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Dee Fischer  
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Dear Dee

**SAICA COMMENT LETTER ON THE NATIONAL ENVIRONMENTAL MANAGEMENT ACT, 1998 (ACT NO. 107 OF 1998) PROPOSED REGULATIONS PERTAINING TO FINANCIAL PROVISIONING FOR THE REHABILITATION AND REMEDIATION OF ENVIRONMENTAL DAMAGE CAUSED BY RECONNAISSANCE, PROSPECTING, EXPLORATION, MINING OR PRODUCTION OPERATIONS**

The South African Institute of Chartered Accountants (SAICA) is the home of Chartered Accountants in South Africa – we currently have over 45,000 members from various constituencies, including members in public practice ( $\pm 30\%$ ), members in business ( $\pm 49\%$ ), in the public sector ( $\pm 4\%$ ), education ( $\pm 2.0\%$ ) and other members ( $\pm 15\%$ ). In meeting our objectives, our long-term professional interests are always in line with the public interest and responsible leadership. SAICA is currently the only professional accountancy organisation that has been accredited by the Audit Regulator in South Africa, the Independent Regulatory Board for Auditors (IRBA).

We welcome the opportunity to comment on the Proposed regulations pertaining to Financial Provisioning for the Rehabilitation and Remediation of Environmental Damage caused by Reconnaissance, Prospecting, Exploration, Mining or Production Operations (proposed regulations). Here within, please find our comment letter.

In the accompanying comment letter, we have repeated certain comments that were expressed in the SAICA comment letter on the Proposed Regulations Pertaining to the Financial Provision for Prospecting, Exploration, Mining or Product Operations addressed to Chantal Engelbrecht, dated 8 December 2017 as we believe that these comments are still valid based on the updated proposed regulations.

Please do not hesitate to contact us should you wish to discuss any of our comments. You are welcome to contact Hayley Barker Hoogwerf ([hayleyb@saica.co.za](mailto:hayleyb@saica.co.za)) or Duma Mkololo ([Dumam@saicai.co.za](mailto:Dumam@saicai.co.za)).

Yours sincerely

***Signed electronically***

**Hayley Barker Hoogwerf**  
**Acting Senior Executive – Assurance and Practice**

## **SAICA's COMMENTS**

### **Background and understanding of the proposed regulations**

1. SAICA's understanding of the essence of the requirements in terms of the proposed regulations is as follows:

Before an 'applicant', 'holder' or 'holder of a right or permit' can start a new development (i.e. prospecting, exploration, mining or production operations), the 'applicant', 'holder' or 'holder of a right or permit' has to determine what it would cost to rehabilitate and remediate the adverse environmental impacts of such activities. This requires the determination of a financial provision and the related cost must be covered by a bank guarantee; a deposit made into an account administered by the Minister; into a trust that is established for that purpose; or a combination of these. The relevant information has to be submitted to the Minister and approval must be obtained before the new development may continue.

For an existing development (i.e. prospecting, exploration, mining or production operations) there is a requirement to make an annual submission to the Minister, based on an annual review, assessment and adjustment of the financial provision, which should continue to be covered in the same manner as described in the above paragraph.

The results of the reviews, confirmations or adjustments of the adequacy of the financial provision contemplated in proposed regulation 12(1), 12(3) and 12(4)(b) are required to be audited, be included in the form of an auditor's report and submitted for approval to the Minister (proposed regulation 13(1)).

### **Matters to consider in relation to the audit requirements in the proposed regulations**

#### *Definitions*

2. The term "audit" is defined in and referred to throughout in the proposed regulations. This term has a very specific meaning as defined in the Auditing Profession Act (Act 26 of 2005) (APA) and we strongly believe that this definition should be aligned to the meaning of audit as specified in the APA. The APA states that an "audit" means the examination of financial statements with the objective of expressing an opinion as to their fairness or compliance with an identified financial reporting framework and any applicable statutory requirements; or financial and other information, prepared in accordance with suitable criteria, with the objective of expressing an opinion on the financial and other information in accordance with prescribed or applicable auditing standards. As indicated in our previous comment letter (submitted on 8 December 2017), it is difficult to explain all the aspects of an "audit" in a written comment letter and we therefore urge the Department to consult with the Independent Regulatory Board for Auditors (IRBA) and SAICA to determine what the Department's needs are in respect of this "audit".
3. In our previous comment letter, we indicated that it is important that the Department considers what the auditor would be able to do and would not be able to do in terms of the different potential types of engagements catered for by the International Auditing Standards (ISAs) issued by the International Auditing and Assurance Standards Board (IAASB) that have been adopted and prescribed for use by registered auditors in South Africa (the auditor(s)). This will ensure that the correct wording is used in the proposed regulations. This will eliminate any unnecessary

expectation gaps and enable the auditor to perform the appropriate engagement, thereby providing the Department with the required information.

