

Japan's brownfields brought to bear

Japan is coming to terms with its recent industrial heritage, bringing a boom to its soil remediation market. But new accounting rules and investor scrutiny could accelerate the disclosure of some hidden liabilities, say **Greg Rogers** and **Miki Mitsunari**

Environmental clean-up is a fast-growing business in Japan. The soil remediation market has grown 30% annually since the country adopted an environmental remediation law in 2003, and regulatory and accounting developments promise to fuel even more clean-up activity in the future.

Government statistics show that approximately 35% of former manufacturing sites in Japan are affected by soil contamination. Due to the prevalence of mixed land use in urban areas, contamination from historical industrial activities is being discovered in commercial and residential areas with increasing frequency.

According to a recent report by the Japanese Ministry of the Environment (MoE), the total value of land (as of 2003) affected by potential soil contamination is estimated at \$360 billion–780 billion. The estimated costs of soil remediation are about \$140 billion.

Currently, only a small portion of contaminated properties are subject to mandatory site assessment requirements. Most site assessment and remediation activities are initiated voluntarily in connection with property transactions. But anticipated changes in regulations would require more site assessments in the future.

On 15 June, the MoE established a committee to consider expansion of site assessment and remediation requirements under the country's soil remediation counter-measure law. It is expected that the ministry will expand the scope of sites subject to mandatory assessment. In addition, new regulations – likely to be introduced in 2009 – are expected to offer more flexible risk-based remediation standards that take into account intended future land use.

As environmental regulators seek to expand the legal obligations of owners and operators for remediation of historical pollution conditions, Japanese accounting officials are taking steps that could bring more remediation liabilities on to corporate balance sheets. Current Japanese accounting rules do not require companies to recognise liabilities for future environmental remediation costs. Only a small minority of Japanese companies voluntarily disclose such costs in their sustainability reports. Thus, it is often impossible for investors to evaluate how many sites are con-



Japan's industrial legacy – soon to loom larger?

aminated and how much it will cost to clean them up.

However, a new accounting standard could increase transparency in the reporting of environmental remediation liabilities. In connection with an international effort to harmonise global accounting standards (so-called 'convergence'), the Accounting Standard Board of Japan (ASBJ) released in May 2007 an issue paper on accounting for asset retirement obligations (AROs), with plans to finalise the standard by March 2008.

The proposed ASBJ practice for AROs is similar to US Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard No 143 and FASB Interpretation No 47 (FIN 47). It would require companies to recognise the market value of liabilities for legal obligations associated with the retirement of tangible, long-lived assets, and disclose the nature of these liabilities.

In its issue paper, ASBJ did not expressly

indicate the AROs could arise from legal obligations to investigate and remediate pollution conditions, such as asbestos-containing building materials, PCBs and soil contaminations. The future impact of the standard on the environmental remediation market in Japan will depend on the coming proposed standard, and its interpretation by financial executives, auditors and regulators.

In the US, the impact of FIN 47, which caught many companies by surprise, continues to unfold. Experience has shown that legal obligations to assess and remediate environmental conditions affecting a company's buildings and real estate can give rise to material AROs. Moreover, companies are required to investigate their facilities proactively to identify possible AROs, making "willful blindness" to such issues problematic for financial executives and auditors. The Europeans are also revising their accounting standards to encompass AROs.

As US and European investors become accustomed to increased environmental transparency and social responsibility, they may expect the same from their Japanese holdings. Foreign investment may thus drive greater disclosure of environmental liabilities and push Japanese companies to perform more clean-ups. In 2006, foreign investors held 28% of publicly-listed companies, double the level of foreign investment of a decade earlier. Foreign investment is currently higher than the holdings of individual shareholders in Japan.

Publicly-traded Japanese companies will have to respond to new environmental remediation obligations and the forthcoming accounting rule on asset retirement obligations under increased scrutiny by financial regulators and investors. The Financial Products Exchange Law, the so-called 'Japanese Sarbanes-Oxley', was enacted in 2006. The law requires listed companies to document their financial reporting processes and controls and disclose certain additional information. To meet a March 2009 deadline, Japanese companies are now busy documenting their financial reporting processes and controls. Soon, corporate accounting and environmental officers may need to consider and document how their companies will identify, evaluate, measure and report environment-related AROs.

These pressures will combine to accelerate the growth of the environmental remediation market in Japan. But they could also lead to some unpleasant surprises for the unwary, as growing investor scrutiny – backed by a combination of expanding environmental legal obligations under Japanese law and new accounting standards for AROs – brings brownfield liabilities to the surface. ■

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