GASB's Asset Retirement Guidance

On December 7, 2016, the Governmental Accounting Standards Board (GASB) released Statement No. 83, *Certain Asset Retirement Obligations*, which establishes recognition and measurement guidance for assets not covered by existing GASB standards. Under the new guidance, a government with a legal obligation for future asset retirement activities for tangible capital assets would be required to recognize a liability in its financial statements. GASB hopes to reduce inconsistency in current reporting, enhance comparability between governments and improve financial statement disclosures.

Governmental utilities that currently do not report Asset Retirement Obligations (AROs) likely will see the greatest effect from the new guidance. The scope includes higher education institutions with research reactors or health care facilities with X-ray machines, magnetic resonance imaging machines or similar equipment.

Background

The most common governmental AROs relate to municipal solid waste landfill closures that are covered by GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs* (GASB 18). However, GASB 18 does not apply to retirement of other capital assets, such as nuclear power plants, coal-fired power plants or sewage treatment facilities. GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations* (GASB 49), addresses governments' obligations at retirement, but does not address reporting before retirement. As a result of these gaps in existing guidance, diversity in accounting and financial reporting of asset retirements has arisen.

Scope

Statement No. 83 applies to financial statements of all state and local governments. GASB defines an ARO as "a legally enforceable liability associated with the retirement of a tangible capital asset." The capital asset must be permanently removed from service through its sale, abandonment, recycling or disposal and not just temporarily idled. AROs result from the normal operations of a tangible capital asset—whether acquired or constructed—and include legally enforceable liabilities associated with all of these activities:

- Retirement of tangible capital assets
- Disposal of a replaced part that is a component of a tangible capital asset
- Environmental remediation associated with the retirement of tangible capital assets that result from normal operation of those capital assets

This statement also applies to legally enforceable liabilities of lessors in connection with the retirement of their leased property if those liabilities meet the definition of an ARO. (Lessees would continue to follow lease guidance.)

Scope Exclusions

The standard specifically excludes:

- Obligations solely arising from a plan to sell or otherwise dispose of a tangible capital asset
- Obligations from activities necessary to prepare a tangible capital asset for an alternative use
- Obligations for pollution remediation, *e.g.*, asbestos removal, that result from the other-than-normal operation of a tangible capital asset, *i.e.*, contamination obligations covered under GASB 49
- Obligations associated with maintenance, rather than retirement, of a tangible capital asset

- The cost of a replacement part that is a component of a tangible capital asset
- Landfill closure and postclosure care obligations, including items not covered by GASB 18
- Conditional obligations to perform asset retirement activities. However, the existing guidance on contingent liabilities in GASB Statement No. 62 would still apply

Recognition & Measurement

Recognition

GASB concluded an ARO meets the criteria for recognition as a liability and should be recognized when the liability is both incurred and reasonably estimable. Determining when an ARO liability is reasonably estimable will require professional judgment. Both an internal (actions the government takes) and external (event external to the government) obligating event is required for an ARO's initial recognition. An external obligating event establishes the legal enforceability of requirements to perform asset retirement activities. This could be the approval of laws or regulations (not the effective date), creation of a legally binding contract or issuance of a court judgment imposing a legal obligation on a government to retire a capital asset. An internal obligating event is the government's action that requires it to apply legal requirements to its specific circumstances. Statement No. 83 includes internal obligation events within several circumstances. An internal obligating event can be any of these:

- For contamination-related AROs, the occurrence of contamination
- For AROs not related to contamination:
  - Operation of the capital asset, if the liability is determined on asset usage, *e.g.*, for a coal strip mine, the mine excavation and using a portion of the mine's capacity
  - Putting the asset into operation, if the liability is not determined on asset usage, *e.g.*, placing a wind turbine into operation
  - Permanent abandonment (before operations commence), *e.g.*, the retirement of a sewage treatment plant permanently abandoned during construction
- For AROs related to acquired tangible assets, the acquisition itself, *e.g.*, an acquired power plant with an existing ARO

Measurement

An ARO liability's initial measurement would be based on the best estimate of the **current value** of expected outlays. Current value is the amount that would be paid if all equipment, facilities and services included in the estimate were acquired at the end of the current reporting period. The best estimate would include probability weighting of all potential outcomes—if the information is available or can be obtained at reasonable cost—or the most likely amount in the range of possible outcomes if probability weighting is not feasible.

