Financial Accounting Standards Board

ORIGINAL PRONOUNCEMENTS

AS AMENDED

FASB Interpretation No. 47

Accounting for Conditional Asset Retirement Obligations

an interpretation of FASB Statement No. 143

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FASB Interpretation No. 47
Accounting for Conditional Asset Retirement Obligations

an interpretation of FASB Statement No. 143

STATUS

Issued: March 2005

Effective Date: No later than the end of fiscal years ending after December 15, 2005; retrospective application for interim financial information is permitted but not required

Affects: No other pronouncements

Affected by: No other pronouncements

SUMMARY

This Interpretation clarifies that the term *conditional asset retirement obligation* as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. The fair value of a liability for the conditional asset retirement obligation should be recognized when incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists. Statement 143 acknowledges that in some cases, sufficient information may not be available to reasonably estimate the fair value of an asset retirement obligation. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

Reason for Issuing This Interpretation

Diverse accounting practices have developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement of the obligation are conditional on a future event. For example, some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the liability's fair value. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired. This Interpretation clarifies that an entity is required to recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. Questions also arose about when sufficient information may not be available to make a reasonable estimate of the fair value of an asset retirement obligation. This Interpretation clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

How This Interpretation Will Improve Financial Reporting

Application of this Interpretation will result in (a) more consistent recognition of liabilities relating to asset retirement obligations, (b) more information about expected future cash outflows associated with those obligations, and (c) more information about investments in long-lived assets because additional asset retirement costs will be recognized as part of the carrying amounts of the assets.

How the Conclusions in This Interpretation Relate to the Conceptual Framework

FASB Concepts Statement No. 6, *Elements of Financial Statements,* states that "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." The Board concluded that asset retirement obligations within the scope of Statement 143 that meet the definition of a liability in Concepts Statement 6 should be recognized as a liability at fair value if fair value can be reasonably estimated. The Board believes that when an existing law, regulation, or contract requires an entity to perform an asset retirement activity, an unambiguous requirement to perform the retirement activity exists, even if that activity can be deferred indefinitely. At some point, deferral is no longer possible, because no tangible asset will last forever (except land). Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. The use of an expected value technique to measure the fair value of the liability reflects any uncertainty about the amount and timing of future cash outflows. The clarification of when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation should improve the relevance, reliability, and comparability of the amounts recognized in the financial statements.

The Effective Date of This Interpretation

This Interpretation is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). Retrospective application for interim financial information is permitted but is not required. Early adoption of this Interpretation is encouraged.

FASB Interpretation No. 47
Accounting for Conditional Asset Retirement Obligations

an interpretation of FASB Statement No. 143

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INTRODUCTION

1. Paragraph 3 of FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* states, "An entity shall recognize the fair value of a liability for an asset retirement obligation in the period in which it is incurred if a reasonable estimate of fair value can be made."[1] Diverse accounting practices have developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement are conditional on a future event. For example, some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the liability's fair value. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired. Questions also arose about when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

INTERPRETATION

2. Statement 143 applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, except as explained in paragraph 17 of that Statement for certain obligations of lessees. The term *retirement*[2] encompasses sale, abandonment, recycling, or disposal in some other manner.

3. The term *conditional asset retirement obligation* as used in paragraph A23 of Statement 143 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Thus, the timing and (or) method of settlement may be conditional on a future event. Accordingly, an entity shall recognize a liability for the fair value of a conditional asset retirement obligation if the fair value of the liability can be reasonably estimated. Statement 143 requires an entity to recognize the fair value of a legal obligation to perform asset retirement activities when the obligation is incurred—generally upon acquisition, construction, or development and (or) through the normal operation of the asset.

[1][Under Statement 143,] if a tangible long-lived asset with an existing asset retirement obligation is acquired, a liability for that obligation shall be recognized at the asset's acquisition date as if that obligation were incurred on that date.

[2]In Statement 143, the term *retirement* is defined as the other-than-temporary removal of a long-lived asset from service. The term does not encompass the temporary idling of a long-lived asset.

