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**Environmental Financial Disclosure Rules
and Their Impact on Brownfields Transactions**

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This article presents an update on recent developments in environmental disclosure rules and discusses their potential impact on brownfields transactions. The headline stories for 2007-2008 include the continuing wholesale revision of accounting principles, a proposal for expanded disclosures for loss contingencies, SEC comment letters on asset retirement obligations (AROs), and the emergence of SEC enforcement for manipulation of environmental reserves.

As recently reported by CFO Magazine, everything you thought you knew about accounting is about to change. “Most publicly traded companies may now be in compliance with Sarbox [Sarbanes Oxley], but the push for transparency that it set in motion is rippling out in all directions, and there is scarcely any aspect of corporate accounting — from overarching principles to specific standards — that isn't ripe for reconsideration. ‘I've been a student of financial reporting for 25 years,” says Greg Jonas, managing director of Moody's Investors Service, “and I've never seen a time when so many big-ticket financial-reporting issues were in play.”¹

These changes will directly affect the recognition, measurement and disclosure of liabilities associated with environmental cleanups, natural resource damages, asset retirement obligations, toxic tort claims, and regulatory fines and penalties—all important considerations in brownfields

¹ “Rewriting the Rules: Everything you thought you knew about accounting is about to change. Is there any reason to smile?,” Michelle Leder, CFO Magazine, October 01, 2007, http://www.cfo.com/article.cfm/9861756/c_9891771?f=singlepage.

transactions. Perhaps most significantly, the notion of “contingent liability” is being redefined in a manner that will have significant consequences for companies, accountants, and lawyers engaged in business mergers and acquisitions beginning next year.

In addition to the ongoing sea change in accounting standards, the SEC is showing interest in environmental issues. After decades of inactivity, three SEC enforcement actions in the past 24 months have featured or involved manipulation of environmental reserves. The public release of SEC comment letters also shows that the agency is paying greater attention to environmental disclosures (or the lack thereof) in SEC filings. At the same time, institutional investor groups are pressing the SEC to demand more disclosure on climate-related risks affecting U.S. public corporations.

The Nexus between Environmental Disclosure and Brownfields Transactions

The primary nexus between environmental disclosure and brownfields is the widespread practice of “mothballing.” The EPA defines the term “mothballed brownfield” as a property where the owner is unwilling or unable to transfer the brownfield or put it into productive reuse. Mothballed brownfields, like other brownfields, can cause blight to neighborhoods, inhibit economic development, threaten public health and the environment, discourage productive reuse of infill areas, and encourage urban sprawl.²

Lack of transparency in financial disclosure has been linked to mothballing.³ The ability to avoid full financial disclosure of potential legal obligations for site cleanup is at least one important factor contributing to the voluntary practice of mothballing properties with known or suspected contamination. As a business strategy, mothballing relies on avoiding accountability by keeping environmental problems out of sight and out of mind. Over time, voluntary mothballing leads to involuntary mothballing as once-viable companies go into bankruptcy or transfer their surplus properties to entities lacking the financial means to pay for needed cleanup.⁴

Recent changes in accounting and disclosure standards, such as accounting rules for “conditional asset retirement obligations,” have placed added pressure on companies to address their mothballed sites. Forthcoming changes will add additional pressure in the following ways:

1. Changes in accounting standards for business mergers and acquisitions (M&A) in some cases will require companies to recognize liabilities for known or suspected contamination of owned properties, even if the buyer’s intention is to continue to mothball the site. These new accounting rules will make it harder for buyers and sellers to avoid valuation of contingent environmental obligations through the use of indemnifications. M&A transactions present an ideal opportunity to resolve or satisfy environmental cleanup obligations, as neither the buyer nor the seller desires to hold these obligations.

² Mothballed Brownfields: Successful Approaches to Revitalization, <http://epa.gov/brownfields/publications/mothballed.htm>.

³ Fooling Investors & Fooling Themselves: How Aggressive Corporate Accounting & Asset Management Tactics Can Lead To Environmental Accounting Fraud, by Sanford Lewis, J.D. and Tim Little. <http://www.rosefdn.org/fooling.pdf>.

⁴ See *Environmental Liabilities: EPA Should Do More to Ensure That Liable Parties Meet Their Cleanup Obligations*, U.S. Governmental Accountability Office, August 2005. <http://www.gao.gov/highlights/d05658high.pdf>.

