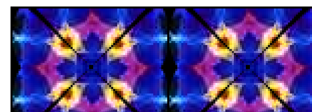

TOOLS AND RESOURCES FOR FINANCIAL EXECUTIVES

Rule Could Force Early Asset Booking

FASB's new interpretation of asset-retirement obligations would affirm that companies have to record liabilities even if assets are not being shuttered.

Marie Leone, CFO.com
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A recent clarification to a rule proposed by the Financial Accounting Standards Board is likely to force companies to recognize legal liabilities related to factories and other long-lived assets earlier than many are used to booking them.

The new interpretation of FAS No. 143 (Accounting for Asset Retirement Obligations), issued late last month and slated to be finalized before the end of the year, reportedly will weigh down corporate balance sheets with more short-term liabilities than in the past.

FAS 143 requires businesses to record the fair value of a legal liability associated with a long-lived asset in the period in which it is incurred. Generally, corporate controllers capitalize such costs by increasing the carrying amount of the related asset; and over time, the liability assumes its present value for each period.

During the two years that FAS 143 has been in effect, however, companies diverged in the practical application of the rule in terms of when to recognize the asset-retirement obligation (ARO). For instance, some companies recognize the fair value of the legal obligation before the retirement of the asset, regardless of the likelihood that the asset will be retired. Others book AROs only when retirement is probable or a done deal.

FASB's new interpretation (Accounting for Conditional Asset Retirement Obligations) aims to make the application of FAS 143 more uniform. The board hopes to assure that financial statements are comparable, officials said.

If finalized in its current form, the interpretation will eliminate a company's choice about when to book an ARO. Indeed, companies won't be able to defer recording the liability because management is uncertain about an asset's retirement date. That uncertainty should be factored into the fair value ARO calculation of all existing long-lived assets, according to the FASB staff.

But many stakeholders — including corporate accountants, industry trade groups, and Big Four audit firm PricewaterhouseCoopers — have complained that the new FASB interpretation misses the mark. Comment letters filed with FASB by such critics argue that an ARO should be recorded only when a legal obligation is triggered and not before. In the case of asbestos removal, for instance, the potential legal liability should be recognized when the asbestos is disturbed, which would set in motion state or federally mandated cleanup laws and the attendant legal obligations, opponents contended.

Officials at PwC also question the scope of the new interpretation, which covers all long-lived assets, ranging from forklifts to office buildings to power plants. Michelle Krupa, a partner in the audit firm's Risk and Quality division, points out that the finalized version of the interpretation could require investigation and valuation of AROs associated with every building a company owns or holds a capital lease on. From a practical perspective, says Krupa, the research and record-keeping involved with identifying and putting a value on every potential ARO would not yield significant incremental benefits to financial-statement users.

PwC argued in its comment letter that the rule clarification would require companies to "undertake considerable efforts to research laws...and develop complex assumptions...to demonstrate that accounting results do not differ significantly" from results recorded before the new interpretation.

Krupa provided the example of an office building that won't be retired until next century. The expense of researching and creating assumptions about asbestos-removal costs "for 100 years out" would greatly outweigh the immaterial accounting change reflected on the balance sheet, she said.

The final interpretation, however, is unlikely to have many changes, says Randall Sokoloff, a FASB practice fellow. The interpretation is expected to take effect no later than the end of fiscal years ending after December 15, 2005.

Some experts, like Greg Rogers, an environmental attorney and CPA with the law firm of Guida, Slavich, and Flores, pointed to other potential effects. Rogers said that the next FAS 143 hurdle would be to figure out whether the interpretation would force companies to develop and document new internal control processes as mandated by Section 404 of the Sarbanes-Oxley Act.

Apparently, not all companies have a formal process in place for identifying, and assigning financial assumptions to, conditional AROs that are not earmarked for retirement. Those could include mothballed plants or newer facilities that are burdened with complex environmental liabilities, experts said.

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