4. An entity shall identify all its asset retirement obligations. If an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation, it must recognize a liability at the time the liability is incurred. An asset retirement obligation would be reasonably estimable if (a) it is evident that the fair value of the obligation is embodied in the acquisition price of the asset,[3] (b) an active market exists for the transfer of the obligation, or (c) sufficient information exists to apply an expected present value technique.[4] An expected present value technique incorporates uncertainty about the timing and method of settlement into the fair value measurement. However, in some cases, sufficient information about the timing and (or) method of settlement may not be available to reasonably estimate fair value. Examples 1 and 2 in Appendix A illustrate the application of this Interpretation when an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation at the time the obligation is incurred.

5. An entity would have sufficient information to apply an expected present value technique and therefore an asset retirement obligation would be reasonably estimable if either of the following conditions exists:

a. The settlement date and method of settlement for the obligation have been specified by others. For example, the law, regulation, or contract that gives rise to the legal obligation specifies the settlement date and method of settlement. In this situation, the settlement date and method of settlement are known and therefore the only uncertainty is whether the obligation will be enforced (that is, whether performance will be required). Uncertainty about whether performance will be required does not defer the recognition of an asset retirement obligation because a legal obligation to stand ready to perform the retirement activities still exists, and it does not prevent the determination of a reasonable estimate of fair value because the only uncertainty is whether performance will be required.[5] In certain cases, determining the settlement date for the obligation that has been specified by others is a matter of judgment that depends on the relevant facts and circumstances.[6]
b. The information is available to reasonably estimate (1) the settlement date or the range of potential settlement dates, (2) the method of settlement or potential methods of settlement,[7] and (3) the probabilities associated with the potential settlement dates and potential methods of settlement.[8] Examples of information that is expected to provide a basis for estimating the potential settlement dates, potential methods of settlement, and the associated probabilities include, but are not limited to, information that is derived from the entity's past practice, industry practice, management's intent, or the asset's estimated economic life.[9] In many cases, the determination as to whether the entity has the information to reasonably estimate the fair value of the asset retirement

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[3]Paragraph 17 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements,* states, "If a price for an asset or liability or an essentially similar asset or liability can be observed in the marketplace, there is no need to use present value measurements. The marketplace assessment of present value is already embodied in such prices."

[4]If the fair value of the liability cannot be estimated based on the acquisition price or on an observable market price, the entity should apply the present value techniques discussed in paragraphs 39–54 and 75–88 of Concepts Statement 7. Paragraph 5 of this Interpretation discusses those situations in which an entity would have sufficient information to apply an expected present value technique.

[5]There are two possible outcomes in situations in which the only uncertainty is whether performance will be required—the entity will be required to perform or the entity will not be required to perform. If there is no information about which outcome is more probable, paragraph A23 of Statement 143 requires a 50 percent likelihood for each outcome to be used until additional information is available.

[6]For example, a contract that provides the entity with an ability to extend its term through renewal should be evaluated to determine whether the settlement date should take into consideration renewal periods.

[7]The term *potential methods of settlement* refers to methods of settling the obligation that are currently available to the entity. Therefore, uncertainty about future methods yet to be developed would not prevent the entity from estimating the fair value of the asset retirement obligation.

[8]The entity should have a reasonable basis for assigning probabilities to the potential settlement dates and potential methods of settlement to reasonably estimate the fair value of the asset retirement obligation. If the entity does not have a reasonable basis of assigning probabilities, it is expected that the entity would still be able to reasonably estimate fair value when the range of time over which the entity may settle the obligation is so narrow and (or) the cash flows associated with each potential method of settlement are so similar that assigning probabilities without having a reasonable basis for doing so would not have a material impact on the fair value of the asset retirement obligation.

[9]The estimated economic life of the asset might indicate a potential settlement date for the asset retirement obligation. However, the original estimated economic life of the asset may not, in and of itself, establish that date because the entity may intend to make improvements to the asset that could extend the life of the asset or the entity could defer settlement of the obligation beyond the economic life of the asset. In those situations, the entity would look beyond the economic life of the asset in determining the settlement date or range of potential settlement dates to use when estimating the fair value of the asset retirement obligation.

obligation is a matter of judgment that depends on the relevant facts and circumstances.[10]

6. If sufficient information is not available at the time the liability is incurred, paragraph 3 of Statement 143 requires a liability to be recognized initially in the period in which sufficient information becomes available to estimate its fair value. Paragraph 22 of Statement 143 requires that if the liability's fair value cannot be reasonably estimated, that fact and the reasons shall be disclosed. Example 3 in Appendix A illustrates the application of this Interpretation when an entity does not have sufficient information to reasonably estimate the fair value of an asset retirement obligation. Example 4 in Appendix A illustrates the application of this Interpretation when an entity initially does not have sufficient information but later has sufficient information to reasonably estimate the fair value of an asset retirement obligation.

