NO. 206-B | FEBRUARY 17, 2000

Financial Accounting Series

EXPOSURE DRAFT (Revised)

Proposed Statement of Financial Accounting Standards

Accounting for Obligations Associated with the Retirement of Long-Lived Assets

Revision of Exposure Draft
issued February 7, 1996

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Research and Technical Activities
File Reference No. 206-B

Comment Deadline: May 18, 2000

Financial Accounting Standards Board
of the Financial Accounting Foundation

Exhibit No. 99
Date 5-30-01 Case No. ER-2001-299
Reporter Stewart

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Order Department
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

This Exposure Draft also is available on the FASB web site at www.fasb.org until May 18, 2000.

To be timely, comments should be postmarked by May 18, 2000. Comments also can be submitted by electronic mail to director@fasb.org. Respondents submitting comments by electronic mail should clearly identify themselves and the organization they represent.

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 Merritt 7, P.O. Box 5116, Norwalk, Connecticut 06856-5116

Notice for Recipients of This Exposure Draft

This proposed Statement addresses accounting for obligations associated with the retirement of tangible long-lived assets. The Board invites comments on all matters in this proposed Statement and particularly on the following specific issues. Respondents need not comment on all of the issues and are encouraged to comment on additional issues. It would be helpful if comments respond to the issues as stated, include any alternatives the Board should consider, and explain the reasons for the positions taken.

Recognition of a Liability for an Asset Retirement Obligation

Issue 1: This proposed Statement would require that an entity recognize a liability for an asset retirement obligation when (a) that obligation meets the definition of a liability, (b) a future transfer of assets is probable, and (c) the amount of the liability can be reasonably estimated. Paragraphs 6–10 and 64–74 of this proposed Statement provide guidance (based on the three characteristics of a liability) for determining whether an obligation meets the definition of a liability. The Board is cognizant that an entity will have to use considerable judgment in applying that guidance, especially when assessing whether a constructive obligation meets the definition of a liability. Is the guidance provided in this proposed Statement sufficient for making those judgments? If not, what additional guidance would be useful in making those judgments?

Paragraphs 57–63 provide the basis for the Board's conclusions.

Expected Present Value Technique

Issue 2: This proposed Statement would require an entity to initially measure the liability for an asset retirement obligation at fair value. Most entities will estimate fair value using the expected present value technique that is described in paragraphs 16–20 and that is illustrated in the examples included in Appendix B. FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* provides a detailed discussion of present value and its use in accounting measurements.

Does this proposed Statement provide enough guidance for implementing an expected present value technique in the measurement of a liability for an asset retirement obligation? If not, what additional guidance would be helpful?

Subsequent Measurement of a Liability for an Asset Retirement Obligation

Issue 3: In periods subsequent to initial measurement, this proposed Statement would require that an entity use an *allocation approach* to recognize and measure changes in the liability for an asset retirement obligation related to the passage of time (interest expense) and revisions in cash flow estimates. Those changes would be measured using the credit-adjusted risk-free rate (defined in paragraph 19) in effect when the liability or portions thereof were initially measured. The Board rejected subsequent measurement using a *fresh-start approach*. Under that approach, an entity would have been required to remeasure the entire liability at fair value in periods subsequent to initial measurement thereby recognizing changes in the liability resulting from fluctuations in market interest rates. The subsequent recognition and measurement provisions of this proposed Statement are provided in paragraphs 21–26. In addition, Appendix B includes several examples illustrating those provisions.

Do you agree with the Board's decision to require an allocation approach rather than a fresh-start (fair value) approach for subsequent measurement of the liability? Is sufficient guidance provided for applying the subsequent measurement provisions of this proposed Statement? If not, what additional guidance is needed?

Paragraphs 89–102 provide the basis for the Board's conclusions about subsequent measurement.

Disclosures

Issue 4: The disclosure requirements of this proposed Statement are included in paragraph 31. The basis for the Board's conclusions with respect to those requirements is discussed in paragraphs 117–121.

