Where Do *Contaminated* Assets Go When They Retire?

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Advanced Environmental Dimensions

Overview

- Introduction to FIN 47 and AROs
- Reporting data and trends
- Emerging issues
- Implications for environmental managers

Within the Past Several Weeks...

- Five delayed 10-K filings
- Three reported material weaknesses in internal control over financial reporting
- Numerous unreported control deficiencies
- Four restatements

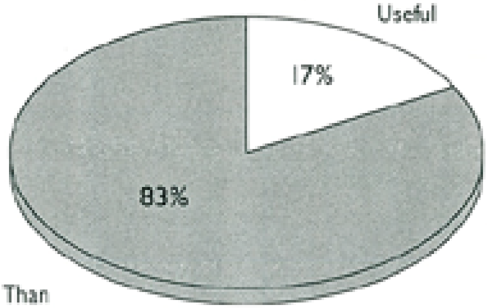
— all as a result of new accounting rules for so-called “asset retirement obligations”

Who Do You Turn To?

Due to inconsistent levels of response from independent auditors…

Usefulness of Independent Auditor Feedback

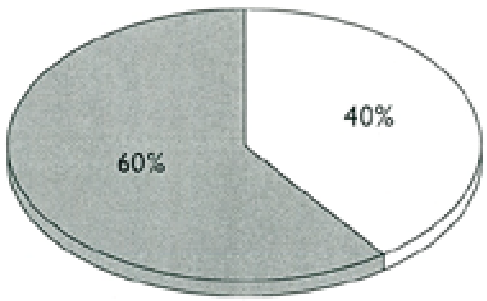
APEx Survey, August 2005



…companies are looking elsewhere for help

Other External Guidance Sought

APEx Survey, August 2005



PEER RELIANCE

"We have received no guidance from our independent auditors, and, as a result, have had to seek peers to collaborate on the challenging judgments associated with FIN 47."

Director of Technical Accounting
Large Retailer

Primary Accounting Standards for Environmental

- Loss contingencies
  - FAS 5 - Contingencies
  - FIN 14 - Estimation of Loss Contingencies
  - SOP 96-1 - Environmental Remediation Liabilities
  - SEC Staff Accounting Bulletin No. 92
- Asset retirement obligations
  - FAS 143 - Asset Retirement Obligations
  - FIN 47 - Conditional AROs
  - SEC Staff Accounting Bulletin No. 103
- Other
  - FIN 45 - Indemnities and guarantees
  - FIN 39 – Rights of recovery

Disclaimer

The advice and strategies covered in this seminar and contained in the program materials are not legal or accounting advice and may not be suitable for your situation. You should consult with your legal and accounting advisors before taking action.

ARO Concepts…

- Asset retirement obligation (ARO)
  - Legal obligations associated with the retirement of tangible long-lived assets and arising from the acquisition, construction, or normal operation of the asset.
- Conditional asset retirement obligation
  - 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.

ARO Concepts…

- Tangible long-lived assets
  - Property, plant, and equipment.
- Retirement
  - The other-than-temporary removal of a long-lived asset from service by **sale**, abandonment, **recycling**, or disposal in some other manner. Retirement does not encompass the temporary idling of a long-lived asset.
- Normal operation
  - FAS 143 is inapplicable to environmental cleanup obligations that result from the improper (other than normal) operation of an asset (e.g., emergency response to an accidental catastrophic release).

ARO Concepts...

- Legal obligation (associated with retirement)
  - An obligation that a party is required to settle as a result of existing or enacted law, statute, ordinance, written or oral contract or by legal construction under the doctrine of promissory estoppel.
  - Typically, settlement of an asset retirement obligation is not required until the associated asset is retired.
  - The fact that partial settlement of an obligation is required or performed prior to full retirement of an asset does not remove that obligation from the scope of FAS 143.
  - Obligations associated with maintenance, rather than retirement, of a long-lived asset are excluded.

Measurement of AROs

- Fair value
  - The amount at which a liability could be settled in a current transaction between willing parties (other than in a forced or liquidation transaction). Quoted market prices in active markets are the best evidence of fair value and should be used, if available.
  - Fair value of environmental liabilities generally determined using expected present value techniques.