2. New accounting rules will require companies to determine the market value of their environmental cleanup obligations. In other words, reporting entities will need to obtain a quote from an independent third party to resolve or satisfy their environmental cleanup obligations, or attempt to estimate the exit price for the liability in the absence of a quote. When forced to report the market value of their environmental liabilities, many reporting entities will elect to extinguish the obligation by cleaning up the site.
3. Proposed new accounting rules, if finalized in the form proposed, will require companies to disclose extensive information about environmental loss contingencies, including environmental cleanup obligations. Many businesses, governments, and non-profits are making substantial efforts to enhance their environmental reputation with stakeholders. Disclosures related to environmental liabilities may be detrimental to an entity's image as "green," "sustainable," or "socially responsible". Unfavorable disclosures, let alone accounting-related enforcement actions, may damage a company's competitive position with customers, employees, suppliers, investors, donors, or taxpayers.

Asset Retirement Obligations

Recent developments in the implementation of Financial Accounting Standards Board (FASB) Statement 143 and Interpretation No. 47 (FIN 47) include the public release of several SEC comment letters and a \$700 million adjustment by a major oil and gas company.

Comment letters from the SEC Division of Corporate Finance released over the last 24 months have raised several questions about how public companies in the telecommunications, chemical, mining, oil and gas, and energy industries are reporting AROs. Following are examples of comments and questions raised by the SEC:

- Explain and disclose the specific legal obligations associated with your manufacturing, distribution, and marketing facilities and how you concluded the economic useful lives were indeterminate in light of the assigned service lives.
- We note your statement that you believe that you do not have any material asset retirement obligations or environmental remediation liabilities related to leased manufacturing facilities. You also state that due to your lack of experience with facility closures and the related asset retirements, you are unable to estimate an asset retirement obligation. It appears to us that these two statements contradict each other.
- Expand your disclosures to include a description of your asset retirement obligations that fall within the scope of Statement 143. Are you trying to convey that the fair value of your asset retirement obligations cannot be reasonably estimated "... because the timing of any ultimate obligation is indefinite." If so, please clarify and revise to provide the disclosures required by paragraph 22 of Statement 143.
- We note your disclosure indicating that certain assets have indeterminate lives which limits your ability to determine the associated asset retirement obligation. Please explain the nature of these assets and the consideration given for other estimates used for these same assets such as your determination of their estimated useful lives. Additionally, please explain why you believe that you have considered all information to reasonably estimate the timing of the settlement of your asset retirement obligations. Please describe to us the limiting factors which prohibit you from further recognizing an asset retirement obligation, if that is your belief.
- Please expand your disclosure to address how you account for asset retirement obligations that cannot be reasonably estimated. Additionally explain that is the case, if

true, and the reasons it cannot be reasonably estimated. Refer to paragraph 22 of Statement 143.

- Given that under FIN 47 you are required to disclose the reasons why you can not estimate the fair value of an asset retirement obligation, please describe to us in a comprehensive manner why you can not reasonably estimate the fair value of each of your asset retirement obligations given your experience in your industry. Be sure to include as part of this discussion a description of the data that you feel is necessary, that you presently do not have, in order to record the cost of your obligation.
- You indicate that you have unrecorded legal obligations to remove poles and asbestos. Describe these obligations and tell us why you are unable to estimate them. What information is not currently available? Explain to us why this information is necessary. Tell us when and under what circumstances this information will or may become available. Describe how you applied the guidance of Statement 143 and FIN 47 to these obligations.

These SEC comments indicate that the practice of not recognizing conditional AROs due to indeterminate settlement dates may not be sustainable. Notably, Chevron, which previously has claimed that it could not estimate AROs for its refining, marketing, transportation, and chemical assets due to indeterminate retirement dates, recently announced an estimated \$700 million in nonrecurring net charges in the third quarter of 2007 for “asset impairments, environmental remediation provisions, income tax adjustments, asset retirement obligations, and severance provisions.”⁵

Fair Value Measurement

FASB Statement 157, which provides standards for the application of fair value measurement,⁶ took effect November 15, 2007, subject to a one-year extension for application to certain non-financial liabilities, including AROs.⁷ Fair value measurement is currently required for AROs under Statement 143 and FIN 47 and environmental indemnities under FASB Interpretation No. 45 (FIN 45). Soon, it will also be required for environmental loss contingencies assumed in a merger or acquisition (see discussion under “Business Combinations” below).