4. The auditor, in terms of the above-mentioned international standards, can provide reasonable assurance or limited assurance in an assurance engagement where the auditor expresses an opinion or conclusion on the subject-matter information; or alternatively, could perform agreed-upon procedures and report objective findings, in which case no assurance is provided but the user/(s) of the report derive their own assurance or comfort from the information reported. Depending on the information needs of the user/(s), in this case that of the Department relating to the financial provision as described in the proposed regulations, any of these engagements could potentially meet those needs, provided that they are properly understood and articulated.
5. The different types of assurance engagements (reasonable assurance or limited assurance), or an agreed-upon procedures engagement, have different requirements in terms of their scope, the practitioner's skills and experience, the work effort, the time to perform the work and the deliverables, which will all have an effect on the cost of the engagement.
6. Since the term 'audit' is used, we presume that the Department requires reasonable assurance, but this should be clarified. SAICA is of the view that the current formulation of proposed regulation 13(1) is inadequate and that it will inevitably lead to uncertainty and different interpretations about what is required from the independent auditor. This situation could be avoided, if the Department engages with the IRBA and SAICA, and other relevant stakeholders as may be applicable, to clarify the type of engagement that would be suitable in the circumstances, to properly describe this to ensure that the preconditions (if any) for such an engagement are met.
7. The proposed regulations define an 'auditor' to mean a suitably qualified independent person or persons responsible or undertaking the audit, which person must be registered with the appropriate professional body. The terms 'suitably qualified' and appropriate professional body are not defined in the regulations and it is not clear as to how these will be assessed by the Minister or Department. The APA defines a "professional body" as a body of, or representing, registered auditors or both accountants and registered auditors. In the context of the proposed regulations, SAICA believes that the definition of "auditor" should be amended and be defined as a "registered auditor accredited to perform an audit in terms of the Auditing Professions Act, 2005 (Act No. 26 of 2005)". The term registered auditor is already defined in the APA and this means an individual or firm registered as an auditor with the IRBA.
8. The term "independent" has been defined in the proposed regulations in relation to a specialist or auditor. Part (a) and (b) of this definitions indicates that "such a specialist or auditor has no business, financial, personal or other interest in undertaking such tasks excluding normal and fair remuneration for work performed in connection with such task or there are no circumstances that may compromise the objectivity of that specialist or auditor in performing such tasks". While this is an extensive definition, SAICA believes that including such a definition will create confusion because registered auditors have their ethical independence requirements that they need to abide by stipulated in the IRBA Code of Professional Conduct for Registered Auditors and the APA.
9. We suggest that the independence of a specialist and auditor be dealt with separately. The term "independent auditor" is not defined in the proposed regulations even though this term has been used in regulation 13(1)(a). To this end, we suggest that the term "independent auditor" be defined as "an auditor who has or had no conflict of interest in respect of that entity, as prescribed in the IRBA Code of Professional Conduct for Registered Auditors and the APA".

### **The auditor's report required**

*"In the form of an auditor's report"*

10. Proposed regulation 13(1)(b) includes the words "included in the form of an auditor's report". It is not clear as to whether the Department requires an engagement separate from the audit of the financial statements of the 'applicant', 'holder' or 'holder of a right or permit' with a separate auditor's report/ opinion being issued. Based on the wording of the proposed regulation, it would appear that an auditor's report in addition to the auditor's report on the audit of the financial statements of the 'applicant', 'holder' or 'holder of a right or permit' is required, however, this should be clarified.
11. As indicated in our previous comment letter, SAICA believes that the Department should consider whether an agreed-upon procedures engagement as mentioned in paragraph 5 above would suit the Department's needs instead of the auditor providing assurance. For further explanation, in an agreed-upon procedures engagement, the procedures to be performed are agreed upfront between the parties involved and the procedures must be objective as the auditor may not apply professional judgement in performing these engagements. The auditor reports his/her factual findings based on the performance of the agreed-upon procedures. The user/(s) of the report interpret the findings and derive their own assurance or comfort from the report.

