

# DO YOUR ASSETS HAVE A RETIREMENT OBLIGATION?

By Julie Desimone

Both the Financial Accounting Standards Board and the Governmental Accounting Standards Board have finally adopted standards addressing asset retirement obligations (ARO). Those who report under FASB guidance have been following this standard for quite some time. In November 2016, GASB issued Statement No. 83—Certain Asset Retirement Obligations. Though the concept for FASB and GASB are quite similar, practical application is vastly different. The requirements of GASB 83 are effective for reporting periods beginning after June 15, 2018. This new standard will require communication between departments (primarily accounting and engineering/operations) and if an ARO is identified, it may require expertise and evaluation outside of the utility's expertise.

The first step is to determine whether an ARO exists. In order to determine this, the following thoughts need to be taken into consideration:

- Is there a legally enforceable liability associated with the retirement of a tangible capital asset?
- Does that liability result from normal operations of a tangible capital asset?

It is vital to remember that though this is an accounting standard, conversations must be had outside the accounting department. Is the communication between your utility's departments currently enough to determine if an ARO exists?

There are very obvious AROs (for example, the decommissioning of a nuclear or coal plant); however, there are many obligations that are not typically considered. For most nuclear and coal facilities there are federal, state, or contractual obligations to remediate the facility and land after the facility has been retired. However, less common AROs may be a wind facility owned by a utility that is on leased land and the lease contract requires that the utility leave the land in its original condition. This is a legally enforceable liability associated with the wind facility as it will require a significant amount of costs to restore the land after the facility is retired. Anytime there is a lease agreement associated with tangible capital assets, an ARO evaluation must take place.

## Initial recognition

Once an ARO is determined, the accounting is very different between FASB and GASB followers. Where FASB followers are required to record the obligation initially at present value and accrete it to full value over the useful life of the asset, GASB has determined that current measurement of the ARO should be based on the best estimate of the current value of outlays expected to be incurred. Also, for FASB, once the initial obligation is recorded, a capital asset is recorded and depreciated over the estimated useful life of the asset. For GASB, a deferred outflow of resources is established and this outflow is reduced in a systematic and rational manner over a period of time

depending on whether the ARO was established at the beginning of the capital asset's estimated useful life or after the asset was placed into operation. For an ARO associated with an asset reported at the beginning of the capital asset's estimated useful life, the reduction of the deferred outflow of resources should be recognized over the entire estimated useful life of the capital asset. For a deferred outflow of resources initially reported after a capital asset has been placed into operations, but before the end of its estimated useful life, the reduction of the deferred outflow of resources should be recognized over the remaining estimated useful life.

## Subsequent measurement

Subsequent to the initial measurement year, both FASB and GASB followers must analyze and update the ARO obligation and asset/deferred outflow of resources.

For FASB, the entity should at least annually consider where the determinates (risk-free credit adjusted rate and inflation) have changed. If so, the standard requires a new layer of the obligation to be reported. Also, if any significant changes to the overall obligation occur (i.e. new study or updated information), an adjustment or new layer will be established. Under the FASB model, this layering could result in very technical calculations and spreadsheets that are generally only understood by a few individuals in the utility.

For GASB followers, the entity should at least annually adjust the current value of its ARO for the effects of general inflation or deflation. A government should also annually evaluate all relevant factors to determine if those factors significantly increase or decrease the estimated outlays associated with the ARO. A government should remeasure the ARO only when the results of the evaluation indicate there is a significant change in the estimated outlays, which may include changes in technology; state or federal laws; or price increases or decreases.

## Notes to the financial statements

Under both standard setters, the utility is required to disclose certain information regarding the ARO and methods and assumptions used to measure the liabilities.

## Retirement of tangible capital asset

The ultimate goal under both standards is that at the time of retirement of the capital asset, the estimated future outlays associated with the ARO are recognized as a liability. Though there will be changes to this amount, as the balance is an estimate, it should be the utility's best estimate.

## Recommendations

Though these standards are very narrow in scope, the impact can be significant to utilities. In order to ensure that your accounting department has the best information available to them, we recommend that each utility initiate meetings between operations, accounting, and management to consider whether any asset retirement obligations exist. If an ARO is determined, a utility may need to utilize outside resources to measure the obligation. This consultation or use of a specialist may take a considerable amount of time; therefore, getting an early start on these discussions will be invaluable to the efficient implementation of these standards. **NWPPA**

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