COMPLIANCE WEEK

New Accounting Rule Snares Financial Reporting

By Tammy Whitehouse — January 31, 2006

Tucked away at the bottom of its 2005 income statement issued last week, Ford Motor Company delivered a $251 million answer to a new accounting question—one that experts say is catching many companies unaware or just starting to get their attention.

Ford booked a $251 million charge to earnings to comply with Interpretation No. 47, a 34-page bundle of guidance issued by the Financial Accounting Standards Board last year to clarify how it expects companies to obey Statement No. 143—*Accounting for Asset Retirement Obligations*.

FIN 47 requires companies to examine more carefully the future liabilities they face when selling or retiring assets. In many cases those liabilities are environmental obligations, such as the removal of underground fuel tanks or asbestos insulation (see box at right for related statements, interpretations and resources).

And those liabilities can be big—other early filers showing FIN 47-related charges include Citigroup at $49 million, Exelon Corp. at $42 million, IBM at $36 million, and Pfizer at $25 million. ConocoPhillips reported a $88 million charge as a result of a change in accounting principle, but without specific reference to FASB's guidance.

FASB issued FIN 47 in March 2005 to resolve differences in how companies were complying with its 2001 statement on booking asset retirement obligations, known to accounting cognescenti as "AROs". In the original statement, FASB said that if companies were legally obligated to dispose of a particular asset in a certain manner, they had to establish a present value for that future obligation and book it as a current financial liability.

Many companies deferred disclosing AROs because they couldn't pinpoint when or how an asset would be settled, and that led to different approaches to complying with No. 143, says Kathryn Pavlovsky, senior manager with Deloitte & Touche. Some companies factored uncertainty into their cost estimates and booked a liability as best they could; others waited until an asset's disposal or retirement was probable so they could pin it to a specific date or method of settlement.

In FIN 47, however, FASB says companies can't hide the liability behind the uncertainty; they must do more work in estimating and reporting their financial liability, even if the ultimate disposal of an asset is uncertain. "The obligation to perform the asset-retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement," FASB says in its interpretation summary.

"FIN 47 is very explicit," says C. Gregory Rogers, an environmental attorney, former auditor and author. "It says these things count."

Rogers

Examples And Disclosures

Counting such liabilities can pose daunting challenges for companies. Take the example of booking a liability today associated with asbestos contained in a building that a company has no foreseeable plans to sell or renovate. As long as the asbestos is left undisturbed, say experts, the company has no obligation to do anything to it. But eventually, when the company sells, renovates, demolishes or abandons the building, that asbestos must be addressed. With so much uncertainty regarding when, how or at what cost such a liability might be faced, how does a business put a present value on that future liability?

Jon Walker, associate vice president of Environmental Data Resources, says a wide variety of environmental regulations

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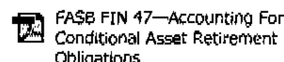
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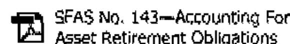
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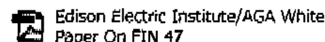
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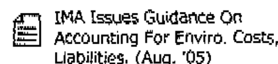
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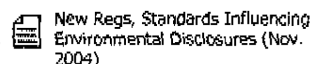
New Regs, Standards Influencing Environmental Disclosures (Nov. 2004)

SEC Issues Accounting Bulletin For Oil, Gas Companies (Oct. 2004)

Further Reading

Details On Rogers' Book On Environmental Liabilities Post-SOX

Walker

create the kind of liabilities FIN 47 is meant to address. In addition to underground storage tanks or asbestos removal, companies may have legal obligations to clean up groundwater or soil contamination when they are finished with a piece of real estate, or to remove chemically treated utility poles. "There could be hundreds of asset retirement obligations that are relevant in specific industries," he says.

In some cases, the ARO rules also apply when companies are required by contract to restore an asset to its original condition, Rogers explains. That's the obligation that set Citigroup back $49 million; in its latest filing the company says it booked the charge to account for its contractual duty to restore leased space back to its original condition when the leases terminate.