Do you agree with the disclosure requirements of this proposed Statement? Are there any disclosures that you would omit from or add to this proposed Statement?

Summary

This proposed Statement would establish standards for accounting for an obligation associated with the retirement of a tangible long-lived asset. The obligations included within the scope are those that are unavoidable as a result of either the acquisition or the normal operation of a long-lived asset. This proposed Statement would require that an obligation associated with the retirement of a tangible long-lived asset be recognized as a liability when incurred. The amount of the liability would initially be measured at fair value. This proposed Statement would require that, subsequent to initial measurement, an entity recognize changes in the amount of the liability resulting from (a) the passage of time and (b) revisions to either the timing or amount of estimated cash flows.

This proposed Statement also would establish standards for accounting for the cost associated with an asset retirement obligation. It would require that, upon initial recognition of a liability for an asset retirement obligation, an entity capitalize that cost by recognizing an increase in the carrying amount of the related long-lived asset.

This proposed Statement would be effective for financial statements issued for fiscal years beginning after June 15, 2001. Earlier application would be encouraged.

Proposed Statement of Financial Accounting Standards

Accounting for Obligations Associated with the Retirement of Long-Lived Assets

February 17, 2000

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Accounting for Obligations Associated with the Retirement of Long-Lived Assets

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INTRODUCTION

1. Diverse accounting practices have developed for recognizing in financial statements obligations associated with the retirement of long-lived assets. Some entities accrue those obligations ratably over the useful life of a long-lived asset, either as a component of depreciation expense (and accumulated depreciation) or as a liability. Other entities do not recognize an obligation in the financial statements until an asset is physically retired. The objectives of this Statement are to establish accounting standards for recognition and measurement of an asset retirement obligation and an associated asset retirement cost.[1]

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

2. This Statement applies to all entities that incur obligations that are associated with the *retirement*[2] of tangible long-lived assets.[3] This Statement applies to functional groups of long-lived assets and component parts of larger groups of long-lived assets for which

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[1]An *asset retirement obligation* is an obligation associated with the retirement of a long-lived asset that is unavoidable as a result of either the acquisition or the normal operation of that asset. In this Statement, the term *asset retirement obligation* is used to refer to the amount recognized as a liability and the term *asset retirement cost* is used to refer to the amount capitalized by increasing the carrying value of the long-lived asset.

[2]In this Statement, the term *retirement* is defined as the other-than-temporary removal of a long-lived asset from service. A long-lived asset could be retired at or before the end of its productive life. As used in this Statement, that term encompasses sale, abandonment, recycling, or disposal in some other manner. However, it does not encompass the temporary idling of a long-lived asset.

[3]In the remainder of this Statement, *long-lived asset* is used to refer to *tangible long-lived asset.*

there are separately identifiable asset retirement obligations.[4] This Statement applies to long-lived assets of a lessee accounted for as a capital lease and long-lived assets of a lessor accounted for as an operating lease.

3. The retirement obligations included within the scope of this Statement are those that an entity cannot avoid as a result of the acquisition, construction, or normal operation of a long-lived asset. This Statement does not apply to obligations that arise solely from a *plan to dispose* of a long-lived asset as that phrase is used in paragraph 15 of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of.*[5]

4. An obligation that relates to the ongoing operation, but not the retirement, of a long-lived asset is not within the scope of this Statement. Generally, obligations of that type are both incurred and settled throughout the operating life of a long-lived asset. An obligation that results from the improper operation of a long-lived asset is not within the scope of this Statement because it does not result from the acquisition, construction, or normal operation of a long-lived asset.[6]

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[4]This Statement uses the terms (a) *functional groups* to refer to two or more assets that are used together or considered as one asset for operating purposes and (b) *component parts of larger groups* to refer to one or more assets within a functional group for which there is a separately identifiable asset retirement obligation.

[5]The Board is addressing those obligations as part of its project on asset impairment and disposal issues.