7. Statement 143 provides guidance for adjusting the liability for revisions to either the timing or the amount of the original estimate of undiscounted cash flows.

EFFECTIVE DATE AND TRANSITION

8. This Interpretation shall be effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). Retrospective application of interim financial information is permitted but is not required. Early adoption of this Interpretation is encouraged.

9. For amounts recognized upon the initial application of this Interpretation, an entity shall recognize the following items in its statement of financial position: (a) a liability for any existing asset retirement obligation(s) adjusted for cumulative accretion to the date of adoption of this Interpretation, (b) an asset retirement cost capitalized as an increase to the carrying amount of the associated long-lived asset(s), and (c) accumulated depreciation on that capitalized cost. Amounts resulting from initial application of this Interpretation shall be measured using current (that is, as of the date of adoption of this Interpretation) information, current assumptions, and current interest rates. The amount recognized as an asset retirement cost shall be measured as of the date the asset retirement obligation was incurred. Cumulative accretion and accumulated depreciation shall be recorded for the time period from the date the liability would have been recognized had the provisions of this Interpretation been in effect when the liability was incurred to the date of adoption of this Interpretation.

10. An entity shall recognize the cumulative effect of initially applying this Interpretation as a change in accounting principle. 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 statement of financial position prior to the application of this Interpretation and the net amount that is recognized in the statement of financial position pursuant to paragraph 9.

11. In addition to disclosures required by paragraphs 19(c), 19(d), and 21 of APB Opinion No. 20, *Accounting Changes,* an entity shall compute on a pro forma basis and disclose in the footnotes to the financial statements for the beginning of the earliest year presented and at the end of all years presented the amount of the liability for asset retirement obligations as if this Interpretation had been applied during all periods affected. The pro forma amounts of that liability shall be measured using the information, assumptions, and interest rates used to measure the obligation recognized upon adoption of this Interpretation.

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

[10]It is expected that the narrower the range of time over which the entity may settle the obligation and the fewer potential methods of settlement the entity has available to it, the more likely it is that the entity will have the information to reasonably estimate the fair value of an asset retirement obligation.

This Interpretation was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
George J. Batavick
G. Michael Crooch
Katherine Schipper
Leslie F. Seidman
Edward W. Trott
Donald M. Young

Appendix A

ILLUSTRATIVE EXAMPLES

A1. This appendix includes four examples that illustrate the application of this Interpretation specifically relating to when an entity would be required to recognize the fair value of an asset retirement obligation. The examples do not provide specific guidance for determining when an entity has sufficient information to reasonably estimate the fair value of the asset retirement obligation. The determination as to when an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation should be based on the guidance in paragraphs 4 and 5 of this Interpretation. Examples 1 and 2 illustrate the recognition provisions when an entity has sufficient information to reasonably estimate the fair value of an asset retirement obligation at the time the obligation is incurred. Example 3 illustrates the application of this Interpretation when an entity does not have sufficient information to reasonably estimate the fair value of an asset retirement obligation at the time the obligation is incurred. Example 4 illustrates the recognition provisions when an entity initially does not have sufficient information and later has sufficient information to reasonably estimate the fair value of an asset retirement obligation. The examples illustrate the initial recognition of a conditional asset retirement obligation based on the facts presented. Any differences in facts from those presented in the examples may result in different conclusions.

Example 1

A2. A telecommunications entity owns and operates a communication network that utilizes wood poles that are treated with certain chemicals. There is no legal requirement to remove the poles from the ground. However, the owner may replace the poles periodically for a number of operational reasons. Once the poles are removed from the ground, they may be disposed of, sold, or reused as part of other activities. There is existing legislation that requires special disposal procedures for the poles in the particular state in which the entity operates.