A government would record a corresponding deferred outflow of resources at the amount of the ARO liability upon initial measurement. The ARO's deferred outflow would be expensed in a systematic and rational manner; either over the asset's remaining useful life if the initial reporting was after the asset was placed into operation OR over the entire estimated useful life if initial reporting occurred at the beginning of the asset's life. For capital assets permanently abandoned before being ready for use, asset retirement costs immediately would be recorded as an outflow of resources (expense) versus being recorded as a deferred outflow of resources.

Subsequent Measurement

At least annually, a government would adjust its ARO's current value for inflation or deflation and also should evaluate all relevant factors to determine if there is a significant change in the ARO's estimated outlays. If the evaluation indicates a significant change, remeasurement is required. Factors that may lead to a significant change in the estimated outlays include, but are not limited to:

- Price changes due to factors other than inflation/deflation for specific components
- Technology changes
- Legal or regulatory changes in requirements
- Changes in the type of equipment, facilities or services used to retire the tangible capital asset

Changes in the estimated outlays would increase or decrease the ARO's carrying amount. For a change in the ARO liability before the asset's retirement, a government would adjust the corresponding deferred outflow of resources, which subsequently would be expensed over the asset's remaining useful life. Changes in an ARO liability at or after the asset's retirement date should be accounted for as outflows or inflows of resources in the period incurred.

Minority Interests

A government may have a minority share (less than 50 percent) in an undivided interest arrangement with joint ownership of a tangible capital asset with each owner liable for its share of the ARO. In some cases, the majority owner may be a nongovernmental entity following accounting standards issued by the Financial Accounting Standards Board (FASB). For example, a governmental utility district may have a 10 percent ownership interest in a power plant with a related ARO, for which 75 percent of the ownership interest belongs to a publicly traded energy company that reports using FASB guidance. There also may be arrangements without a single majority owner, and a nongovernmental joint owner with the operational responsibility for the jointly owned tangible capital asset and reports the associated ARO under FASB standards.

The standard provides an exception to the initial and subsequent measurement provisions for a government's minority interest in an ARO when the majority owner or the venture's operator reports under FASB guidance. The exception allows governments to report their minority share of an ARO liability using the measurements provided by the FASB reporting entity without adjustment. The ARO's measurement date should be no more than one year and one day before the government's financial reporting date.

Financial Statements Prepared Using the Current Financial Resources Measurement Focus

In financial statements prepared using the current financial resources measurement focus, liabilities and expenditures should be recognized for goods and services used for asset retirement activities upon receipt of those goods and services, to the extent the amounts normally are expected to be liquidated with expendable available financial resources. The accumulation of resources in a governmental fund for eventual payment of unmatured general long-term indebtedness—including AROs—does not constitute an outflow of current financial resources and should not result in the recognition of an additional governmental fund liability or expenditure.

Presentation & Disclosure

Governments would be required to disclose a general description of the ARO and the associated tangible capital assets, and the source of the obligation to retire the assets (federal, state or local laws and regulations, contracts or court judgments). Additional disclosures include:

- Methods and assumptions used to measure ARO liabilities
- Estimated remaining useful life of associated tangible capital assets

- Information about how legally required financial assurance provisions, if any, are being met, *e.g.*, surety bonds, insurance policies, etc.
- Amount of assets restricted for payment of the liabilities, if not separately displayed in the financial statements

Any AROs or portions of AROs that are incurred but not yet recognized because they cannot be reasonably estimated should be disclosed, including the reasons why.

A government may voluntarily or be legally obligated to provide funding and assurance to satisfy its ARO obligation. Legally required funding and assurance provisions should be disclosed. Governments should not offset ARO liabilities with assets restricted for payment of those liabilities. The costs to comply with funding and assurance provisions should be separately accounted for as period costs and excluded from the ARO liability.

Effective Date & Transition

The requirements are effective for reporting periods beginning after June 15, 2018; earlier application is encouraged. Transition would be on a retrospective basis, if practicable. In the period first applied, changes made to comply with this standard would be treated as an adjustment of prior periods, and all financial statements presented should be restated. In the first period the statement is applied, notes to the financial statements should disclose the nature of the restatement and its effect.

If restatement for all prior periods presented is not practicable, the cumulative effect should be reported as a restatement of beginning net position for the earliest period restated, with an explanation of the reason for not restating.

To learn more about how this change could affect your organization, contact your BKD advisor.

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