASTM Standards:

D 5746 Classification of Environmental Condition of Property Area Types for Defense Base Closure and Realignment Facilities³

E 1527 Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process³

E 1739 Guide for Risk Based Corrective Action Applied at Petroleum Release Sites³

E 2137 Guide for Estimating Monetary Costs and Liabilities for Environmental Matters³

2.2 EPA Directives:⁴

United States Environmental Protection Agency, OSWER Directive 9610.17: Use of Risk-Based Decision-Making in UST Corrective Action Programs

3. Terminology

3.1 Definitions of Terms Specific to This Standard:

3.1.1 *CERCLA*—Comprehensive Environmental Response, Compensation and Liability Act of 1980 (as amended, 42 USC Section 9601 *et seq.*).

3.1.2 *CERCLIS*—Comprehensive Environmental Response, Compensation and Liability Information System, the list of

sites compiled by the EPA that the EPA has investigated or is currently investigating for potential hazardous substance contamination for possible inclusion on the National Priorities List.

3.1.3 *CFR*—Code of Federal Regulations.

3.1.4 *claim*—a demand for payment.

3.1.5 *environmental liabilities*—accrued liabilities and loss contingencies associated with conditions that present an unacceptable risk of harm to public health or the environment and that would be the subject of an enforcement action or other legal action.

3.1.6 *EPA*—United States Environmental Protection Agency.

3.1.7 *Federal Register, (FR)*—publication of the United States government published daily (except for federal holidays and weekends) containing all proposed and final regulations and some other activities of the federal government. When regulations become final, they are included in the Code of Federal Regulations (CFR), as well as published in the Federal Register.

3.1.8 *financial statements*—include, but are not limited to, statements associated with shareholder reporting, loans, mergers, acquisitions, or divestitures.

3.1.9 *materiality*—the significance of an item to users of a financial statement that considers all relevant and surrounding circumstances. A material item is one that its omission or misstatement is of such a magnitude in the surrounding circumstances that either the judgment of a reasonable person relying on the financial statement would have been changed or influenced by its inclusion or correction, or there is a substantial likelihood that the item, after assessing the inferences, and their significance, drawn from the given set of facts associated with the financial statement, would be viewed as significantly altering the information made available to the investor or shareholder. Relevant sources of information and references are included in Appendix X2.

3.1.10 *National Priorities List (NPL)*—a list compiled by the EPA pursuant to CERCLA 42 USC § 9605(a)(8)(B) of properties with the highest priority for cleanup pursuant to the EPA's Hazard Ranking System. See 40 CFR Part 300.

3.1.11 *Potentially Responsible Party (PRP)*—any individual, legal entity, or government—including owners, operators, transporters, or generators—potentially responsible for, or contributing to, conditions that present an unacceptable risk of

¹ This guide is under the jurisdiction of ASTM Committee E50 on Environmental Assessment and is the direct responsibility of Subcommittee E50.05 on Wetland Ecosystems.

Current edition approved Dec. 10, 2001. Published February 2002.

² This guide alone does not satisfy or include all disclosure requirements under GAAP, SEC, or any other agency or regulatory body. Appendix X1 provides some examples of where such requirements are contained.

³ *Annual Book of ASTM Standards*, Vol 11.04.

⁴ Available from the United States Environmental Protection Agency (U.S. EPA), Ariel Rios Building, 1200 Pennsylvania Ave., N.W., Washington, DC 20460.

harm to human health or the environment and that would be the subject of an enforcement action or other legal action.

3.1.12 *RCRA*—Resource Conservation and Recovery Act (as amended, 42 USC § 6901 *et seq.*).

3.1.13 *reasonably possible*—the likelihood, or probability, associated with a given event occurring that lies in the range between remote and probable. The probability values assigned to remote and probable will depend on the industry, the aggregate number of sites, observations, and possible outcomes, and the uncertainty associated with estimating probabilities.

3.1.14 *release*—any spilling, leaking, pumping, pouring, emitting, emptying, discharging, injecting, escaping, leaching, dumping, or disposing into the environment.

3.1.15 *remedial or corrective action*—all environmental response activities to an environmental liability.

3.1.16 *reporting entity*—any business or public agency preparing a financial statement.

3.1.17 *site*—real property affected by an environmental liability.

4. Significance and Use

4.1 *Uses*—This guide is intended for use on a voluntary basis by a reporting entity that provides disclosure in their financial statements regarding environmental liabilities. The degree and type of disclosure depends on the scope and objective of the financial statements.