[6]Obligations resulting from the improper operation of a long-lived asset may be subject to the provisions of AICPA Statement of Position 96-1, *Environmental Remediation Liabilities.*

Recognition of a Liability for an Asset Retirement Obligation

5. An entity shall recognize a liability for an asset retirement obligation[7] in the period in which all of the following conditions are met:

a. The obligation meets the definition of a liability in paragraph 35 of FASB Concepts Statement No. 6, *Elements of Financial Statements.*[8]
b. A future transfer of assets associated with the obligation is *probable.*[9]
c. The amount of the liability can be reasonably estimated.

An asset retirement obligation that does not meet all of those conditions shall not be recognized as a liability.

6. In assessing whether an asset retirement obligation meets the definition of a liability, an entity shall determine if the three characteristics of a liability in paragraph 36 of Concepts Statement 6 are met. Specifically, an entity shall determine whether:

a. It has a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets.
b. It has little or no discretion to avoid a future transfer or use of assets.
c. An obligating event has already happened.

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[7]This Statement applies to both legal obligations and constructive obligations. In general, a legal obligation results from a law, statute, regulation, or contract, whereas a constructive obligation is created, inferred, or construed from the facts in a particular situation.

[8]Paragraph 35 of Concepts Statement 6 states:

> Liabilities are *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. [Emphasis added, footnote references omitted.]

The term *probable* is used in this definition with its usual general meaning, rather than in a specific accounting or technical sense, and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved.

[9]The term *probable* is used in this context with the meaning associated with it in FASB Statement No. 5, *Accounting for Contingencies:* "the future event or events are likely to occur" (paragraph 3(a)).

Identification of Obligating Events Requiring Liability Recognition

7. An entity shall use the guidance in paragraphs 8–10 to determine whether an obligating event has occurred that requires recognition of a liability for an asset retirement obligation. That guidance addresses obligations using the following three categories:

a. Obligations incurred upon acquisition, construction, or development of an asset
b. Obligations incurred during the operating life of an asset, either ratably or nonratably
c. Obligations incurred any time during the life of an asset because of a newly enacted law or statute or a change in contract provisions or because an entity has otherwise incurred a duty or responsibility to one or more other entities.

8. An entity shall recognize an obligation encompassed by paragraph 7(a) as a liability when it initially recognizes the cost of the long-lived asset. For obligations of that type, the acquisition, and not the operation, of the asset creates the obligation. For example, the construction and placement of an oil and gas production facility would typically be the event that creates the obligation to dismantle and remove that facility. In general, an obligation encompassed by paragraph 7(a) does not change (even though the estimated amount of the obligation may change) with the operation of the asset or the passage of time.

9. An entity shall recognize an obligation encompassed by paragraph 7(b) as a liability over the life of the asset concurrent with the event that creates the obligation. In some instances, an entity will incur a disproportionate amount of a liability early in the life of the asset. For example, the obligating event for the decommissioning of a nuclear power plant is the radioactive contamination of the facility, a disproportionate amount of which occurs during the early years in the life of the asset. In other instances, an entity will incur the liability ratably over the life of an asset concurrent with the level of operations or the

passage of time. For example, in a landfill operation, the consumption of space with waste is an obligating event that occurs somewhat ratably over the life of the landfill. For a mining operation, the digging of a mine that must be reclaimed at the end of its productive life is an obligating event that requires liability recognition.

10. An entity shall recognize an obligation encompassed by paragraph 7(c) after considering the nature of the duty or responsibility created by, for example, the new law along with the guidance provided in paragraphs 8 and 9 to determine whether an obligating event or events have occurred that require liability recognition. For example, a new law that requires an entity to remove an existing gasoline storage tank when that tank is retired would result in the recognition of a liability upon enactment of the law because the events requiring the removal of that tank (placement of the tank into the ground along with the enactment of the law) have already occurred. In that situation, the law is the obligating event requiring initial recognition of a liability. However, a new law that requires an entity to clean up and dispose of hazardous waste from an already existing production process upon retirement of a manufacturing facility would result in immediate recognition of that portion of the liability attributable to hazardous waste existing when the law was enacted. Additional liabilities would be recognized over the remaining life of the facility as waste is emitted. In that situation, the events requiring the cleanup and disposal of waste are the enactment of the law along with the emission of waste from the production process. Therefore, the law is the obligating event requiring recognition of a liability related to the waste emitted from past production. However, the obligating event requiring recognition

of the remaining portion of the liability will be the waste emitted from future production, which has not yet occurred.

