

## Environmental Audits-Emerging Opportunities for Chartered Accountants

*The growth in interest and activity in environmental accounting and auditing in the past two decades has been astonishing. From the most marginal and irrelevant subset of social accounting at the beginning of 1990s, it has expanded to become something which is now seen as an essential element in any organisation's environmental responsibility. In this context, a question generally asked is whether a chartered accountant (CA) has the required capabilities to conduct environmental audits or what role a professional accountant can play in dealing with environmental concerns. The article explores the opportunities for CAs in the area of environmental accounting and auditing and thus contribute to Sustainable Development Goals. Read on to know more...*



Chartered Accountants in the past have been reluctant to participate in green issues because their capability and knowledge to conduct environmental audits may be challenged. They felt that environmental audit is a diverse activity which involves knowledge about various technical, legal and non-financial matters. It may involve multiple agencies as well as multiple users. In the absence of established standards and guidelines, it is difficult to conduct environmental audits. But over the time, it has been realised that the role of chartered accountants in green accounting and audit is significant.

According to INTOSAI, 2004, "Accountants, as providers of information, reports and assurance on which business and government decisions are frequently based, have

increasingly been drawn into the environmental arena. The influence of accountants and auditors comes from their access to financial information. They analyse reports and communicate information on which decisions are based and performance is evaluated. They can encourage greater transparency and informed decisions about application of resources and the impact of activities on environmental outcomes without distorting existing accounting standards. Thus, in order to ensure the provision of accurate information by annual reports, it is necessary to involve the environmental audit."

The accounting literature clearly establishes the potential for financial auditors to play a role in the conduct of environmental audits. FEE and INTOSAI created work groups for environmental audit that published guidance

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on conducting audits of activities with environmental perspectives in 2001. These work groups conducted numerous studies and research projects on the issue. Accounting profession of various countries have also published research reports on environmental accounting and auditing, of which the most notable work done by the Canadian Institute of Accountants (CICA) is titled '*Environmental Auditing and the Accounting Profession.*' Another important work, 'The Environmental Audit and the Audit Profession' has been done by the Limpberg Institute of Netherlands on behalf of the Dutch Accounting Professions. All these reports emphasise that the accounting profession has significant role to play in environmental matters. By establishing

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commonality between the principles of financial auditing and other forms of assurance practice, such as environmental audits, financial auditors have claimed sufficient expertise to coordinate the provision of environmental audit services. The role of accountant in helping an organisation in dealing with environmental

issues can be analysed under following heads:

### **CA as Environmental Accountant**

Environmental financial accounting refers to the preparation of the environmental financial reports for external audiences using generally accepted accounting principles (GAAP). It mainly includes estimation and public reporting of all significant and financially material environmental information such as, significant environmental costs, liabilities and contingencies. CAs due to their specialised accounting skills can help an organisation in preparing environmental financial accounts, i.e., in dealing with identification, measurement, recognition and disclosure of all significant environmental financial costs, benefits, assets, liabilities and contingencies. In this context, a highly relevant work is of the United Nations Inter Governmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR). ISAR began to focus on the subject of Environmental Accounting and Reporting (EAR) in the late 1980s. Starting from 1989, ISAR has issued number of recommendations on EAR. Apart from ISAR, different types of supra-national bodies (e.g., FEE, European Union) have also shown interest in EAR and some of these have issued guidelines in this connection. Professional accounting bodies all over the world have this item on their agenda.

**Environmental management accounting (EMA) is the process of identifying, collecting and analysing information about environmental costs and performance to help an organisation's decision-making (EPA, 1995a).**

### **CA's Role in Environmental Management Accounting**

In addition to the significant role that the chartered accountants can play in environmental financial accounting and reporting, environmental management accounting also offers an opportunity for accountants to develop the services they offer beyond the traditional core activities. The focus of environmental management accounting is internal. Environmental management accounting (EMA) is the process of identifying, collecting and analysing information about environmental costs and performance to help an organisation's decision-making (EPA, 1995a). EMA is mainly concerned with the presentation of data about environmental activities and performance to the management, so that it can also be considered while making number of business decisions like, capital budgeting decision, costing determinations, process/product design decisions or performance evaluations. It has been felt that the accountants have the necessary skills and experience to:

- (i) monitor, measure and control environmental costs;
- (ii) manage environmental information systems so that the outputs are accurate and reliable;
- (iii) identify and plan financial budgets for improvement projects;
- (iv) help formulate and implement environmental strategy; and
- (v) provide highly regarded advice on improvement of environmental performance.