The fair value of a liability is the price that would be paid to transfer the liability in an orderly transaction between market participants at the measurement date (exit price).⁸ A quoted price for the identical liability in an active market is the best evidence of fair value.⁹ If an active market does not exist, companies must estimate the exit price based on the assumptions that market

⁵ Chevron Corporation Form 8-K dated October 9, 2007, <http://www.sec.gov/Archives/edgar/data/93410/000095013407021068/f34376exv99w1.htm>.

⁶ See “Fair Value Measurement of Environmental Liabilities,” C. Gregory Rogers, ABA Environmental Disclosure Committee Newsletter [Vol. 3, No. 1 - October 2005](#).

⁷ FASB Staff Position No. FSP 157-2 (Feb. 12, 2008).

⁸ Statement 157 ¶ 5.

⁹ Statement 157 ¶¶ 22 and 24.

participants would use in pricing the liability, including probabilistic analysis, risk premium, and profit margin.¹⁰

Fair value measurement presents difficult challenges when applied to assets and liabilities that are thinly traded or, as in the case of environmental remediation liabilities and AROs, have no market with which to gauge their value. Many accountants and financial executives recognize that companies are not prepared for implementation of fair value measurement. Arguing that internal accounting teams, valuation experts, and external auditors need more time to grasp the many aspects of the standard, the Institute of Management Accountants and Financial Executives International petitioned the FASB to postpone the effective date of Statement 157, to give companies a one-year break. At its November 14, 2007 Board meeting, the FASB agreed to a one year deferral for the implementation of Statement 157 for nonfinancial assets and liabilities, such as environmental indemnities and AROs.¹¹

Business Combinations

In December 2007, the FASB issued a revision of Statement 141 (business combinations) that dramatically alters the prior standards for recognizing (i.e., recording a liability on the balance sheet) and measuring contingent liabilities, including environmental liabilities, assumed by the surviving entity in a business acquisition or merger. Statement 141R replaces the long-standing recognition criteria under Statement 5 (i.e., probable and reasonably estimable). Instead, beginning in 2009, acquirers in a business combination must recognize, without regard to the probability of loss:

1. All loss contingencies arising from contractual obligations (e.g., environmental remediation covenants and indemnifications) at the acquisition date; and
2. Loss contingencies that do not arise from contractual obligations (e.g., environmental obligations arising under statute or common law) if it is “more likely than not” that the contingency meets the definition of a liability (i.e., a present obligation arising from a past event, the settlement of which is reasonably expected to result in an outflow of resources) at the acquisition date.

The recognition criteria in Statement 141R are fundamentally different from the recognition criteria in Statement 5. Under Statement 5, a liability is recognized if it is both (1) probable that a liability has been incurred, and (2) the amount of the loss is reasonably estimable.¹² In practice, liabilities are not recognized under Statement 5 “unless there is a high likelihood of a future outflow of resources.”¹³ Thus, under Statement 5, recognition depends on the likelihood of *loss* rather than the likelihood of *liability*. By contrast, under Statement 141R, recognition depends on the likelihood of *liability* rather than the likelihood of *loss*.

¹⁰ Statement 157 ¶ B2. See also proposed FASB Staff Position (FSP) FAS 157-c regarding clarification of Statement 157 on the measurement of liabilities. http://www.fasb.org/fasb_staff_positions/prop_fsp_fas157-c.pdf.

¹¹ “FASB Rejects Deferral of Statement 157 for Financial Assets and Liabilities: Partial Deferral Granted for Nonfinancial Assets and Nonfinancial Liabilities,” FASB News Release, November 14, 2007, <http://www.fasb.org/news/nr111407.shtml>.

¹² Statement 5 ¶ 8.

¹³ Statement 141R ¶ B226.

Element uncertainty refers to uncertainty about whether and when a loss contingency gives rise to a liability. Element uncertainty—whether a liability exists—is distinct from uncertainty about the value of a liability. FASB determined that contingencies related to contracts (*contractual contingencies*) involved limited element uncertainty. For all other contingencies (*noncontractual contingencies*), FASB imposed a probability threshold to address element uncertainty.