FIN 47 – Conditional AROs

- Issued March 30, 2005 (effective 12/15/05)
- FAS 143 not consistently applied
- Conditional AROs (CAROs)
  - No legal obligation to retire asset
  - Legal obligation upon retirement
  - Timing and/or method of settlement uncertain
- Clarifies that CAROs are liabilities
- Clarifies "ability to reasonably estimate"

Summary of Accounting for AROs

- Obligation presumed NOT to arise from claim or assessment
- Obligation must be associated with an owned or leased asset
- Applicable to voluntary cleanups and periods prior to accrual of claim
- *Probability* of loss is NOT a threshold for liability recognition
- Liability must be reasonably estimable
- Liability must be reported at fair value (not known minimum value or most likely value)
- Relates to environmental “cleanup costs”

FIN 47 Adoption

Following is a limited list of corporate announcements regarding the cumulative effect (after-tax) of a change in accounting principle for the adoption of FIN 47.

Company	Cumulative Effect of Adoption Dollars (Millions)	Per Share	File Date	Auditor	AROs*
Iron Mountain	$3	$0.02	3/1/06	Deloitte	
Crown Castle	$9		3/1/06	KPMG	$19.2
El Paso Corp.	$4		3/1/06	PWC	
Payless	$4.1	$0.06	2/28/06	Deloitte	
Williams Cos.	$1.7		2/28/06	E&Y	
Enterprise Products	$4.2		2/27/06	Deloitte	$10.1
Huntsman	$31.7		2/24/06	Deloitte	
American Tower	$35.5		2/24/06	Deloitte	
CF Industries	$2.8		2/24/06	KPMG	
Frontier Oil		$.04	2/23/06	Deloitte	
Extendicare	$6.4		2/22/06	KPMG	
Sprint Nextel	$16		2/22/06	KPMG	
DPL		$0.03	2/21/06	KPMG	
Barnes Group	$0.39	$0.02	2/16/06	PWC	
Goodyear	$11	$0.06	2/16/06	PWC	$16

FIN 47 Effective December 15, 2005

Financial Accounting Standards Board, Interpretation No. 47, "Accounting for Conditional Asset Retirement Obligations: An Interpretation of FASB Statement No. 143" is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). Retrospective application for interim financial information is permitted but is not required. Early adoption of this Interpretation is encouraged.

What are Companies Reporting?

- Impact of adoption of FIN 47
  - $225,000 – $251 million
  - $0.01 - $0.26 per share
- Reported AROs
  - Three utility companies > $1 billion (1 > $4 B)
  - Mining company - $398 million ($1.4 B undiscounted)
  - Oil refining company - $51 million
  - Chemical company - $34 million
  - Retail shoe store - $4.1 million (adoption)

What are Companies Reporting?

- Quantitative disclosures
  - Effect of change in accounting policy
    - Effect known and quantified
    - Still evaluating effect
    - Don't believe effect is material
    - No material effect
  - Ability to reasonably estimate
    - Broad use of this exemption
    - Limited or no explanation of what and why

What are Companies Reporting?

- Non-quantitative disclosures
  - No identification of conditions evaluated
  - Identification of limited scope of conditions
    - ACM and PCB transformers only
    - Lease obligations
  - Identification of broad scope of conditions
    - Ash ponds, evaporation ponds, solid waste management units, environmental restoration
  - General non-conformance with FAS 143 disclosure requirements