### Consideration of Environmental Matters in Audit of Financial Statements\*

The International Auditing Practices Committee (IAPC) of the International Federation of Accountants (IFAC) has published a discussion paper titled *'The Audit Profession and the Environment'* in May 1995. According to IAPC, 'Environmental matters are becoming significant to an increasing number of entities and may, in certain circumstances, have a material impact on their financial statements. These issues are of growing interest to the users of financial statements. The recognition, measurement, and disclosure of these matters are the responsibility of management. For some entities, environmental matters are not significant. However, when environmental matters are significant to an entity, there may be a risk of material misstatement (including inadequate disclosure) in the

financial statements arising from such matters. In these circumstances, the auditor needs to give consideration to environmental matters in the audit of the financial statements. Environmental matters can be complex and may therefore require additional consideration by auditors.'

International Auditing Practice Statement (IAPS) 1010, *'The Consideration of Environmental Matters in the Audit of Financial Statements'* was approved by the IAPC in March 1998. The Statement provides practical assistance to auditors by describing:

- (i) The auditor's main considerations in an audit of financial statements with respect to environmental matters;
- (ii) Examples of possible impacts of environmental matters on financial statements; and
- (iii) Guidance that the auditor may consider when exercising professional judgement in this context to determine the nature, timing, and extent of audit procedures with respect to:
  - (a) Knowledge of the business (ISA 310, *'Knowledge of the Business'*);
  - (b) Risk assessments and internal control (ISA 400, *'Risk Assessments and Internal Control'*);
  - (c) Consideration of laws and regulations (ISA 250, *'Consideration of Laws and Regulations in an Audit of Financial*

*Statements'*); and

- (d) Other substantive procedures (ISA 620, *'Using the Work of an Expert'* and some others).

The guidance under (c) reflects the typical sequence of audit process. Having acquired a sufficient knowledge of the business, the auditor assesses the risk of a material misstatement in the financial statements. The assessment includes consideration of environmental laws and regulations that may pertain to the entity, and provides a basis for the auditor to decide whether there is a need to pay attention to environmental matters in the course of the audit of financial statements. The statement also gives meaning of environmental matters and examples of environmental matters which have impact on financial statements.

When planning and performing audit procedures and evaluating and reporting the results thereof, the auditor should recognise that non-compliance by the entity with laws and regulations may materially affect the financial statements. However, an auditor cannot be expected to detect

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non-compliance with laws and regulations. According to ISA 250, "the auditor's training; experience and understanding of the entity and its industry may provide a basis for recognition that some acts coming to the auditor's attention may constitute non-compliance with laws and regulations. The determination as to whether a particular act constitutes or is likely to constitute non-compliance is generally based on the advice of an informed expert qualified to practice law but ultimately can only be determined by a court of law."

## CA's Role in Compliance and Certification Audits

Compliance audits are conducted to verify an entity's compliance with environmental laws, regulations, standards, industry guidelines or company's own policy. It is felt that CAs can very efficiently conduct compliance audits if they gain knowledge of relevant environmental laws and regulations. They can also conduct certification audits. Such arguments, generally, center on the requirements outlined in ISO 14012 Guidelines for environmental auditing issued in 1996. ISO 14012 para 4 recommends that, environmental auditors should have "appropriate work experience, formal training and/ or on-the-job training in some or all of a number of areas, including audit procedures, processes and techniques". In 2002, ISO 19011 was issued which superseded ISO 14012. ISO 19011 also provides that in addition to personal attributes like, ethical, open-minded, versatile, observant, decisive, etc., an environmental auditor should have specific knowledge of:

(a) skills in application of audit principles, procedures, techniques,

(b) knowledge of EMS, terminology related to environmental matters, relevant environmental laws, environmental aspects of operations, etc.

CAs, already have first set of required skills. After obtaining knowledge about environmental laws, EMS and relevant terms, they can very efficiently conduct environmental audits, particularly certifications audits. These audits may include monitoring of environmental management system of the unit, checking the status of consent orders, compliance of consent orders, water cess, other legal requirements, industrial data collection regarding product process, electric consumption, water consumption, raw materials and energy balance, etc.