The FASB concluded that most cases of significant uncertainty about whether a potential asset or liability arising from a contingency meets the pertinent definition (element uncertainty) are likely to involve noncontractual contingencies. To help preparers and their auditors deal with element uncertainty, the FASB decided to add a requirement for the acquirer to assess whether it is **more likely than not** that the contingency gives rise to an asset or a liability as defined in Concepts Statement 6. For an asset arising from a contingency, applying that criterion focuses on whether it is more likely than not that the acquirer has obtained control of a future economic benefit as a result of a past transaction or other event. For a liability, the more-likely-than-not criterion focuses on whether the acquirer has a present obligation to sacrifice future economic benefits as a result of a past transaction or other event. If that criterion is met at the acquisition date, the acquirer recognizes the asset or liability, measured at its acquisition-date fair value, as part of the accounting for the business combination. If that criterion is not met at the acquisition date, the acquirer accounts for the noncontractual contingency in accordance with other GAAP, including Statement 5, as appropriate. The FASB concluded that adding the more-likely-than-not criterion would permit acquirers to focus their efforts on the more readily identifiable contingencies of acquirees, thereby avoiding spending disproportionate amounts of time searching for contingencies that, even if identified, would have less significant effects.¹⁴

The FASB provided additional clarification to differentiate between the likelihood of *liability* and the likelihood of *loss* when addressing element uncertainty under Statement 141R.

Paragraph 24 establishes a *more-likely-than-not* criterion to determine whether to recognize as of the acquisition date an asset or a liability arising from a noncontractual contingency. If that criterion is not met as of the acquisition date, the noncontractual contingency is recognized and measured at a later date in accordance with other GAAP, including FASB Statement No. 5, *Accounting for Contingencies*, as appropriate.

This Statement uses *more likely than not* for a purpose that differs from the purpose of the probability notion in the definition of assets and liabilities in FASB Concepts Statement No. 6, *Elements of Financial Statements*. For example, Concepts Statement 6 defines liabilities as:

probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events. [Paragraph 35; footnote references omitted.]

Thus, *probable* applies to the future sacrifice of economic benefits embodied in the liability; it does not apply directly to whether the entity has a *present*

¹⁴ Statement 141R ¶ B271.

obligation. A footnote to paragraph 35 of Concepts Statement 6 explains that *probable* is used in the definition “to acknowledge that business and other economic activities occur in an environment characterized by uncertainty in which few outcomes are certain” (paragraph 35, footnote 21). *In contrast, the more-likely-than-not criterion in this Statement applies to whether the acquirer has incurred an obligation to pay if a specified event—the contingency—occurs. The criterion asks: Is it more likely than not that the entity has a present obligation. If that threshold is met, uncertainties about the amount and timing of the future cash flows—the future sacrifice—embodied in a liability arising from a contingency are incorporated in its fair value measure.* The same analysis applies equally to an asset arising from a contingency.¹⁵

Statement 141R contains the following example of a noncontractual contingency:

In December 20X8, a former employee filed suit against TC alleging violation of age discrimination laws. On June 30, 20X9, AC purchases all of TC’s outstanding equity shares for cash. As of the acquisition date, discovery proceedings related to the discrimination lawsuit were underway but were not yet complete. TC’s management asserts that its hiring and promotion practices complied with all applicable laws and regulations.

AC would recognize a liability as of the acquisition date, measured at its acquisition-date fair value, if it concludes based on the facts known as of that date that it is more likely than not that TC had violated the age discrimination laws. In making that assessment, AC would consider all relevant facts and circumstances, such as the results of discovery proceedings to date, advice from its lawyers about whether TC would be found liable based on the facts known at that date, and any other relevant information gathered through due diligence or other procedures. However, neither a past practice of settling similar suits out of court nor consideration of an out-of-court settlement of the lawsuit against TC, in and of itself, provides a conclusive basis for recognizing a liability. Rather, AC would consider such information together with other evidence in determining whether it is more likely than not that TC has violated the applicable laws or regulations and is likely to be found liable under the lawsuit. The acquisition-date fair value measure of the recognized liability, if any, would reflect possible outcomes of the litigation, including possible out-of-court settlement.¹⁶

The new recognition criteria in Statement 141R are likely to trigger recognition of many environmental liabilities that would not be recognized under Statement 5. This may have particular relevance to mothballed brownfields. For example, if available evidence indicates that it is more likely than not that the buyer in a M&A transaction will assume a present obligation under state or federal law to address environmental conditions on property owned by the seller, the buyer must record a liability for that obligation, whether or not government enforcement is foreseeable or the buyer intends to clean up the site voluntarily. Uncertainty about the existence of a “present obligation” (element uncertainty) is likely to cause M&A buyers to exercise greater diligence before taking ownership of operating and non-operating properties with known or suspected contamination.