4.2 Principles:

4.2.1 The following principles are an integral part of this guide and are intended to be referred to in resolving any ambiguity or dispute regarding the interpretation of disclosures regarding environmental liabilities.

4.2.1.1 *Uncertainty Not Eliminated*—Although a reporting entity, as of the time when its financial statements are prepared, may hold a certain position with regard to the existence and extent of its environmental liabilities, there remains uncertainty with regard to the final resolution of factual, technological, regulatory, legislative, and judicial matters, which could affect its environmental liabilities.

4.2.1.2 *Disclosure Dependent on Circumstances*—Not every environmental liability warrants the same level of detail in its disclosure. Disclosure will be guided by the scope and objective of the financial statement, and accordingly, by the materiality of the environmental liability and the level of information available.

4.2.1.3 *Comparison with Subsequent Disclosures*—Subsequent disclosures that convey different information regarding the extent or magnitude of the reporting entity's exposures should not be construed as indicating the initial disclosures were inappropriate. Disclosures shall be evaluated on the reasonableness of judgments and inquiries made at the time and under the circumstances in which they were made. Subsequent disclosures should not be considered valid standards to judge the appropriateness of any prior disclosure based on hindsight, new information, use of developing analytical techniques, or other factors. However, information on trends may be of value to a user of financial statements.

4.2.1.4 *Not Exhaustive*—Appropriate disclosure does not necessarily mean an exhaustive disclosure of the reporting

entity's environmental liabilities. There is a point at which the cost of obtaining information or the time required to gather it outweighs the usefulness of the information and, in fact, may be a material detriment to the orderly preparation of financial statements and the ability of readers to understand the information contained therein. However, all relevant and reasonably ascertainable information should be used to determine the content of appropriate disclosure for environmental liabilities.

4.2.1.5 *Assessment of Risk*—As the reporting entity becomes aware of an environmental liability or an environmental compliance issue, the condition or issue should be evaluated to assess the actual or potential risk to human health and environment. This process may be dependent on the regulatory environment, an understanding of the specifics of the condition or issue, and potential future uses. For example, guidance on petroleum release sites is provided in Guide E 1739 and additional guidance is provided in EPA OSWER Directive 9610.17. The degree of risk suggests the appropriate response actions and should be a factor in the level of effort devoted to developing the cost and liability estimates associated with the environmental condition or the compliance issue.

5. Determining Whether a Disclosure is Warranted

5.1 *Circumstances Associated with Environmental Liabilities:*

5.1.1 Following are the major circumstances that might give rise to environmental liabilities:

5.1.1.1 Enforcement of environmental laws or regulations regarding investigation, clean-up, maintenance, and other costs. Such circumstance arises if the EPA, a state agency, or a local government has named the reporting entity a PRP on a site, or a reporting entity is required to perform corrective action under RCRA, or is required to remediate a contaminated property under any other environmental law.

5.1.1.2 Contractual assumptions of risk or risk transfer agreements. The most familiar forms of risk transfer agreements are insurance contracts, hold harmless agreements, indemnity agreements, and similar terms within contracts for the transfer of property.

5.1.1.3 Commencement of litigation or assertion of a claim or assessment by a party alleging legal liability on the part of the reporting entity.

5.1.1.4 Information is known by the reporting entity that indicates an environmental liability has been incurred.

5.2 *Sources of Information*—This guide identifies standard sources that should be reviewed by a reporting entity to properly determine if conditions warrant disclosure. Such sources may include but are not limited to:

5.2.1 Published List of PRP's,

5.2.2 Federal National Priorities List (NPL) site list,

5.2.3 CERCLIS list,

5.2.4 Published list of sites and identified responsible parties under state environmental laws,

5.2.5 Environmental suits involving the reporting entity,

5.2.6 Lists of leaking underground storage tanks (LUSTs),

5.2.7 Title searches of at least fifty years on known sites that were currently or previously owned or operated by the reporting entity,



5.2.8 Known payments by the reporting entity for environmental claims and costs,

5.2.9 Environmental claims or demands involving the reporting entity, other than filed suits, and

5.2.10 Reporting entity's environmental records, for example, the results of site assessment or investigation reports, environmental audits, monitoring results.

6. Content of the Disclosure Accompanying Financial Statements

6.1 Application:

6.1.1 The content of the disclosures addressed by this guide are provided by management and are not meant to replace the disclosure requirements as prescribed or regulated through GAAP, SEC, or any other agency or regulatory body. This guide would apply to management's discussion and analysis accompanying financial statements as an example.