In Ford's year-end 2005 earnings release last week, the company described the $251 million charge to earnings as the cumulative effect of a change in accounting principle, but through a spokeswoman the company declined to discuss how it arrived at its FIN 47 figure.

FirstEnergy Corp. accounting research manager Dena McKee says FirstEnergy began researching its AROs in the summer to prepare for year-end filings. She can't disclose the expected impact on earnings because the utility company's results won't be issued until mid-February.

McKee says FirstEnergy already booked a $1.1 billion ARO related to its nuclear facilities when it adopted Statement No. 143. To comply with FIN 47, the company created a fresh inventory of its assets to look for retirement liabilities it hadn't already booked, using a team of four people and an outside consultant who spent the latter half of 2005 culling records related to some 60 separate facilities.

FirstEnergy's primary focus ended up being asbestos, McKee says. The company identified nearly 20 areas of potential concern, but ruled out the remaining as either immaterial or not subject to the accounting rule.

A Mess Of Liabilities?

Walker and Rogers, who published a book in October on financial reporting of environmental issues (see box above, right), say not all companies are as prepared as FirstEnergy to disclose a meaningful FIN 47 figure. They say companies seem unaware of the new reporting requirement, unprepared to meet it, or even uncertain about when it became effective.

"A limited number of companies are just starting into the process and have no numbers yet," Rogers says. "I would expect most companies will say they won't expect any material effect or they can't reasonably estimate it."

Walker, who helps companies assess their environmental liabilities, says he's seen a small uptick in inquiries, but not as much as he'd expect for the magnitude of the rule. "Companies are looking at this and they just don't think it's real," he says. "It appears to me that not a tremendous number of companies are looking into this. Instead of going through the process [of inventorying assets and determining prospective liabilities], they're just pre-determining that they're not material."

Pfefferle

Ben Pfefferle, an environmental attorney with Baker & Hostetler, says he does not yet see much effort going into enhancing ARO calculations as a result of FIN 47, but he expects that soon will change. "A lot of companies are going to be caught flat-footed," he says. "Many companies haven't started calculating what their obligations will be."

Pfefferle notes that companies didn't get much lead time between FASB's issuance of the interpretation and its effective date, and

SAMPLE DISCLOSURES

Citigroup

Citigroup's "Quarterly Financial Data Supplement" filed on Form 8-K on Jan. 20, 2006, cited a $49 million charge attributed to a "Cumulative Effect of Accounting Change." According to the filing, the "Cumulative Effect of Accounting Change represents the adoption of FIN 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of SFAS No. 143". This pronouncement is applicable to real estate leasing agreements that required Citigroup to restore the leased space back to its original condition upon termination of the lease."

Citigroup Jan. 20, 2006, Form 8-K (Courtesy SEC's EDGAR System)

IBM

In the "Comparative Financial Results" section of an 8-K filed by IBM on Jan. 17, 2006, the company noted that "In the fourth quarter, IBM recorded a $36 million charge, net of tax, to reflect the cumulative effect of a change in accounting principle related to the adoption of FASB Interpretation No. 47 (FIN 47), 'Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143.' "

IBM Jan. 17, 2006, Form 8-K (Courtesy SEC's EDGAR System)

Pfizer

In an 8-K filed Jan. 19, 2006, Pfizer disclosed that, "In December 2005, we adopted the provisions of the Financial Accounting Standards Board (FASB) Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47), a new accounting interpretation issued in March 2005. As a result, we recorded a non-cash pre-tax charge of $40 million ($25 million, net of tax) for costs associated with the eventual retirement of certain facilities. This charge is reported as a one-time cumulative effect of a change in accounting principle in the fourth quarter of 2005."

Pfizer Jan. 19, 2006, Form 8-K (Courtesy SEC's EDGAR System)

even the effective date itself is a subject of debate and uncertainty. Pfefferle and Rogers both read the language in FIN 47 and say calendar-year filers still have another year before they must book the expanded liability.