Recognition and Allocation of an Asset Retirement Cost and Asset Impairment

11. Upon initial recognition of a liability for an asset retirement obligation, an entity shall capitalize an asset retirement cost by increasing the carrying amount of the related long-lived asset by the same amount as that recognized for the corresponding liability.[10] An entity shall subsequently allocate that asset retirement cost to expense using a systematic and rational method over periods no longer than that for which the related long-lived asset is expected to provide benefits. The objectives of the requirements for capitalization and systematic and rational allocation to expense are to obtain a measure of cost that reflects the entity's total investment in the long-lived asset and to allocate that cost to expense in the period or periods during which the long-lived asset is expected to provide benefits. Application of a systematic and rational allocation method does not preclude an entity from capitalizing an amount of asset retirement cost and allocating an equal amount to expense in the same accounting period.[11]

12. Long-lived assets subject to the provisions of this Statement shall be tested for impairment pursuant to the provisions of Statement 121. In applying Statement 121, the carrying amount of the asset shall include amounts of capitalized asset retirement costs.

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[10]Capitalized asset retirement costs do not qualify as *expenditures* for purposes of paragraph 16 of FASB Statement No. 34, *Capitalization of Interest Cost.*

[11]For example, assume an entity acquires a long-lived asset with an estimated life of 10 years. As that asset is operated, the entity incurs one-tenth of the liability for an asset retirement obligation each year. Application of a systematic and rational allocation method would not preclude that entity from capitalizing and then expensing one-tenth of the asset retirement cost each year.

Furthermore, cash flows related to the liability for an asset retirement obligation that has been recognized in the financial statements shall be excluded from (a) the undiscounted cash flows used to test the asset for recoverability and (b) the discounted cash flows used in any measurement of the asset's fair value.

Initial Measurement

13. The objective of the initial measurement of a liability for an asset retirement obligation shall be fair value. Fair value is the amount that an entity would be required to pay in an active market to settle the asset retirement obligation in a current transaction in circumstances other than a forced or liquidation settlement. In that context, fair value represents the amount that a willing third party of comparable credit standing would demand to assume all of the duties, uncertainties, and risks inherent in the entity's obligation. The Board acknowledges that most asset retirement obligations cannot be settled in a current transaction with a third party and that some entities may perform the retirement activities using, for example, internal workforces. However, the objective of the initial measurement is to estimate the price that a third party would demand if current settlement in an active market was possible.

14. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances. The estimate of fair value shall consider prices for similar liabilities and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include expected present value and fundamental analysis.

15. In most instances, a market for settling asset retirement obligations will not exist. Therefore, the Board expects that most entities will use an expected present value technique to estimate fair value. Such a technique is described in paragraphs 16–20.

Expected Present Value

16. Expected present value refers to the sum of probability-weighted present values[12] in a range of estimated cash flows, all discounted using the same interest rate convention. Because the objective of using an expected present value technique to estimate the liability for an asset retirement obligation is to determine fair value, an entity should incorporate assumptions that marketplace participants would use in their estimates of cash flows.

17. Having fair value as the objective for initially measuring a liability for an asset retirement obligation does not preclude the use of information and assumptions based on an entity's expectations when an entity has little or no observable or comparable information about the assumptions that marketplace participants would use in assessing the fair value of that liability. In that situation, an entity must necessarily use information that is available without undue cost and effort in developing cash flow estimates. The use of an entity's own assumptions about future cash flows is compatible with an estimate of fair value provided that there are no contrary data indicating that marketplace participants would use different assumptions. If an entity is aware that its future cash flows will differ from those that are prevalent in the market, it must adjust its assumptions to incorporate

[12]Present value is the current measure of an estimated future cash inflow or outflow, discounted at an interest rate for the number of periods between today and the date of the estimated cash flow. The present value of $X due n periods in the future and discounted at interest of i per period is computed using the formula
$X \div (1 + i)^n$.

that market information in the cash flows it uses to estimate fair value. For example, if an entity's labor costs are lower than or higher than labor costs in the market, it must adjust the labor costs used in estimating cash flows to reflect the market amounts.