¹⁵ Statement 141R ¶¶ A62-A63 (emphasis added).

¹⁶ Statement 141R ¶ A64.

Instead of using the measurement techniques under Statement 5 (as set forth in FASB Interpretation No. 14) (i.e., use the most likely value or the low end of the range of estimates if there is no most likely value), contingencies that meet the recognition criteria in Statement 141R must be measured at fair value. Many, perhaps all, contingent environmental liabilities that are not considered “reasonably estimable” under Statement 5 and FIN 14 can be estimated using fair value measurement techniques. Thus, the new recognition and measurement standards under Statement 141R, taken together, can be expected to significantly increase both the number and magnitude of reported environmental liabilities assumed in M&A transactions.

The following hypothetical examples describe how fair value measurement may affect environmental contingencies in M&A deals.

Example 1: Buyer plans to purchase the stock of Seller. Seller owns an industrial facility with soil and groundwater contamination resulting from historical releases of chlorinated solvents (TCE) caused by Seller. Under state law, the property owner is obligated to address the contamination. Seller estimates that a thorough site investigation will cost \$250,000. Depending on the extent of contamination, cleanup costs are expected to range between \$2 million and \$10 million. In accordance with applicable accounting standards, Seller has used the reasonably estimable cost of the investigation as a surrogate for the known minimum value of the total cleanup and booked a contingent liability in the amount of \$250,000. Buyer estimates that it would charge \$5 million to assume cleanup liability for the facility in a stand-alone transaction. This estimate is comparable to a quote obtained from an environmental liability buy-out company. Upon acquisition of Seller, instead of recording a \$250,000 liability, Buyer records a contingent liability in the amount of \$5 million representing its estimate of the acquisition-date fair value of the cleanup liability.

Example 2: Same facts as above, except that preliminary investigation indicates that TCE in groundwater has migrated offsite under a residential neighborhood at concentrations posing a risk of vapor intrusion. As of the acquisition date, Seller has not notified the government or the adjacent property owners and no claims have been asserted against Seller. In accordance with applicable accounting standards, Seller has not recorded a contingent liability for unasserted claims for property damage or bodily injury because Seller does not consider litigation to be probable (highly likely) and it believes the amount of the potential loss cannot be reasonably estimated. Based on existing information, Buyer’s legal counsel concludes it is more likely than not that Seller is liable for trespass and related property damages (but not for bodily injury). Considering possible outcomes of potential litigation, including possible out-of-court settlement, Buyer’s counsel estimates the maximum exposure to loss for property damage claims is \$15 million. Buyer obtains three quotes for 10-year environmental insurance policies with limits of \$15 million that would respond in the event of lawsuits by offsite impacted property owners arising from pre-existing pollution conditions (bodily injury and cleanup cost coverage is excluded). Upon acquisition of Seller, Buyer records a liability in the amount of \$1.5 million — the average of the three insurance premium quotes — as its estimate of the acquisition-date fair value of Seller’s offsite property damage liability.

Example 3: Same facts as above, except that Seller recently sold the facility in 2001 and gave the current owner an unlimited contractual indemnity for third-party claims for cleanup costs, property damages, or bodily injury arising from pre-existing pollution conditions. At the time of the acquisition, no third-party claims have been asserted and the current owner has made no demand against Seller under the indemnity. In accordance with applicable accounting standards, Seller has not recorded a contingent liability for its contractual indemnity obligation because Seller does not consider a claim to be probable (highly likely) and it believes the amount of the potential loss cannot be reasonably estimated. Based on available information and experience with vapor intrusion litigation in other parts of the country, Buyer’s counsel estimates the maximum exposure to loss for bodily injury and property damage claims is \$100 million. Buyer

obtains a quote in the amount of \$10 million for a 10-year, \$100 million environmental insurance policy that would respond in the event of claims for bodily injury or property damage arising from pre-existing pollution conditions (cleanup cost coverage is excluded). Upon acquisition of Seller, Buyer records a contingent liability in the amount of \$15 million — \$5 million for cleanup (see Example 1) plus the insurance premium quote for bodily injury and property damage coverage — as its estimate of the acquisition-date fair value of Seller's contractual indemnity obligation.