*A single engagement (and report) or multiple engagements (and reports)*

12. SAICA believes that it is essential that the proposed regulations clarify whether an 'audit' is required per permit or right, or is required per 'holder' as one holder could have more than one permit or right. There is a significant difference in terms of work effort and cost in undertaking a single assurance engagement to express an opinion in relation to the holder's regulatory financial provisions overall (i.e. in relation to the holder's permits and rights as a whole), or expressing an opinion with respect to each individual permit or right.

*Preconditions for an assurance engagement*

13. When the registered auditor is required to express an opinion or conclusion on any particular subject matter or subject matter information, the implication is that an assurance engagement is required. Depending on the nature of the subject matter or subject matter information, and the information needs of the intended users, such engagements can provide either reasonable assurance or limited assurance in accordance with ISAs, International Standards on Review Engagements (ISREs) or International Standards on Assurance Engagements (ISAEs), as applicable.
14. The registered auditor can only accept an engagement if the preconditions for an audit or an assurance engagement are met. The preconditions for an assurance engagement are as follows (as discussed in International Framework for Assurance Engagements):
  - The roles and responsibilities of the appropriate parties are suitable in the circumstances (i.e. referring to the different roles of the Department, the 'applicant', 'holder' or 'holder of a right or permit', and the external auditor)
  - The engagement exhibits all of the following characteristics
    - The underlying subject matter is appropriate (i.e. a provision, expressed in financial terms, that is intended to ensure the availability of sufficient funds to undertake rehabilitation and remediation of identified prospecting, exploration, mining or production operations)

- The criteria (i.e. the regulations and appendices) to be applied in the preparation of the subject matter information (i.e. the calculated financial provision that is submitted to the Minister) are suitable, including that they exhibit the following characteristics:
    - Relevance
    - Completeness
    - Reliability
    - Neutrality
    - Understandability
  - The criteria is available to the intended users
  - The auditor expects to be able to obtain evidence to support his/her opinion/ conclusion
  - The opinion/ conclusion is to be contained in a written report
  - The engagement has to have a rational purpose
15. As the proposed regulations are currently drafted, it is not clear whether reasonable assurance is required on the financial provision itself or on whether the holder's assessment thereof is adequate.
16. If assurance is required on the adequacy of holder's assessment of the financial provision, this cannot be provided thereon as 'adequacy' is not identifiable and is not capable of consistent measurement or evaluation by the auditor as there are no criteria against which this could be tested.
17. If assurance is required on the financial provision itself, the preconditions of an assurance engagement have to be met before such an engagement can be performed. Considering that a number of uncertainties around the involvement of the auditor and the nature of the financial provision exist, as highlighted in this comment letter, we have decided not to provide a comprehensive discussion of these preconditions at this stage, including whether or not the criteria to measure or evaluate the financial provision in appendices of the proposed regulations meet the characteristics of 'suitable criteria'.

*The nature of the information that is subject to "audit"*

18. Proposed regulation 13(1) refers to the financial provision contemplated in proposed regulation 12(1), which states that "the holder must, one per financial year, review and update the plans and report". Proposed regulation 13 is therefore written in the context of the annual review, assessment and adjustment of the financial provision. It is not clear whether an 'audit' is required of the financial provision in the initial application for a new development (in terms of appendix 4) or only in relation to the subsequent annual review of the financial provision for an existing development (in terms of appendix 5).
19. A specific matter that has to be considered when assurance is required (whether reasonable assurance or limited assurance), is whether assurance is required on historical financial information or prospective financial information or information other than financial information. From the description and requirements of the financial provision in terms of the proposed regulations, it can be concluded that the nature of the subject matter information is financial information.
20. With regard to the distinction between historical financial information and prospective financial information, these two terms are defined as follows in the International Standards of the IAASB<sup>1</sup>:

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<sup>1</sup> Glossary of Terms

