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SEC EYES RARE ENFORCEMENT STEP OVER CLEANUP RESERVES ACCOUNTING

The Securities & Exchange Commission (SEC) is proposing a rare enforcement action against a public corporation for allegedly illegally reporting reserves needed for possible cleanup efforts, a development that observers say could show new SEC interest in ensuring that corporations accurately report their environmental risks under strict new financial accounting standards.

SEC staff April 25 notified Kentucky-based Ashland Inc., a major manufacturer and distributor of chemicals and plastics, of their intent to seek authorization from the commission to pursue civil action against Ashland over “adjustments” to the company’s environmental remediation reserves, which are required to fund cleanup cost overruns. *Relevant documents are available on InsideEPA.com.*

The SEC staff, which must first receive approval to seek action by the five-member commission appointed by the president, says it intends to seek injunctive or administrative relief against the company, which sources say could include not allowing Ashland accountants to sign-off on filings sent to the SEC. Such action would require more oversight of the company’s accounting practices by SEC staff and damage the reputation of the company’s accountants and the public perception of the company, one environmentalist says.

Ashland says it will seek authorization from the SEC to pursue action against a current employee who was responsible for the adjustments to the reserve. An Ashland spokesman says the company intends to file a Wells submission to the SEC, which is an option by defendants that allows them one last chance to submit information that may put an end to suspicion that they committed securities fraud.

The concern was raised over adjustments that were made to the cleanup reserves for fiscal years 1999 and 2000. Minimizing the reserves can downplay warning signs to investors about a company’s risk of tort claims and government action that could weaken a company’s bottom line, sources say. The SEC action was triggered by a required periodic filing known as an “8K” statement.

An SEC spokesman could not comment on the specifics of the Ashland case.

In the past, SEC scrutiny of corporate environmental disclosures was not a top priority for commission officials, sources say. One of the few known cases where the SEC took action against a corporation for downplaying likely cleanup liability was against Lee Pharmaceuticals in 1998 for falsely reporting to its shareholders that it was responsible for remediating San Gabriel Superfund site in California. As a result, the company’s accountant was not allowed to practice for three years.

SEC staff also resisted calls by the Government Accountability Office in 2004 to formalize information-sharing agreements with EPA to improve oversight of such disclosures. As a result, one SEC commissioner said at the time the commission was pushing SEC staff to pay more attention to environmental risk disclosure, but that determining what had to be reported was still difficult.

Reports released in 2004 by public interest groups Friends of the Earth and the Rose Foundation highlight how companies avoid full disclosure, listing tactics such as delaying the quantification of liabilities for decades or years; avoiding meaningful disclosure when liabilities cannot be quantified; hiding significant issues in footnotes; and employing artificial time horizons to prevent disclosure of known future liabilities. Other tactics cited include “mothballing” contaminated facilities to avoid environmental assessment and denying emerging hazards such as global warming.

But observes say the proposed enforcement action against Ashland suggests SEC staff may be seeking to ensure that corporations comply with rigorous new financial accounting standards that took effect earlier this year.

The new accounting rules were developed by the Financial Accounting Standards Board (FASB), a government-designated private sector organization that establishes financial accounting and reporting standards. The rules were finalized in March 2005 and include a first-time requirement to use a formula for determining the cost of liabilities that will likely raise a corporation’s estimated liabilities, according to experts. Similar requirements will soon go into effect for state and local governments in accounting for their pollution reduction liabilities.

The rules require companies to use a weighted probability formula in determining the cost of such liabilities, regardless of how likely it is to occur, in reporting those liabilities on their income statements, experts say. FASB Interpretation No. 47, or FIN 47, specifically requires companies to examine the future liabilities they face when selling or retiring assets, including buildings that may have asbestos and sites such as electric utility poles containing polychlorinated biphenyls. In addition to including the liabilities in their income statements, the companies are expected to detail actual cleanup costs when they unveil their balance sheets later this year, experts say.

The new rules have already prompted increased reporting of potential environmental liabilities by public corporations. Earlier this year, for example, United Technologies, ConocoPhillips, Marathon Oil, Dow Chemical, 3M, Commonwealth Edison, Citigroup and Eastman Kodak all reported tens of millions in liabilities, and the Ford Motor Co. reported a $251 million charge to earnings (*Inside EPA*, Feb. 3, p1).