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## This FIN Has 47 Teeth: New Accounting Requirements for Environmental Liabilities

In the wake of accounting scandals such as Enron and the passage of the Sarbanes-Oxley Act, the Securities and Exchange Commission (SEC) and the Financial Accounting Standards Board (FASB) have recently promulgated important and wide-reaching new standards governing the accounting and disclosure of environmental liabilities. Of these, FASB's interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47) is bound to have far-reaching and long-lasting impacts on corporate accounting policies and practices for practically all types of industries.

FIN 47 interprets FASB Statement No. 143, *Accounting for Asset Retirement Obligations* (FAS 143), which applies to the liabilities associated with the retirement of long-lived, tangible assets, such as factories, mines, refineries, power plants, etc. FAS 143 is not industry-specific. Retirement of assets includes closure, sale, abandonment, recycling, and other forms of disposition. While FAS 143 required all companies to account for the liabilities associated with asset retirement, diverse accounting practices arose regarding the timing of the recognition of these liabilities. FIN 47 requires that companies account for asset retirement obligations as they arise, irrespective of when such liabilities will finally be settled, if the company has "sufficient information" to reasonably estimate the costs of retirement.

FIN 47 is effective for fiscal years ending after December 15, 2005, which for most companies is the calendar year 2006. Companies must now include information required under FIN 47 in any of their financial statements. FIN 47 seems to have largely gone unnoticed by industry and many corporations are now scrambling to deal with the new standard. GM recently booked an after-tax charge of \$109 million based on the new standard. Other companies have also recently booked charges: Olin Corporation (\$10.5 million, pre-tax) and Boeing (\$4 million after-tax). No doubt many other companies will follow suit this year and in years to come.

Of particular interest is FASB's specific focus on environmental liabilities. All four of the illustrative scenarios included in FIN 47 involve long-term environmental liabilities associated with asset retirement. FIN 47 states that asset retirement liabilities must be recognized as they are incurred if the company has "sufficient information to reasonably estimate the fair value of an asset retirement obligation." FIN 47 at 2. By definition, an asset retirement obligation is reasonably estimable if (a) it is evident that the fair value of the obligation is embodied in the acquisition price of the asset, (b) an active market exists for the transfer of the obligation, or (c) sufficient information exists to apply an expected present value technique. *Id.*

We recommend that companies act quickly to develop a policy and procedure for identification and reporting of their asset retirement obligations in a systematic way, through a four-step process: (1) identification; (2) characterization; (3) measurement; and (4) reporting. Companies that may be subject to asset retirement reporting obligations should immediately consider retaining a multi-disciplinary team of

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environmental counsel, environmental consultants, and accountants. Such a team will assist the company to develop materiality standards and cost estimates where sufficient information exists to develop estimates. Where sufficient information for an estimate is not available, the team will also be able to help the company develop and document a rationale supporting that conclusion. Where applicable, the company's insurance program should also be reviewed and consideration should be given to selling or otherwise transferring or disposing of assets that may be impacted by the new standards. The corporate policies and procedures for managing asset retirement liabilities should also include a mechanism for periodic review and updating.

Both private and in-house counsel working on compliance with FIN 47 should pay particular attention to the potential impacts such liability estimates may have with respect to collateral claims, litigation, and enforcement actions involving potentially responsible parties, governmental entities, shareholders, buyers and sellers, etc. Moreover, counsel should be very familiar with the requirements of the ABA's "Statement of Policy Regarding Lawyer's Responses to Auditor's Request for Information" and the attorney reporting requirements of Section 307 of the Sarbanes-Oxley Act and the implementing SEC regulations, which impose duties upon attorneys to independently evaluate the need and advisability of public disclosure of information, to advise clients, and to take certain additional steps if the client disregards the advice provided.

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Attorneys in Chapman and Cutler LLP's Environment, Energy and Resources practice group have substantial experience assisting industrial clients identify, quantify, and manage environmental liabilities.