- “Historical financial information is information expressed in financial terms in relation to a particular entity, derived primarily from that entity’s accounting system, about economic events occurring in past time periods or about economic conditions or circumstances at points in time in the past”.
  - “Prospective financial information means financial information based on assumptions about events that may occur in the future and possible actions by an entity. It is highly subjective in the nature and its preparation requires the exercise of considerable judgement. Prospective financial information can be in the form of a forecast, a projection or a combination of both, for example, a one year forecast plus a five-year projection”.
21. The information used in calculating the financial provision relating to appendix 4, i.e. in the case of a new development, before any disturbance has been effected on the site is not historical financial information as this does not relate to economic events occurring in past time periods and is not part of the applicant’s or holder’s accounting system. The information could fall within the definition of prospective financial information which means that ISAE 3400<sup>2</sup> and the preconditions of an assurance engagement in ISAE 3000 (Revised)<sup>3</sup> as described in paragraph 17 above would be applicable and have to be met before assurance can be provided.
22. The information used in calculating the financial provision relating to appendix 5, i.e. in the case of an existing development where disturbance has been effected on the site would appear to fall within the definition of historical financial information as there is a past economic event (i.e. the activities that have already taken place and the related damage or disturbance) and the financial provision would be in respect of the cost relating to the rehabilitation and remediation of the environmental impacts that have been caused through prospecting, exploration, mining or production operations. Although appendix 5 requires adjustments of “CPI plus 2%” for a three-year period, it would appear that the “Year 0” estimate is based on historical financial information. When assurance on historical financial information is required, the ISAs are applicable and the preconditions of an audit in terms of the ISAs would have to be met before such an engagement can be accepted. These preconditions are similar to those described in paragraph 17 above.
23. In the case of the latter, namely a financial provision that is based on historical financial information, a question that arose during SAICA’s consideration of this comment letter, is whether the Department has considered the alignment of the financial provision required in terms of the proposed regulations (the regulatory financial provision) with the provision that the ‘applicant’, ‘holder’ or ‘holder of a right or permit’ would include in its financial statements prepared in accordance with an applicable financial reporting framework, such as the International Financial Reporting Standards (IFRS). In this context, the applicable standard from the IFRS financial reporting frameworks is IAS 37<sup>4</sup>
24. Such alignment or clarification will have a significant impact on the uncertainty that exists regarding the nature and determination of the regulatory financial provision, as well as the work effort of both the audited entity and the auditor, including the potential cost of any assurance engagement with respect to the regulatory financial provision.

We suggest that the Department considers the following:

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<sup>2</sup> ISAE 3400 The Examination of prospective financial information

<sup>3</sup> ISAE 3000 Assurance engagements other than audits or reviews of historical financial statements

<sup>4</sup> IAS37 Provisions, Contingent Liabilities and Contingent Assets

- In this context, a provision in terms of IFRS in essence, is an accounting estimate, at the reporting date (i.e. the last day of the financial year), of the future clean-up costs of the environmental impacts of prospecting, exploration, mining or production operations (including, but not limited to, costs of rehabilitation, remediation, decommissioning, closure activities and other subsequent activities that may have to be undertaken).
- The IFRS provision is only recognised in respect of past events as at the reporting date, i.e. damage and disturbance that have already been effected on the site / incurred at the end of the reporting period (i.e. it does not recognise future damage). As the provision is reviewed from year to year, any damage and disturbance effected in subsequent periods will be taken into account when determining the IFRS financial provision at the end of those subsequent periods.
- The IFRS provision is measured as the present value of the expected cash flows to settle the obligation to rehabilitate and remediate (in accordance with the relevant rehabilitation, decommissioning and closure plans) the damage and disturbance that has already been effected / incurred as at the reporting date.
- It is relevant to understand whether the IFRS provision would satisfy the “Year 0” calculation as required in terms of appendix 2 of the proposed regulations; in respect of both “Total 1” (current premature closure cost) and “Total 2” (the present value of residual environmental impacts).
- If so, the IFRS provision, as recognised, measured and disclosed in the financial statements of the reporting entity, would already have been audited as part of the external auditor’s audit of the reporting entity’s financial statements for the period under review. It should however be noted that the auditor’s opinion is on the financial statements as a whole and not specifically on the provision. Still, the audit evidence obtained with respect to the IFRS provision would have formed part of the auditor’s overall audit evidence in relation to forming an opinion on the financial statements as a whole.
- Significant efficiencies would be possible if the IFRS provision could be the starting point, requiring some specific and identified adjustments set out in the appendix to the proposed regulations in order to produce the regulatory financial provision. Such approach would have to be clarified and described properly in the proposed regulations.

#### **Other comments**

25. Proposed Regulation 13(2) indicates that where relevant the holder must submit to the Minister the financial audit undertaken in compliance with the Companies Act, 2008 (Act No. 71 of 2008) once completed. The words “where relevant” and “financial audit” are not defined. Additionally, it is not clear as to whether “financial audit” means an audit of the financial statements. The proposed regulations should be clear in specifying in detail that where an audit of an entity (i.e. the ‘applicant’, ‘holder’ or ‘holder of a right or permit’) is required in terms of the Companies Act, 2008 and the Companies Regulations, 2011, the holder is required to submit the audited annual financial statements to the Minister.