6.2 Disclosures to be Made for Material Environmental Liabilities:

6.2.1 Disclosure should be made when an entity believes its environmental liability for an individual circumstance or its environmental liability in the aggregate is material. These amounts include, but are not limited to, damages attributed to the entity's products or processes, cleanup of hazardous waste or substances, reclamation costs, fines, and litigation costs.

6.2.2 The following disclosures should be made by reporting entities for the material circumstance(s) in 6.2.1:

6.2.2.1 Statement regarding the judgment or assumptions used by the reporting entity regarding the likelihood of liability from any or all individual sites, actions, suits, cases, claims, requests for payment, notices or demands, and the potential materiality of that liability.

6.2.2.2 Statement regarding the number of sites for which the reporting entity has been named as a PRP and the number of claims, suits, actions, demands, requests for payment, notices, or cases that have been presented to the reporting entity for environmental liabilities.

6.2.2.3 The reporting entity's estimate of its environmental liabilities, a description of the approach used to estimate the

amounts, and the amounts accrued by the reporting entity for environmental liabilities.

(1) Environmental liabilities should be stated prior to reduction for amounts anticipated to be recovered from any third parties (for example, recoveries from insurance companies).

(2) The reporting entity should disclose the cost estimation methodology employed for accrued liabilities and a characterization of any material loss contingencies. Refer to Guide E 2137.

(3) In a situation where a reporting entity believes it has a material environmental liability but cannot quantify all or part of that liability, a written statement shall be included that describes the conditions or problems associated with estimating the liability.

6.2.2.4 The reporting entity's estimate of anticipated recoveries and a description of their approach to estimate the amount of anticipated recoveries from other parties by means of risk transfer agreement(s) that are associated with the estimated liabilities. The description should disclose any significant issues regarding the collectibility of recoveries.

6.2.2.5 A discussion of key external and internal environmental factors regarding the timing or amount of the liabilities, or recoveries. These factors include, but are not limited to, the following:

(1) Uncertainties with respect to joint and several liability that may affect the magnitude of the contingency, including disclosure of the aggregate expected cost to remediate particular sites that are individually material if the likelihood of contribution by other significant parties has not been established.

(2) The nature and terms of cost-sharing arrangements with other PRP's.

(3) The anticipated time frame over which the accrued or presently unrecognized amounts for environmental liability may be paid out.

