

PREPARE EARLY - RECOGNITION OF ASSET RETIREMENT OBLIGATIONS WILL BE REQUIRED

Earlier this year, the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants (CICA) issued an exposure draft (ED), Asset Retirement Obligations. The ED dealt with the recognition and measurement of liabilities for obligations associated with the retirement of property, plant and equipment when those obligations result from the acquisition, construction, development or normal operation of the assets. The proposed standard would apply to, for example, site restoration of a mine, oil or gas well or landfill, nuclear plant decommissioning and removal of plant and equipment from leased property on termination of the lease. The proposed standard would require the recognition of any statutory, contractual or other legal obligation, normally when incurred. The obligations would be measured initially at fair value and the resulting costs capitalized into the carrying amount of the related asset. In subsequent periods, the liability would be adjusted for the accretion of discount and any changes in the amount or timing of the underlying future cash flows. For capital-intensive organizations, the recognition of the asset retirement obligation (ARO) will lead to a significant increase in capital tax. The asset retirement cost would be amortized to income on a systematic and rational basis. Entities would be required to disclose certain key information about the liability.

The AcSB has begun its review of the responses to the ED. The responses provided support for the AcSB's proposals but raised several key issues for the AcSB to consider. The AcSB has tentatively agreed to make some clarifications to the ED proposals but remains committed to harmonizing with the U.S. Standard on this topic, Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations. The proposed implementation date in Canada is 2004, while the U.S. requirements are effective for 2003. For cross-border filers, such entities will be required to disclose the effects of adopting SFAS No. 143 as part of their Canada - U.S. GAAP reconciliation, under the requirements of Staff Accounting Bulletin (SAB) 74, Disclosure of the Impact that Recently Issued Accounting Standards Will Have on the Financial Statements of the Registrant When Adopted in a Future Period.

The new standard of accounting for AROs may be a difficult standard to implement for many companies because of the significant effort that could be required to identify all AROs and measure those obligations. The first step of the implementation process should be the

identification of any potential AROs. These efforts will require the assistance of the managers responsible for the operation of tangible long-lived assets as well as in-house legal counsel in order to identify all legal obligations subject to the new rules. The assistance of legal counsel will be especially important in identifying obligations that arise from the doctrine of promissory estoppel. Management and legal counsel will need to review governmental and other third party contracts, lease agreements, easements, and other similar "right of way" agreements to determine whether any provisions in these agreements obligate the company to perform asset retirement activities.

Once retirement obligations are identified, management will be required to estimate the fair value of those obligations. This process will require a company to estimate costs that a third party would incur in performing the retirement activities. This would include estimating labor and overhead that would be incurred to perform the retirement activities, a reasonable profit margin on those activities, future inflation, and a market risk premium required for a third party to assume a future obligation to perform retirement activities in exchange for a fixed amount of consideration. Since many of the AROs may not be settled until many years in the future, these estimates will necessarily entail a significant degree of subjectivity. In some cases, the assistance of valuation specialists may be required. Because of the complexity associated with identifying and measuring AROs, companies should begin now to form a multi-disciplinary team of operating, legal, and accounting specialists to help in this effort. As a matter of reference for our membership, the following links are provided as additional sources of accounting guidance.

CICA links:

Project summary, Asset Retirement Obligations

http://www.cica.ca/index.cfm/ci_id/1551/la_id/1.htm

Presentation material, Asset Retirement Obligations

http://www.knotia.ca/Courses/ASBF/mod4/Eng/pdfs/knotia/ASBF_mod4.pdf

FASB Links:

Summary of Statement No. 143

<http://www.fasb.org/st/summary/stsum143.shtml>

Issue No. 02-6, "Classification in the Statement of Cash Flows of Payment

Made to Settle an Asset Retirement Obligation within the Scope of FASB

Statement No. 143, Accounting for Asset Retirement Obligations."

<http://www.fasb.org/eitf/eitfissu.shtml#02-6>

IASB Link:

<http://www.iasb.org.uk/cmt/0001.asp?n=981&s=1280159&sc={9C1BC560-BB09-4151-8331-A569506B6D9C}&sd=167616611>

Other accounting guidance and literature:

E&Y Interpretive Guidance: Summary of FASB Statement No. 143, Accounting for

Asset Retirement Obligations

http://www.ey.com/global/Content.nsf/US/AABS_-_Assurance_-_Articles_-_FASB_Statement_143

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Journal of Accountancy Article, December 2001, Accounting for Asset Retirement Obligations

<http://www.aicpa.org/pubs/jofa/dec2001/index.htm>

CPA Journal, May 2002, Accounting for Asset Retirement Obligations

<http://www.nysscpa.org/cpajournal/2002/0502/soon.htm>

McGraw Hill Higher Education, Accounting for Asset Retirement Obligations

<<http://www.mhhe.com/business/accounting/spiceland2e/graphics/spiceland2eacc>

[tg_s/updates/SFAS_143.doc](http://www.mhhe.com/business/accounting/spiceland2e/graphics/spiceland2eacc_tg_s/updates/SFAS_143.doc)>.

CFO.com, FASB Issues FAS 143, Accounting for Asset Retirement Obligations

<http://www.cfo.com/article/1,5309,4618%7C%7CA%7C1%7C,00.html>