18. In estimating the fair value of a liability for an asset retirement obligation using an expected present value technique, an entity shall begin by estimating a set of cash flows that reflect, to the extent possible, a marketplace assessment of the cost and timing of performing the required retirement activities. In estimating those cash flows, an entity shall develop and incorporate explicit assumptions about all of the following:

a. The costs that a third party[13] would incur in performing the tasks necessary to retire the asset
b. Other amounts that a third party would include in determining the price of settlement, including, for example, inflation, overhead, equipment charges, profit margin, advances in technology, and offsetting cash inflows, if any
c. The extent to which the amount of a third party's costs or the timing of its costs would vary under different future scenarios and the relative probabilities of those scenarios
d. The price that a third party would demand and could expect to receive for bearing the uncertainties and unforeseeable circumstances inherent in the obligation, sometimes referred to as a market risk premium.

19. An entity shall discount the estimated cash flows resulting from the application of paragraph 18 using a *credit-adjusted risk-free rate* that equates to a risk-free interest rate adjusted for the effect of its credit standing.[14] The risk-free interest rate is the interest rate on monetary assets that are essentially risk free and that have maturity dates that coincide

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[13]In this context, a third party is meant to encompass participants (or hypothetical participants) that provide settlement of asset retirement obligations in a market.

[14]In determining the adjustment for the effect of its credit standing an entity should consider the effects of all terms, collateral, and existing guarantees that would affect the amount required to settle the liability.

with the expected timing of the estimated cash flows required to satisfy the asset retirement obligation.[15]

20. A liability for an asset retirement obligation may be incurred over more than one reporting period. Any incremental liability incurred in a reporting period shall be considered to be a separate liability for the purposes of applying paragraphs 13–19. Appendix B, Example 3 illustrates the measurement of a liability incurred over more than one reporting period.

Subsequent Recognition and Measurement

21. In periods subsequent to initial measurement, an entity shall recognize period-to-period changes in a liability for an asset retirement obligation resulting from (a) the passage of time and (b) revisions to either the timing or the amount of estimated cash flows. Those changes shall be incorporated into the carrying amount of the liability recognized in the financial statements. An entity shall incorporate a change due to the passage of time into the carrying amount of the liability before it measures a change in that liability resulting from a revision to either the timing or amount of estimated cash flows.

22. Changes due to the passage of time shall be recognized as an increase in the carrying amount of the liability and as a period cost classified as interest expense in the financial statements. That interest expense shall not be considered to be interest cost for purposes of applying FASB Statement No. 34, *Capitalization of Interest Cost*.

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[15]In the United States, the risk-free rate is the rate for zero-coupon U.S. Treasury instruments.

23. Changes resulting from revisions to the timing or amount of estimated cash flows shall be recognized as an increase or a decrease in (a) the carrying amount of the liability for an asset retirement obligation and (b) the related asset retirement cost capitalized as part of the carrying amount of the related long-lived asset.

24. An entity shall measure changes in the liability for an asset retirement obligation due to the passage of time by applying an interest method of allocation.[16] The objective of that measurement is to determine a periodic cost that represents a level effective interest rate applied to the carrying amount of the liability at the beginning of each period. The interest rate used to measure changes due to the passage of time shall be the credit-adjusted risk-free rate or rates applied when the liability, or portion thereof, was initially measured.

