

FIN 47: Reporting Environmental Liabilities a Serious Obligation

In December 2005, the Financial Accounting Standards Board (FASB) implemented interpretation number 47, otherwise known as FIN 47. This new interpretation significantly expands environmental liabilities corporations are required to report in their financial statements.

Essentially, in accounting terms, FIN 47 clarifies FASB statement No. 143, "Accounting for Asset Retirement Obligations (AROs)" and refers to a "legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing or method of settlement."

What does all this confusing accounting jargon mean? Basically, you are required to account for the retirement of your assets. In doing so you must, to the best of your ability, account for any remedy of environmental liabilities associated with the future retirement of that asset on a present value basis. FIN 47 also clarifies when an entity would have sufficient information to estimate the fair value of an asset retirement obligation and associated environmental liabilities.

Previously, FAS 5 and FAS 143 were the FASB standards that covered contingent environmental liability. These standards required a company to accrue all environmental liabilities that are "probable" and "reasonably estimable." However, because of diverse accounting practices which have developed with respect to the timing of liability recognition, corporations have been able to avoid or delay recognizing potentially substantial liability when establishing fair value associated with the retirement of a long-lived asset. As a result, FASB concluded that there has been a general under-reporting of such "conditional" asset retirement obligations (CAROs). To improve reporting for these accruals, FASB issued FIN 47.

Several examples of situations reprinted from "Inside the Industry" may help highlight areas you may want to consider discussing with your accounting departments and independent accountants:

> A corporation with 100 underground storage tanks (USTs) in its real estate portfolio must actively recognize the fair value of the future closure obligations of each one, including closing, removal, and remediation costs.

> A manufacturer has mothballed a plant that contains asbestos pipe insulation, lead cabling or roof flashing, or PCB paints and coatings. The manufacturer will have to assess their CAROs and adjust their balance sheet to reflect clean-up costs for the site and/or equipment.

> A utility company has chemically treated poles that were purchased and known not to last forever. These poles will have to be disposed of in an environmentally acceptable manner due to creosote coatings. Under FIN 47, the utility will have to accrue the expected present value of the liability for poles at the time of the purchase.

There is no question that FIN 47 was established to clarify and tighten standards for reporting environmental liabilities. This could have a great impact in many industries, especially for manufacturers in older facilities with a history of long-time manufacturing practices. While the accounting industry is still considering the combined impact of FIN 47 and the certifications of the Sarbanes-Oxley Act, any company that has not settled and accrued their AROs would be wise to understand their liabilities immediately. Begin by having discussions with your accounting representatives to better understand the impact of FIN 47 on your business. If you have a need to assess the environmental liabilities associated with your assets, please call us at ECS for assistance with clarification of those liabilities.

* Sources include the Financial Accounting Standards Board, Air and Waste Management Association February 2006, and Wolf and Company.

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