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Where Assets Go When They Retire

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I'm going to talk accounting today, folks. I know accounting can be dreadfully boring, but it's important to comprehend the basics in order to better understand the companies in which we invest. Without a working knowledge, reading financial statements is like deciphering a foreign language. So when there is a change in accounting treatments, it makes sense to pay a little bit of attention.

The accounting topic for today is asset retirement obligations, which you'll see as its more familiar name -- FIN 47 (Financial Interpretation Number 47; accountants come up with such catchy names, you know) -- in Securities and Exchange Commission filings. Asset retirement obligations were already covered under FASB Statement 143, but FIN 47 gives companies a clarification on when and how to recognize conditional asset retirement obligations.

In something closer to plain English, this means that when companies know that they'll eventually have to pay costs to retire an asset, an estimate of the fair value of those future costs needs to be made and put on the balance sheet as a liability. These estimates will not be perfect, but it's important that investors recognize that such liabilities exist and that in the future, when a plant or a mine is closed -- or when a lease runs out and the lessee must pay to have certain improvements it made removed -- shutting down those operations will incur costs above and beyond the company's normal operating expenses.

The obvious companies that will need to comply with FIN 47 are industrial in nature, such as **General Electric**(NYSE: GE), **United Technologies**(NYSE: UTX), and **ExxonMobil**(NYSE: XOM). However, companies outside the manufacturing and chemical businesses are also beginning to make disclosures, though crude, about their asset retirement obligations. I've been somewhat surprised to see asset retirement obligation reports from **Payless ShoeSource**(NYSE: PSS), **Caribou Coffee**(Nasdaq: CBOU), **Kimberly-Clark**(NYSE: KMB), and **CarmikeCinemas**(Nasdaq: CKEC), among others.

As companies begin to implement FIN 47, investors will see one-time charges. Those who own shares of United Technologies and the companies above have already seen them in the most recent quarter's earnings reports. These charges recognize the initial liability being put on the balance sheet, which reflects the asset retirement expense that has accrued for assets that the company is still using but will have to pay for to dispose of at a later date. This initial charge is non-cash, and some companies will likely refer to it as such. However, it's important to remember that just like any other liability, this charge reflects a future cash outlay that the company *will* need to make.

It's important to note that when a company begins using FIN 47 and reports the corresponding initial charge, it isn't something that reflects positively or negatively on it. That said, I do believe FIN 47 is a good thing. It brings an estimate of future costs that a company is likely to incur out into the light and onto the balance sheet for all to see. The estimates are not going to be perfect, but they are far better than nothing, and I much prefer having an estimate available that may be wrong to having an unexpected one-time charge that magically appears at a later date.

For investors who are curious about accounting rules in general and want to keep up on recent trends, I recommend bookmarking the Accounting Observer weblog. Along with the Financial Accounting Standards Board documentation itself, I find the site quite helpful in trying to keep up with accounting changes.

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Nathan Parmelee has no financial interest in any of the companies mentioned. The Motley Fool has an ironclad disclosure policy.

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