25. Revisions in the timing or amount of estimated cash flows change the initial estimate of the amount of liability. The rate to be used in measuring a change resulting from a revision in the timing or amount of estimated cash flows shall be the credit-adjusted risk-free rate(s) applied to the estimated cash flows in the period(s) in which the liability was initially measured.[17] If a liability is incurred over more than one reporting period and it is not practicable to separately identify the period to which a revision in estimated cash flows

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[16]The subsequent measurement provisions require an entity to identify undiscounted estimated cash flows associated with the initial measurement of a liability. Therefore, an entity that obtains an initial measurement of fair value from a market price must determine the undiscounted cash flows that are embedded in that price for purposes of applying the subsequent measurement provisions. Appendix D includes an example of the subsequent measurement of a liability that is initially obtained from a market price.

[17]A change in the requirements of a law, statute, or contract that affects the amount of an existing liability (underlying obligation) is considered to result in a revision in the timing or amount of the cash flows that were used to initially measure that liability or portions thereof. Therefore, revisions in cash flow estimates resulting from those types of changes should be discounted using the credit-adjusted risk-free rate(s) applied to the initial measurement of the underlying obligation.

relates, an entity may use a weighted-average credit-adjusted risk-free rate to measure a change in the liability resulting from that revision.

26. When an entity recognizes and measures a change in the carrying amount of a long-lived asset pursuant to the provisions of paragraphs 23 and 25, it shall adjust the amount of asset retirement cost allocated to expense in the period of change if the change affects that period only or in the period of change and future periods if the change affects both.[18]

Effects of Funding and Assurance Provisions

27. An entity may be required to provide assurance that it will be able to satisfy its asset retirement obligation. Methods of providing assurance include surety bonds, insurance policies, letters of credit, guarantees by other entities, and establishment of trust funds or identification of other assets dedicated to satisfy the asset retirement obligation. Providing assurance does not satisfy or extinguish the related liability. Accordingly, the reported amount of a liability for an asset retirement obligation shall not be reduced because of compliance with any assurance provisions. However, the effects of those provisions should be considered in adjusting the risk-free interest rate for the effect of the entity's credit standing to arrive at the credit-adjusted risk-free rate required by paragraph 19.

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[18]In other words, the amount of asset retirement cost allocated to expense is accounted for as a change in estimate as discussed in paragraph 31 of APB Opinion No. 20, *Accounting Changes*.

Rate-Regulated Entities

28. Paragraphs 29 and 30 of this Statement apply to a rate-regulated entity that meets the criteria for application of FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* as provided in paragraph 5 of that Statement. Paragraphs 9 and 11 of Statement 71 provide specific conditions that must be met to recognize a regulatory asset and a regulatory liability, respectively.

29. Many rate-regulated entities currently provide for the costs related to the retirement of certain long-lived assets in their financial statements and recover those amounts in rates charged to their customers. Some of those costs result from asset retirement obligations within the scope of this Statement; others result from costs that are not within the scope of this Statement. The amounts charged to customers for the costs related to the retirement of long-lived assets may differ from the period costs recognized in accordance with this Statement and, therefore, may result in a difference in the timing of recognition of period costs for financial reporting and rate-making purposes. An additional timing difference may exist when the costs related to the retirement of long-lived assets are included in amounts charged to customers but liabilities are not recognized in the financial statements. If the requirements of Statement 71 are met, a regulated entity also shall recognize a regulatory asset or liability for differences, if any, in the timing of recognition of the period costs associated with asset retirement obligations for financial reporting and rate-making purposes.

30. The capitalized amount of an asset retirement cost shall be included in the assessment of impairment of long-lived assets of a rate-regulated entity just as that cost is included in

the assessment of impairment of long-lived assets of any other entity. FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs,* applies to the asset retirement cost related to a long-lived asset of a rate-regulated entity that has been closed or abandoned.

Disclosures

31. An entity shall disclose the following information about its asset retirement obligations:

a. A general description of the asset retirement obligations and the associated long-lived assets
b. A description of how the fair value of the liability for asset retirement obligations was determined, for example, by using an expected present value technique or some other valuation technique
c. The funding policy, if any, for asset retirement obligations
d. The fair value of assets, if any, dedicated to satisfy the liability
e. A reconciliation of the beginning and ending aggregate carrying amount of the liability showing separately the changes attributable to (1) the liability incurred in the current period, (2) the liability settled in the current period, (3) interest expense, and (4) revisions in expected cash flows
f. An explanation of any significant changes in the asset retirement obligations not otherwise apparent in other disclosures required by this Statement.