7. Keywords

7.1 disclosure; environmental liability; financial statement; reporting entity

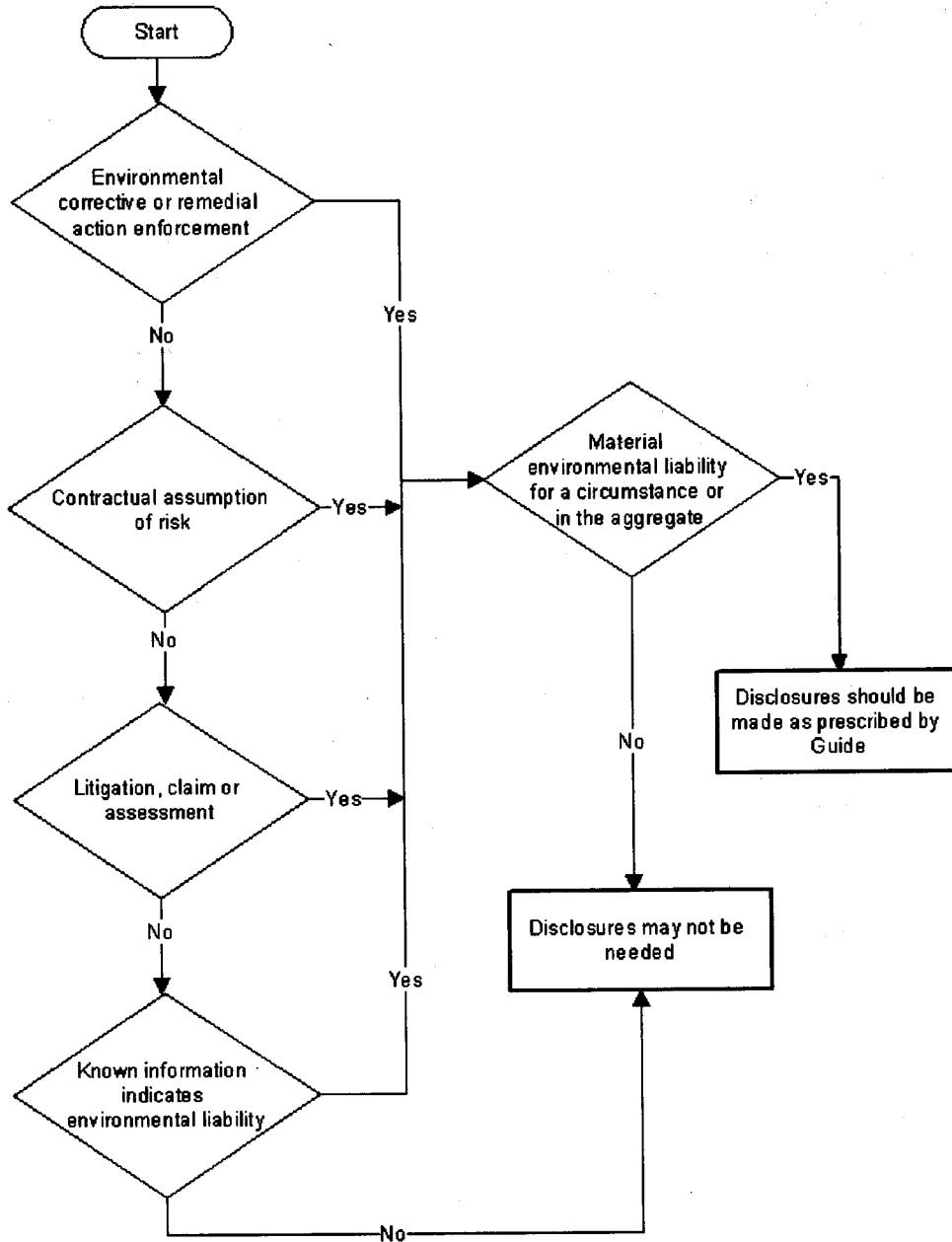


FIG. 1 Disclosure of Environmental Liabilities

APPENDIXES

(Nonmandatory Information)

X1. RELATED DOCUMENTS

Financial Accounting Standards Bulletin (FASB) Interpretation No. 14, "Reasonable Estimation of the Amount of a Loss and Interpretation of FASB-5."

FASB Statements/ FAS 5: Accounting For Contingencies, Issued March 1975.

Security and Exchange Commission (SEC) Staff Accounting Bulletin No. 92.

SEC Regulations S-K.

American Institute of Certified Public Accountants (AICPA) Statement of Position 96-1, Environmental Remediation Liabilities (Including Auditing Guidance), October 10, 1996.

SEC Staff Accounting Bulletin No. 99—Materiality, dated August 12, 1999.

ASTM D 5746 - 98 Classification of Environmental Condition of Property Area Types for Defense Base Closure and Realignment Facilities.³

X2. MATERIALITY REFERENCES

X2.1 The most recent authoritative literature on materiality is “SEC Staff Accounting Bulletin No. 99—Materiality,” dated August 12, 1999. (See Appendix X1.) The “bulletin expresses the views of the staff that exclusive reliance on certain quantitative benchmarks to assess materiality in preparing financial statements and performing audits of those financial statements is inappropriate.” Several other references are provided below regarding the definition of materiality.

X2.2 SEC Concept Release on Management’s Discussion and Analysis of Financial Condition and Operations, April 24, 1987.

X2.3 TSC Industries Inc. versus Northway, Inc. 426 U.S. 438, 448 (1976). (Note: Concluded that an “omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.” To fulfill materiality requirement “there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the ‘total mix’ of information available.”

Materiality should not be so expansive as to result in shareholders being “bur[ie]d in an avalanche of trivial information.”)

X2.4 In re Caterpillar Inc., SEC Docket 147, March 31, 1992. (Indicates that material information is information “necessary [for the investor] to understand the registrant’s financial statements.”)

X2.5 SEC Regulation S-K, Item 103, Legal Proceedings 17 CFR 229.103. (Instruction 5 to Item 103 requires disclosure of environmental proceedings when such proceedings: (1) are material to the business or financial condition of the registrant; (2) involve primarily a claim for damages that exceeds ten percent of the current assets of the registrant and its subsidiaries on a consolidated basis; or (3) involve a governmental authority as a party and such proceedings result in monetary sanctions, unless the registrant reasonably believes that the proceeding will result in no monetary sanctions or in monetary sanctions, exclusive of interest and costs, of less than \$100,000.)

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