

COMPLIANCE WEEK

Costs Soaring For Asset Retirement Rule

By Tammy Whitehouse — April 4, 2006

Corporate America has collectively shaved more than \$1 billion from its earnings thanks to a new accounting rule that cracks down on the cost of retiring physical assets—yet environmental and legal analysts say companies are still confused about what to report and can expect to show even bigger losses in future disclosures.

The eye-popping costs come from compliance with Financial Interpretation No. 47, issued by the Financial Accounting Standards Board in 2005. FIN 47 requires companies to more carefully examine the future liabilities they will face when they decommission or dispose of any physical asset like land, buildings, equipment and other property. Companies had to start reporting those costs in annual reports this spring.

Greg Rogers, an environmental attorney and president of Advanced Environmental Dimensions, has been tracking FIN 47 disclosures and estimates that through March 1, 53 companies have collectively recorded losses exceeding \$1.15 billion. Ford Motor Co. recorded the biggest setback at \$251 million. General Motors showed a \$109 million hit to earnings, and ConocoPhillips recorded an \$88 million charge. Dow Chemical showed a \$20 million charge to earnings, but for only the fourth quarter of 2005.

Rogers says the numbers are only a drop in the bucket of what's to come. "Companies are overlooking a massive amount of asset retirement obligations," he says. "They're arguing over things that are immaterial and overlooking things that are very material."

FASB issued FIN 47 in March 2005 to shore up differences in how companies were complying with its 2001 statement, FAS No. 143, on booking asset retirement obligations. In the original statement, FASB said that if companies are under a legal obligation to dispose of a particular asset in a certain manner, they must establish a present value for that future obligation and book it as a current financial liability.

Many companies deferred disclosing those so-called "AROs" because they couldn't

pinpoint when or how an asset would be settled, leading to different approaches to complying with FAS No. 143. Some companies factored uncertainty into their cost estimates and booked a liability the 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 declared companies can't ignore the liability even if they're uncertain about how or when it will be settled.

Rogers says public companies and the Big 4 accounting firms disagree over what should be disclosed under FIN 47, and even among the Big 4 opinions differ about what firms should advise clients to do, creating inconsistencies in disclosures. "The level of inconsistency has to get resolved," he says.

No Big 4 firm would discuss its positions on FIN 47 interpretation for this article. Rogers says that based on confidential conversations he's had with a number of clients, accounting firms differ over what they consider to be subject to FIN 47.

"It's a legal judgment, an overlay of accounting rules and legal obligations that requires a fact-specific analysis," he says. "Disclosures are all over the board."

For example, Rogers says companies and accounting firms take different views regarding the extent to which land-based obligations are subject to FIN 47. Rogers says some are reading a single line in FIN 47—"At some point, deferral is no longer possible, because no tangible asset will last forever (except land)" —to mean the interpretation does not apply to land-based obligations.

"Some are interpreting the inclusion of that sentence as meaning the rule doesn't apply to land-based issues," Rogers says. "Other areas of the rule make it clear it applies to land."

Jon Walker, associate vice president of Environmental Data Resources, said he sees company reports pointing to only a few types of AROs, mainly asbestos and polychlorinated byphenils (the carcinogens often known as PCBs). Indeed, those two items are the only issues Ford's most recent 10-K addressed in its FIN 47 discussion.

"I'm not an accountant or an attorney, but I'm seeing information that's publicly available that would suggest the actual obligations are far broader than what's being disclosed," Walker says.

Ford's 10-K describes elsewhere a variety of environmental liabilities the companies may face, but for which it can't reasonably estimate the related dollar figures. It makes no reference to those liabilities in its FIN 47 disclosure. Rogers says Ford's disclosure "comes up short" when matched against the requirements of FAS No. 143.

Defining FIN 47 Disclosures

Walker says he would expect that disclosures generally address issues such as underground storage tanks, hazardous waste management units, and solid waste management units, all of which are common in industrial companies.

In some cases, states require assurances that companies have closure costs and post-closure costs reserved in a contingency fund, Walker says. Those "financial assurances" also constitute asset retirement obligations, he said. He estimates the amount that should be set aside for even a single waste management unit closure could hit \$100 million.

Walker says EPA data reflect thousands of treatment, storage and disposal facilities in the United States and thousands more underground storage tanks—all of which are assets with a future retirement obligation. He says corporate landfills and above-ground storage tanks should probably get closer attention as well.

Acknowledging not all such facilities would be owned by public companies, "I would think some evidence of that ought to show up in FIN 47 disclosures," he says. "It's not clear to me that they've identified it. They're not reporting it."

Lawrence Schnapf, an environmental attorney with Schultze Roth & Zabel, said companies are still uncertain what to do. "A lot of companies are still in a wait-and-see mode," he said. "There's still a big learning curve out there."

SAMPLE COSTS	
Below is an excerpt from a list of corporate announcements specifying FIN 47 losses, as tracked by Advanced Environmental Dimensions, LLC:	
Company	Amount
Ford	\$251,000,000
General Motors	\$109,000,000
United Tech.	\$95,000,000
ConocoPhillips	\$88,000,000
FIN 47 Adoption (Advanced Environmental Dimensions, LLC)	

Brownfields are a particular subject of concern and uncertainty, he adds. Brownfields are abandoned, idled or underused industrial or commercial facilities where real or perceived environmental problems have impeded better use; Schnapf says companies typically mothball such facilities and let them languish because selling or redeveloping them costs too much. Now that they fall under FIN 47 disclosure, he says, companies have new motivation to clean up or dispose of them.

“The thinking is that eventually, as corporations have to realize and reflect the fair market value of these properties, they’ll have an incentive to start divesting themselves of these properties,” Schnapf says.

Schnapf consulted with a company recently that has held such a property for a number of years but is now talking with a local developer that wants to reclaim the site for a housing project. Now the company is more receptive to that discussion.

Schnapf and Rogers says companies also face uncertainty about the difference between liabilities that arise from “normal” use compared with liabilities that arise from “improper” use.

“I think you will find substantial differences of opinion among environmental lawyers as to whether contamination arose from normal or improper operations,” Rogers says. “From an overall disclosure standpoint, it’s not a big issue because it has to get disclosed somewhere. From an accounting standpoint, there’s a difference because you have to decide which bucket it belongs in.”

Rogers is referring to FAS No. 5, Accounting for Contingencies, which since 1975 has requires to companies to report liabilities contingent on some future event, like a prospective legal or regulatory action, and FAS No. 143, which requires companies to report future asset retirement obligations.

“There’s significantly more awareness now than there was before Christmas,” Walker says. “It’s real now. If you read into the 10-Ks, some companies are right on and some are still determining what it means to them. They probably didn’t realize how lengthy the process is. You can’t start at the last minute and complete the process.”