As these examples illustrate, fair value measurement of environmental liabilities in business combinations can be expected to result in more booked liabilities and higher, sometimes much higher, estimates.

In addition, the new business combination standard will require significantly more information in the footnotes to the financial statements. For assets and liabilities arising from contingencies, companies must disclose:

- The amounts recognized at the acquisition date or an explanation of why no amount was recognized.
- The nature of recognized and unrecognized contingencies.
- An estimate of the range of outcomes (undiscounted) for contingencies (recognized and unrecognized) or, if a range cannot be estimated, that fact and the reasons why a range cannot be estimated.¹⁷

Statement 141R changes prior practice for recording measurement period adjustments. Instead of recognizing changes to provisional amounts prospectively as a change in estimate, acquirers must revise comparative information for prior periods. This requirement will increase the pressure on due diligence to enable timely and accurate market-based estimates and thereby minimize the need to revise prior-period financial statements in subsequent filings.

Contingent Liabilities

In March 2005, FASB rejected a request by the Rose Foundation to reconsider the accounting standards applicable to contingent environmental liabilities. At that time, FASB said that it did not desire to reconsider Statement 5, solely in the context of environmental liabilities. FASB hinted that a more comprehensive project was in the works.

At its September 6, 2007 meeting, the FASB voted to add a comprehensive project to revise Statement 5. FASB stated at that time that reconsideration of Statement 5 is necessary because the existing recognition criteria for contingent liabilities (i.e., probable and reasonably estimable) result in delayed recognition of liabilities and because that the disclosure criteria in Statement 5 are inadequate or ineffective. FASB split the Statement 5 project into two components: (1) an interim solution to expand disclosures; and (2) an overall long-term reconsideration of the recognition and measurement of contingencies. The second component will be coordinated with the ongoing convergence of U.S. accounting standards with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). The IASB is already well underway with an overhaul of its Statement 5-equivalent standard.¹⁸

¹⁷ Statement 141R ¶ 68(j). An acquirer may aggregate disclosures for assets and liabilities arising from contingencies that are similar in nature. *Id.*

¹⁸ See <http://www.iasb.org/Current+Projects/IASB+Projects/Liabilities/Liabilities.htm>.

On June 5, 2008, FASB released Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies*, which amends and expands the disclosure provisions in SFAS 5 and 141R.¹⁹ The proposed Statement would be effective for fiscal years ending after December 15, 2008, and interim and annual periods in subsequent fiscal years.

FASB believes the expanded disclosure provisions are necessary because:

Investors and other users of financial information have expressed concerns that disclosures about loss contingencies under the existing guidance in FASB Statement No. 5, *Accounting for Contingencies*, do not provide adequate information to assist users of financial statements in assessing the likelihood, timing, and amount of future cash flows associated with loss contingencies.

The proposed Standard would require that all loss contingencies be disclosed unless certain narrow criteria are met. If management determines that the likelihood of a loss is remote, disclosure would not be required. However, any contingency, regardless of the likelihood of a loss, with the potential to result in a near-term (within one year) and severe impact on the financial position, cash flows, or results of operations of an entity would be subject to disclosure.

The proposed Standard would require companies to disclose significantly more information about contingencies than currently required, including:

- Quantitative information about the entity's exposure to loss from the contingency, including:
 - The amount of the claim or assessment (including damages, such as treble or punitive damages), if applicable.
 - If there is no claim or assessment amount, the entity's best estimate of the maximum exposure to loss.
- Qualitative information, including, at a minimum, a description of the contingency, including how it arose, its legal or contractual basis, its current status, and the anticipated timing of its resolution.
- A description of the factors that are likely to affect the ultimate outcome of the contingency along with their potential effect on the outcome.
- The entity's qualitative assessment of the most likely outcome of the contingency.
- Significant assumptions used in estimating amounts and predicting outcomes.
- A qualitative and quantitative description of insurance or indemnification arrangements that could lead to a recovery of some or all of the possible loss, including any caps, limitations, or deductibles that could affect the amount of recovery.