Amendment to Existing Pronouncement

32. Paragraph 37 of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies,* is replaced by the following:

> Obligations for dismantlement, restoration, and abandonment costs shall be accounted for in accordance with the provisions of FASB Statement No. XXX, *Accounting for Obligations Associated with the Retirement of Long-Lived Assets.* Estimated residual salvage values shall be taken into account in determining amortization and depreciation rates.

Effective Date and Transition

33. This Statement shall be effective for financial statements issued for fiscal years beginning after June 15, 2001. Earlier application is encouraged. Initial application of this Statement shall be as of the beginning of an entity's fiscal year. If this Statement is adopted prior to the effective date and during an interim period other than the first interim period of a fiscal year, all prior interim periods of that fiscal year shall be restated.

34. Upon initial application of this Statement, an entity shall recognize the following items in its statement of financial position as if the provisions of this Statement had been in effect when a liability was incurred: (a) a liability for any existing asset retirement obligations adjusted for cumulative interest to the date of adoption of this Statement, (b) an asset retirement cost capitalized as an increase to the carrying amount of the associated long-lived asset, and (c) accumulated depreciation on that capitalized cost.[19] Amounts resulting from initial application of this Statement shall be measured using current (as of the date of adoption of this Statement) information, current assumptions, and current interest rates.

35. An entity shall recognize the cumulative effect of initially applying this Statement as a change in accounting principle as described in paragraph 20 of APB Opinion No. 20, *Accounting Changes*. The amount to be reported as a cumulative-effect adjustment in the statement of operations is the difference between the amounts, if any, recognized in the

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[19]Cumulative interest and accumulated depreciation shall be measured for the time period from (a) the date the liability would have been recognized had the provisions of this Statement been in effect to (b) the date that this Statement is first applied.

statement of financial position prior to the application of this Statement (for example, under the provisions of Statement 19) and the net amount that is recognized in the statement of financial position pursuant to paragraph 34.

36. In addition to disclosures required by paragraphs 19(c), 19(d), and 21 of Opinion 20,[20] an entity shall compute on a pro forma basis and disclose on the face of the statement of financial position for the beginning of the earliest year presented and the end of all years presented the amount of liability for asset retirement obligations as if this Statement had been applied during all periods affected. As required by paragraph 34 of this Statement, the pro forma amounts of that liability shall be measured using current information, current assumptions, and current interest rates Appendix C provides examples that illustrate application of the transition provisions of this Statement.

The provisions of this Statement need not be applied to immaterial items.

[20]Opinion 20 requires an entity to disclose the effect, if any, of adopting a new accounting principle on income before extraordinary items and on net income (and on the related per-share amounts) of the period of the change. In addition, it requires an entity to compute on a pro forma basis and disclose on the face of the income statements for all periods presented income before extraordinary items and net income (and the related per-share amounts) as if the newly adopted accounting principle had been applied during all periods affected.

plan assets and liabilities. This Statement provides for immediate recognition of changes in liabilities for asset retirement obligations and of changes in certain assets dedicated to satisfy those obligations that are subject to the provisions of FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Therefore, the Board decided that it should not provide an exception to the general principle for offsetting in this Statement.

109. FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,* requires that a liability be derecognized if and only if either the debtor pays the creditor and is relieved of its obligation for the liability or the debtor is legally released from being the primary obligor under the liability. Therefore, a liability is not considered extinguished by an in-substance defeasance.

Rate-Regulated Entities

110. The Board considered how existing rate-making practices for entities subject to FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation,* would affect the accounting by those entities for costs related to asset retirement obligations. The way in which those costs are treated for financial reporting purposes and the way in which they are treated for rate-making purposes often differ. The most common differences arise from different estimates by the entity and its regulator of the future cost of asset retirement activities. Those differences may relate to the estimates of the cost of performing asset retirement activities or the assumptions necessary to develop the estimated future cash flows required to satisfy those obligations. In addition, an entity may

make revisions to its estimate of the obligation before a regulator considers those revisions in setting the entity's rates.

