

ACCOUNTING  
DEPARTMENT

## New Accounting Rule for Brownfields

By Greg Rogers

Expect to see a marked increase in the cleanup, sale and redevelopment of brownfields in the wake of a recent pronouncement by the Financial Accounting Standards Board (FASB). The pronouncement affects the way companies must account for environmental conditions at company-owned properties and facilities.

In the past, generally accepted accounting principles (GAAP) have not required companies to report liabilities for environmental impairments, such as asbestos-containing materials in buildings or contamination of soil and groundwater, in the absence of pending or threatened legal proceedings.

Now companies must account for environmental legal obligations associated with company-owned assets regardless of the likelihood of future enforcement of those obligations and even though management believes the company can delay settlement of such obligations indefinitely.

Public and non-public companies that prepare audited financial statements will be required to report previously undisclosed liabilities for environmental cleanup obligations associated with environmentally impaired properties and facilities when the fair value of such obligations can be reasonably estimated. Faced with this new reporting

obligation, many companies will elect to avoid disclosure by remediating the environmental conditions and/or transferring the asset and associated liabilities to an unaffiliated entity.

Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations" (FAS 143), requires companies to recognize the fair value of an ARO's liability in the period in which it is incurred if a reasonable estimate of fair value can be determined.

AROs are legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction or development and/or the normal operation of the asset.

Property, plants and equipment are examples of tangible long-lived assets. Retirement is defined as the other-than-temporary removal of a long-lived asset from service by sale, abandonment, recycling or disposal in another manner.

FAS 143, which became effective in 2003, was the culmination of an eight-year project by the FASB that initially focused on retirement obligations related to the costs of decommissioning nuclear power plants. FASB subsequently expanded the scope of the project to include similar closure or removal-type obligations in other industries.

FAS 143 applies to all entities, all types of long-lived tangible assets and all types of legal obligations, including environmental legal obligations.

Following the issuance of FAS 143, many public accounting firms and industry groups concluded that the new standard did not apply to "conditional" AROs. A conditional ARO is a legal obligation to perform an asset retirement activity in which

the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Consequently, implementation of FAS 143 did little to increase financial reporting of off-balance sheet environmental liabilities.

Most environmental cleanup obligations are conditional AROs in that the timing and/or method of settlement (e.g., abatement of asbestos-containing materials [ACM] or remediation of contaminated soil and groundwater) is conditional on one or more future events.

Often, such events are within the control of management. For example, management may have the ability to indefinitely postpone renovation or demolition of a building with asbestos-containing materials or investigation of a property with known or suspected soil or groundwater contamination.

On March 30, 2005, the FASB issued FASB Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations" (FIN 47). The interpretation:

- Requires companies to identify all AROs.
- Clarifies that companies are required to recognize a liability for the fair value of a conditional ARO if the fair value of the liability can be reasonably estimated.
- Explains when an entity would have sufficient information to reasonably estimate the fair value of an ARO.
- Provides four examples of conditional AROs (all of which are environmental in nature).

FIN 47 is effective for fiscal years ending after December 15, 2005 (2006 for calendar-year companies).

While its primary objective is improved financial transparency, FIN 47 can be expected to have the unintended consequence of accelerating the cleanup, transfer, and redevelopment of brownfields. **BFN**

Greg Rogers, JD, CPA, practices environmental law with Guida, Slavich & Flores, PC in Dallas.

### IMPACT ON ELECTRIC UTILITIES

The Wall Street Journal recently reported that FASB's guidance on FIN 47 is likely to require electric utility companies to immediately expense hundreds of millions of dollars to record the cumulative effects of the accounting change on their income statements, this while adding previously unrecorded liabilities to their balance sheets for future AROs.

The Journal quoted the response from electric utilities and dozens of other companies as being one of "shock."

Photo: Greg Mullis