Controller's Leadership Roundtable Study

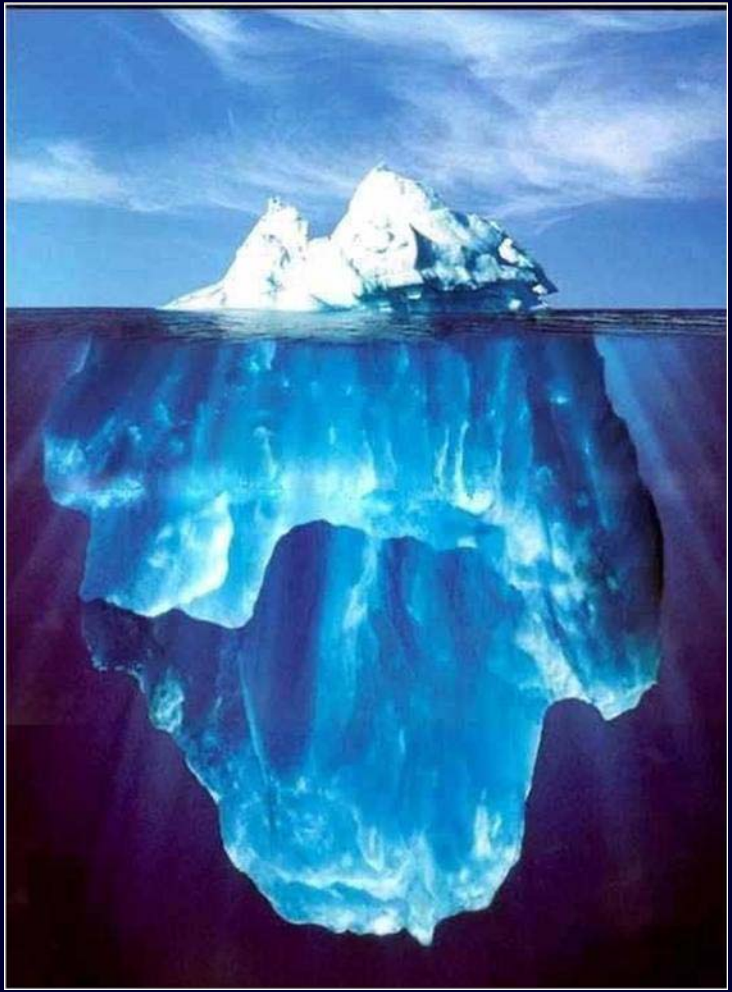
- Financial statement impact varies widely across companies
  - $202 M vs. "no material effect"
- FIN 47 resource consumption varies widely across companies
  - 6 hours vs. 5,000 hours
- Not all companies are estimating the value of identified conditional AROs

Reporting Trends

- Reporting is highly inconsistent
- Delayed 10-K filings
- Restatements
- Control deficiencies
- Auditors requiring identification of AROs
- No consistency on what is an ARO
- Wide variance in time and effort applied
- Environmental staff often not involved
- Deloitte and PWC appear more conservative
- Process documentation will be key for auditors

What's included in the numbers…and what's not?

Potential AROs



Facilities

Utility Poles
Asbestos in Buildings
UST Removal
Process Equipment
Lease Obligations

Real Estate

UST Cleanup
Contractual Covenants
TSDF Closure and Corrective Action
Site Restoration
Mothballed Sites
Routine Leaks, Spills, etc.
Owned Superfund Sites
Unknown Releases

What potential AROs are out there?

- 2004 EPA Study "Cleaning up the Nation's Waste Sites"
  - $209 billion to clean up 294,000 hazardous waste sites between 2004 – 2033
  - $128 billion to clean up 45,000 MGP sites
  - $29 - $54 billion to clean up hardrock mine sites
  - $6.3 billion to clean up dry cleaner sites

Emerging Issues

- Reclassification of FAS 5 accruals
- “Normal” vs. “improper” operations
- Legal obligations “associated with retirement”
- Indeterminate useful life
- Duty to investigate

Risk Equation

Severity

- Not just an environmental issue any more…
- Nonconformance with GAAP
- Integrity of management
- Busted transactions
- Technical insolvency
- Fraudulent conveyances
- Illegal dividends
- Accounting fraud
- Securities law violations
- Civil and criminal liability

Probability

- Trigger events
  - Annual financial audit
  - SEC filings
  - Mergers & acquisitions
  - Financing
  - Bankruptcy
- Enforcers
  - Independent auditors
  - Whistle-blowers
  - Creditors
  - Shareholders
  - SEC

Implications for Environmental Managers

- Opportunity
  - Link EHS directly to financial reporting
  - Enterprise level process ownership
  - Direct input to C-suite and board
- Risk
  - Accountability without authority
  - Cascading certifications
  - Lack of corporate support
  - Inconsistency among audit and law firms
  - Preferred scapegoat
  - Corporate whistle-blower

Questions?