In the same way, CAs can play important role in non-financial auditing or carbon audits.

## CA and Environmental Information Audit

The main role of financial auditor is to express opinion on truth and fairness of assertions made in financial statements. This role can be very well extended to include environmental information audit where all types of environmental information reported by a concern through various mediums is verified with the help of all available evidences.

## CA as Environmental Consultants

CAs can enter in the environmental consultancy area and help organisations in

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obtaining consents required under various environmental laws. For example, before establishing an industrial unit a CA's certificate about proposed Capital Investment or Gross capital investment (land, building, plant and machinery) is required to be submitted along with the application for establishment of a unit. This certificate is also known as Gross Block Investment certificate. This certificate should include the cost of land, building, plant and machinery without depreciation. CAs can also provide information on the capital and recurring (O&M) expenditure on various aspects of environment protection such as effluent, emission, hazardous wastes, solid wastes, tree-plantation, monitoring, data acquisition, etc. This is important information to be given in the application for consent to establish/ operate/ renewal of consent.

Chartered Accountants as environment consultants can play an important role in obtaining environmental clearance under the Environment Impact Assessment Notification. The environmental consultant should be conversant with the existing legal and procedural requirements of obtaining

environmental clearance for a proposed project. The consultant should guide the project proponent (i.e., the person who is going to establish an industrial unit) through initial screening of the project and establish whether Environment Impact Assessment (EIA) studies are required to be conducted and, if so, finalise the scope of such study. Chartered Accountants as environmental consultants can give opinion on viability of various projects, technologies to prevent pollution and clean up polluted resources.

### CA's Role in Sustainable Development

Professional accountants in all types of organisations have a significant role to play in sustainable development also. In 2011, the IFAC has issued a sustainability framework. According to IFAC, "Achieving a sustainable future is only possible if organisations recognise the role that they can and need to play. Effective action by the accountancy profession and professional accountants to better integrate and account for sustainability is an essential part of that role. The IFAC Sustainability framework primarily targets professional accountants working in commerce, industry, financial services, education, and the public and non-profit sectors. IFAC strongly believes that these professional accountants can influence the way organisations integrate sustainability into their mission, goals and objectives, strategies, management and

operations, definitions of success and stakeholders' communications." IFAC's Sustainability Framework —

- (i) Emphasises on role of professional accountants in sustainable development.

**Accountants have significant role in green audits (particularly, environmental financial audit and environmental information audit) because they have knowledge of law and accounting standards and expertise in accounting and financial matters.**

- (ii) Feels that accountants have knowledge and expertise in dealing with environmental matters.
- (iii) Believes that professional accountants have a significant role in integrating sustainability issues into strategy, operations and reporting and in ensuring that accurate and credible necessary information, analysis and insights are available to relevant stakeholders to support decision-making.

Accountants are interested in finding a solution to the environmental issues and they are ready to accept challenges posed by global environmental concerns. Some audit

companies have already started training specialised teams on environmental audit. These teams include environmental engineers, legal professionals, finance specialists, ISO 14001 certifiers, certified chartered accountants, etc. Accountants have significant role in green audits (particularly, environmental financial audit and environmental information audit) because they have knowledge of law and accounting standards and expertise in accounting and financial matters. They can ensure that environmental information provided by government or business is accurate, complete/ authentic and can encourage greater transparency and informed decisions. CAs can play significant role in environmental matters as accountant, decision maker, advisor, manager, consultant, analyst, as a part of internal audit team or as an independent verifier. There are significant opportunities in this area, but to avail these opportunities it is necessary to provide relevant education to deal with issues like, social audit, carbon audit, energy audit, and sustainability auditing. In addition, continuous training is required to deal with dynamic and diverse environmental issues. The need has also been felt to develop a conceptual framework for environmental reporting and some guidelines and standards for incorporating environmental issues in the financial statements. ■

*"The ability of the planet's eco-systems to sustain future generations can no longer be taken for granted.... Humanity is, in essence, impairing the very foundations of our health and prosperity. Governments have a key role to play in reversing these trends and in protecting our national heritage. So do environmental auditors" - 2005 Millenium Ecosystem Assessment.*