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SOX offshoot: poison the land, prepare to pay

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Under a new accounting rule, in place since December but only just now coming to the attention of many executives, both public and private corporations must now disclose environmental liabilities they may incur.

So-called "brownfields" are a ready example of such future liabilities, says a Birmingham attorney specializing in environmental law, but the accounting rule also requires the disclosure of any inventory or process that has the potential to produce environmental waste.

Public companies' stock prices are likely to be affected by such disclosures, says Rebecca Wright Pritchett, chairwoman of Sirote & Permutt PC's environmental and natural resources practice. But that is only the beginning. Enforcing greater transparency with respect to environmental liability also could affect a company's ability to borrow money, Pritchett says, or send an already struggling firm into bankruptcy.

Pritchett outlined the effects of the new disclosure rule for more than 200 real estate professionals at a commercial real estate conference in Tuscaloosa earlier this month. The conference is an annual event presented by the Alabama Research and Education Center at the University of Alabama.

Pritchett noted that while some companies are already adhering to the stricter rule, the vast majority have not begun to do so. Many of those businesses' owners and managers may be unaware the requirements have now taken effect.

The accounting rule related to environmental liabilities, FIN 47, is a new interpretation of FAS 143, or Accounting for Asset Retirement Obligations. FAS 143, in turn, was one of many new rules of accountancy drafted in 2001, fed by huge financial frauds at Enron Corp. and WorldCom Inc.

Since this past December, companies have been required under the new accounting rule to include on their financial statements any future environmental liabilities, particularly those related to closing a facility.

Before FIN 47, companies understood FAS 143 to mean that they were only required to list the costs of environmental cleanup for facilities that faced imminent closure.

Those were the "don't ask, don't tell" times, says Pritchett. In the past, she says, environmental liabilities have been treated as contingent retirement obligations, "meaning we may or may not ever have to clean up this property because we may or may not ever sell it, so we may or may not ever try to take it off our books."

Impact on earnings cited

Continues Pritchett: "As long as the property remained on their books and no governmental agency ever told them they were going to have to clean it up, they didn't report it. They didn't have to."

While some companies haven't realized the rule affects them, others are acutely aware of at least its potential impact. The American Bar Association, in a recent posting to its members, noted that several large firms have reported the effect FIN 47 is having on them. ABA cited the following anticipated after-tax effects on several companies' earnings (in millions): Eli Lily & Co., ($22), Marathon Oil ($19), Dow Chemical ($20), Commonwealth Edison ($42), Kimberly Clark ($12), 3M ($35), United Technologies ($95), Ford ($251), Alltel ($7), Citigroup ($49), Pfizer ($25), IBM ($36), and ConocoPhillips ($55 for environmental and legal accruals; no specific reference to FIN 47).

The ABA noted that these figures reflect only reductions in earnings that are expected as a result of FIN 47, not liabilities for conditional asset retirement obligations, "which may be significantly larger."

Bob Wilkerson, coordinator of the Greater Birmingham Brownfield Redevelopment Task Force , says the effect of the new rule will be interesting to watch, not just locally but nationally and internationally.

Before implementation of the rule, "you would see all these articles saying how it wasn't going to happen. Well, it did happen and now there have been a flurry of financial reports that have begun to reflect the effect of this."

Pritchett points out that the implications will be far-reaching and envelop many facets of business.

"For example, you've got a power company that buys chemically treated power poles. When they buy them, they are ... things they are going to use in the normal course of business. But at some point in the future, they are going to have to replace that utility pole. When, they do, it's going to have to be disposed of in a certain way, frequently as hazardous waste."

Therefore, the future cost of disposing of utility poles purchased this year will have to be accounted for this year.

Determining this cost is neither cheap nor easy, Pritchett says.

The rule will create work for environmental companies, which will be called on to estimate costs for cleanup. Pritchett says if a company has no plans to retire an asset in the foreseeable future, it must report that asset as an uncertain potential liability.

For publicly traded companies, she says, that uncertainty "could have a serious effect on the trading of that stock."

Taken together, FIN 47 requirements carry "huge potential implications," says Pritchett. "We're still waiting to see what will happen. But it's going to have a ripple effect, and maybe even an unfair effect on some companies as well."

An online trade publication, CFO.com, notes in a story titled "The Future is Now" that companies in the utility, refining, mining and chemical industries will be affected most dramatically by the new rule.

Says Pritchett: "I expect the Department of Justice to be looking over those audits to make sure they're done right. And companies that don't do it right are going to get a knock on the door."

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