Rogers, however, says some audit firms and issuers are pressing to comply with their year-end 2005 financial statements, like Ford, FirstEnergy and others who already disclose FIN 47's effect. That gels with FASB's intention, according to FASB spokesman Gerard Carney, who said calendar year-end companies are expected to begin reporting with their 2005 financials.

Enter Section 404

If companies are getting a late start and making broad guesses about their actual FIN 47 disclosures, auditors will be the first gatekeepers to determine if the disclosures are adequate, Rogers says. "On the one hand, there are folks saying this is as big as SuperFund," he says. "On the other hand, there are folks saying this isn't anything. It's in the hands of the accounting firms now. They're the ones who are in charge of signing off on a company's internal controls."

Rogers refers, of course, to Section 404 of Sarbanes-Oxley, which requires companies to assess the soundness of their internal control over financial reporting. He and Pfefferle both suggest that if companies gloss over FIN 47 and make claims they can't support, it could become a weakness or deficiency for purposes of Section 404 reporting.

Accounting firms generally did not respond to inquiries about how they're addressing FIN 47 with their clients, but Deloitte's Pavlovsky provided a written statement that supports the notion that auditors will look at FIN 47 disclosures with SOX in mind.

"From a Sarbanes-Oxley perspective, companies will need to update their processes and procedures for identifying, assessing, valuing and reporting obligations subject to FIN 47 and they will also need to test those processes and procedures and document appropriately," Pavlovsky wrote. "As a result, for many companies, FIN 47 will serve as a test of their ability to incorporate updates into their existing SOX programs, and could potentially result in a deficiency if FIN 47-related obligations are not identified or accrued appropriately."

ConocoPhillips

In an 8-K filed Jan. 25, 2006, ConocoPhillips disclosed that, "Net income in the fourth quarter of 2005 includes a $88 million charge related to the cumulative effect of a change in accounting principle associated with the adoption of Financial Accounting Standards Board (FASB) Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143."

ConocoPhillips Jan. 25, 2006, Form 8-K (Courtesy SEC's EDGAR System)

Alltel Corp.

In an 8-K filed Jan. 20, 2006, Alltel disclosed a $7.4 million cumulative effect of accounting change that "Represents the cumulative effect of the change in accounting principle resulting from the Company's adoption of FASB Interpretation No. 47, 'Accounting for Conditional Asset Retirement Obligations' (FIN 47). The Company evaluated the effects of FIN 47 on its operations and determined that, for certain buildings containing asbestos, Alltel is legally obligated to remediate the asbestos if the Company were to abandon, sell or otherwise dispose of the buildings. In addition, for its acquired Kentucky and Nebraska wireline operations not subject to SFAS No. 71, 'Accounting for the Effects of Certain Types of Regulation', the Company is legally obligated to properly dispose of its chemically-treated telephone poles at the time they are removed from service. In accordance with federal and state regulations, depreciation expense for the Company's wireline operations that follow the accounting prescribed by SFAS No. 71 have historically included an additional provision for cost of removal, and accordingly, the adoption of FIN 47 had no impact to these operations."

Alltel Jan. 20, 2006, Form 8-K (Courtesy SEC's EDGAR System)

Rogers and Pfefferle said the handful of disclosures that had trickled out by mid-January represent only the tip of the iceberg in the losses companies will report as FIN 47 is more fully explored and adopted. "There's the potential that this could be huge," Rogers predicts.

McKee says FirstEnergy's squeeze on earnings actually will be smaller than initially expected, only because the company thoroughly researched its numbers and braced senior management for the likely outcome. She said the company's close networking in the utility industry and its use of an industry white paper as a roadmap was critical to its FIN 47 compliance effort.

"We wouldn't have been able to report this if we hadn't started back in June," she says. "I think there are a lot of companies out there that don't get it. I wouldn't be surprised if there are a lot of companies scrambling at the last minute to determine what their liabilities are going to be."

Rogers questions whether it's even possible to put together a last-minute disclosure. "I live in a world where we spend months trying to identify these kinds of things," he says. "For a large company, it could even take years."

Related resources and be found in the box above, right.

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