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Pollution Costs Return to Balance Sheets

A new interpretation of FAS 143 gives companies less flexibility when recording conditional environmental liabilities.

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As the restful memories of the long Memorial Day weekend fade, corporate accountants begin a summer that could be spent sorting out the effects of a new Financial Accounting Standards Board interpretation likely to force hundreds of companies to book conditional environmental liabilities.

FIN 47, the new reading of FAS No. 143 (Accounting for Asset Retirement Obligations), could obligate those corporations to record, rather than defer or avoid, cleanup charges on income statements if their fair value can be reasonably estimated.

On March 30, FASB issued the new rule, which seeks to clarify the term "conditional asset-retirement obligation." In doing so, FASB changed the way companies book asset-retirement obligations (AROs).

An ARO is a corporation's legal obligation to clean up environmentally impaired properties or facilities. An ARO is conditional when it's contingent on a future event associated with the asset. The event could be the retirement, sale, construction, or redevelopment of the asset, all of which would trigger environmental cleanup laws.

Before Fin 47, companies weren't obliged to recognize conditional AROs until the liability is incurred. As a result, some corporate executives and auditors would make the case that they were unsure of when, for example, a plant would be retired or sold. They would contend that they didn't know when the liability would be incurred and that they thus couldn't provide a reasonable cost estimate for the cleanup. In the end, many AROs weren't carried on corporate balance sheets.

FIN 47 negates those arguments. Now companies must account for AROs regardless of the likelihood of future events and whether or not management believes it can delay those events, notes Greg Rogers, an environmental attorney with Guida, Slavich, and Flores. The net effect, according to Rogers: Companies will be required to report previously undisclosed liabilities.

FASB staffers say that FIN 47 will have several effects on a company’s financial statements. One is that total liabilities generally will increase because more retired assets will be recorded. What’s more, the recognized cost of assets will rise because asset-retirement costs will be added to the carrying amount of long-lived assets.

"The bottom line is that ignorance was bliss, but now it’s expensive," contends environmental engineer Robert Lipscomb of Barge, Waggoner, Sumner, and Cannon, an architecture and engineering firm involved in environmental remediation.

Lipscomb advises managements to set up reserve funds because companies will have to pre-pay for environmental cleanup. "If you have to recognize an environmental condition, you should set up reserves to follow up on the related investigation, assessment, and remediation," he adds.