Disclosures can be aggregated by the nature of the loss contingency (for example, environmental matters). Thus, companies would not be required to separately disclose information on each environmental contingency.

The proposed Standard would require reconciliation, in tabular format, of recognized loss contingencies at the beginning and end of the accounting period. The reconciliation must address, at a minimum:

¹⁹ Proposed Statement of Financial Accounting Standards, *Disclosure of Certain Loss Contingencies: an amendment of FASB Statements No. 5 and 141R*. http://www.fasb.org/draft/ed_contingencies.pdf.

- Increases for loss contingencies recognized during the period.
- Increases resulting from changes in estimates of the amounts of loss contingencies previously recognized.
- Decreases resulting from changes in estimates or derecognition of loss contingencies previously recognized.
- Decreases resulting from cash payments (or other forms of settlement) for loss contingencies.
- Recoveries from insurance or indemnification arrangements.

The proposed Standard provides an exemption to disclosure about certain contingencies, such as pending or threatened litigation, where disclosure could detrimentally affect the outcome of the contingency itself. In those circumstances, the company would be allowed to aggregate disclosures or, in rare instances, forgo certain prejudicial disclosures altogether.

This interim development can be expected to have a significant future impact on the recognition and measurement of environmental remediation, toxic tort, and product-related liabilities, as well as other types of contingent liabilities. In the second phase of the project, it seems likely that FASB will fashion the revisions to Statement 5 after the new standards for contingencies contained in Statement 141R (see “Business Combinations” above). Thus, companies would account for their existing contingencies under a revised Statement 5 in the same manner as they will be required to account for new contingencies assumed in a business acquisition or merger under Statement 141R.

Internal Control: Restatements and SEC Enforcement

In March 2007, General Motors restated its 2004 and 2005 financial statements to increase its accrued liabilities for environmental operation and maintenance costs for certain environmental sites. Pre-tax earnings were decreased, through an increase to cost of sales, by \$1.4 million (\$0.9 million after tax) and \$4.9 million (\$3.2 million after tax) in 2005 and 2004, respectively, and retained earnings at January 1, 2004 was decreased by \$32.2 million.²⁰

In the past 12 months, the SEC has concluded three enforcement actions against corporate executives accused of illegal environmental financial reporting. The three matters are:

1. The November 2006 imposition of a cease-and-desist order on Ashland, Inc. and its former Environmental Remediation Director for improperly reducing the company’s estimated remediation reserves.
2. The June 2007 settlement of civil charges against ConAgra executives that alleged the improper reduction of environmental reserve estimates in order to offset losses; and
3. The June 2007 entry of a guilty plea by Safety-Kleen’s former CFO, Paul Humphreys, who was accused of improperly reducing environmental remediation reserve account estimates to overstate earnings.

These recent actions, which follow decades of seeming indifference to environmental matters, suggest that the SEC may have a new-found appetite for policing fraud and internal control weaknesses relating to environmental accounting and disclosure.

Governmental Remediation Liabilities

In November 2006 the Governmental Accounting Standards Board (GASB) issued a new standard that will require state and local governments to provide the public with better information about the financial impact of environmental cleanup obligations. Statement 49, which takes effect for periods beginning after June 15, 2007, requires a government entity to report a liability for pollution remediation obligations if it knows a site is polluted and any of the following recognition triggers occur:

1. Pollution poses an imminent danger to the public or environment and a government has little or no discretion to avoid fixing the problem.
2. A government has violated a pollution prevention-related permit.
3. A regulator has identified (or evidence indicates it will identify) a government as responsible (or potentially responsible) for cleaning up pollution, or for paying all or some of the cost of the cleanup.
4. A government is named (or evidence indicates that it will be named) in a lawsuit to compel it to address the pollution.
5. A government begins or legally obligates itself to begin cleanup or post-cleanup activities (limited to amounts the government is legally required to complete).

Under Statement 49, liabilities must be estimated at current value — the amount that would be paid if all equipment, services included in the estimate were acquired during the current period (rather than their present value) using an expected cash flow (probabilistic weighted-average) measurement technique. Unlike fair value measurement, only in situations where the government intends to hire another party to perform the work should the estimate incorporate profit and risk premiums expected to be charged by an outside party.