111. Statement 71 requires, subject to meeting certain criteria, that the timing of recognition of certain revenues and expenses for financial reporting purposes conform to decisions or probable decisions of regulators responsible for setting the entity's rates. Because the practices of those regulators for allowing costs related to asset retirement activities are well established, the Board did not consider any future changes in those practices. The Board considered specific issues arising from current rate-making practices about the recognition of regulatory assets or liabilities for differences, if any, in the timing of recognition of costs for financial reporting and rate-making purposes. The Board also considered the appropriate method for recognition and measurement of impairment of the capitalized amount of an asset retirement cost.

112. An entity is responsible for developing timely and reasonably accurate estimates of the cash flows related to asset retirement obligations. That responsibility is inherent in the preparation of external financial statements and may be a part of the entity's reporting to others in connection with its asset retirement obligations. The regulator that sets the entity's rates has a responsibility to both the entity and its customers to establish rates that are just and reasonable. Sometimes the responsibilities of the regulator and those of the regulated entity conflict, producing differences in the estimated costs related to asset retirement obligations as discussed in paragraph 110. Statement 71, as amended, specifies the general criteria for the recognition of regulatory assets and liabilities that result from differences, if any, in the timing of recognition of costs for financial reporting and rate-

making purposes. FASB Statement No. 92, *Regulated Enterprises—Accounting for Phase-in Plans,* establishes more restrictive criteria for the recognition of regulatory assets in certain situations.

113. The Board considered whether the general principles of Statement 71 should apply or whether specific criteria similar to those in Statement 92 should apply to the recognition of regulatory assets and liabilities that result from the circumstances described in paragraph 111. The Board concluded that judgment would be required in recognizing regulatory assets and liabilities because of the many reasons for differences between the obligations and costs related to asset retirement obligations recognized for financial reporting and those considered for rate-making purposes. Therefore, the Board decided that the general principles in Statement 71 should be applied in recognizing regulatory assets and liabilities for those differences.

114. The Board also considered the appropriate method for recognition and measurement of impairment of assets that include capitalized asset retirement costs for entities subject to Statement 71. In FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* the Board considered the issues of recognition and measurement of impairment of long-lived assets of rate-regulated entities. The Board concluded that no additional guidance was needed for recognition and impairment of capitalized assets that include capitalized retirement costs for rate-regulated entities.

115. Paragraph 12 of this Statement requires that capitalized asset retirement costs be included in the assessment of impairment of long-lived assets. In recent years, several

nuclear power plants have ceased operations, and the method and timing of their nuclear decommissioning are being considered. Some of those plants reached the end of their expected useful lives, and others closed prior to the end of their expected useful lives. The actual decommissioning may begin immediately after plant closure or it may be deferred until some future time. In either case, the Board decided that FASB Statement No. 90, *Regulated Enterprises—Accounting for Abandonments and Disallowances of Plant Costs,* should apply to asset retirement costs recognized under the provisions of this Statement in the same way that it applies to other costs of closed or abandoned facilities of rate-regulated entities.

116. Many rate-regulated entities currently provide for the costs related to asset retirement obligations in their financial statements and recover those amounts in rates charged to their customers. Some of those costs relate to asset retirement obligations within the scope of this Statement; others are not within the scope of this Statement and, therefore, cannot be recognized as liabilities under its provisions. The objective of including those amounts in rates currently charged to customers is to allocate costs to customers over the lives of those assets. The amount charged to customers is adjusted periodically to reflect the excess or deficiency of the amounts charged over the amounts incurred for the retirement of long-lived assets. The Board concluded that if asset retirement costs are charged to customers of rate-regulated entities but no liability is recognized, a regulatory liability should be recognized if the requirements of Statement 71 are met.