A3. At the date of purchase of the treated poles, the entity has the information to estimate a range of potential settlement dates, the potential methods of settlement, and the probabilities associated with the potential settlement dates and methods based on established industry practice. Therefore, at the date of purchase, the entity is able to estimate the fair value of the liability for the required disposal procedures using an expected present value technique.

A4. Although the timing of the performance of the asset retirement activity is conditional on removing the poles from the ground and disposing of them, existing legislation creates a duty or responsibility for the entity to dispose of the poles in accordance with special procedures, and the obligating event occurs when the entity purchases the treated poles. Although the entity may decide not to remove the poles from the ground or may decide to reuse the poles and thereby defer settlement of the obligation, the ability to defer settlement does not relieve the entity of the obligation. The poles will eventually need to be disposed of using special procedures, because the poles will not last forever. Additionally, the ability of the entity to sell the poles prior to disposal does not relieve the entity of its present duty or responsibility to settle the obligation. The sale of the poles transfers the obligation to another entity. The assumption of the obligation by the buyer affects the exchange price. The bargaining of the exchange price reflects the buyer's and seller's individual estimates of the timing and (or) amount of the cost to extinguish the obligation.

A5. The asset retirement obligation should be recognized when the entity purchases the poles because the entity has sufficient information to estimate the fair value of the asset retirement obligation. Because the legal requirement relates only to the disposal of the treated poles, the cost to remove the poles is not included in the asset retirement obligation. However, if there was a legal requirement to remove the treated poles, the cost of removal would be included.

Example 2

A6. An entity recently purchased several kilns lined with a special type of brick. As of the date of purchase, the kilns had not yet been used in any smelting processes. The kilns have a long useful life, but the bricks are replaced periodically. Because the bricks become contaminated with hazardous chemicals while the kiln is operated, a state law requires that when the bricks are removed, they must be disposed of at a special hazardous waste site. The entity has the information to estimate a range of potential settlement dates, the method of settlement, and the probabilities associated with the potential settlement dates based on its past practice of replacing the bricks to maintain the efficient operation of the kiln. Therefore, at the date the bricks become contaminated because of the operation of the kiln, the entity is able to estimate the fair value of the liability for the required disposal procedures using an expected present value technique.

A7. Although performance of the asset retirement activity is conditional on removing the bricks from the kiln, existing legislation creates a duty or responsibility for the entity to dispose of the bricks at a special hazardous waste site, and the obligating event occurs when the entity contaminates the bricks. As of the purchase date, the kilns have not yet been used in any smelting processes, and the bricks have not yet been contaminated. Therefore, at the date of purchase, no obligation exists because the bricks have not been contaminated and could be disposed of without performing any special disposal activities.

A8. The fair value of the asset retirement obligation should be recognized once the kilns have been placed into operation and the bricks are contaminated. Although the entity may decide not to remove the bricks from the kiln and thereby defer settlement of the obligation, the ability to defer settlement does not relieve the entity of the obligation. The contaminated bricks will eventually need to be removed and disposed of at a special hazardous waste site, because a kiln will not last forever. Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing of settlement. An asset retirement obligation should be recognized once the kilns have been placed into operation and the bricks are contaminated because the entity has sufficient information to estimate the fair value of the asset retirement obligation. The asset retirement obligation is the requirement to dispose of the contaminated bricks at a special hazardous waste site. The cost to remove the bricks is not part of the obligation and should be accounted for as a maintenance or replacement activity.

Example 3

A9. An entity acquires a factory that contains asbestos. After the acquisition date, regulations are put in place that require the entity to handle and dispose of this type of asbestos in a special manner if the factory undergoes major renovations or is demolished. Otherwise, the entity is not required to remove the asbestos from the factory. The entity has several options to retire the factory in the future including demolishing, selling, or abandoning it. The entity believes it does not have sufficient information to estimate the fair value of the asset retirement obligation because the settlement date or the range of potential settlement dates has not been specified by others and information is not available to apply an expected present value technique. For example, there are no plans or expectation of plans to undertake a major renovation that would require removal of the asbestos or demolition of the factory. The factory is expected to be maintained by repairs and maintenance activities that would not involve the removal of the asbestos. Also, the need for major renovations caused by technology changes, operational changes, or other factors has not been identified.

A10. Although the timing of the performance of the asset retirement activity is conditional on the factory undergoing major renovations or being demolished, existing regulations create a duty or responsibility for the entity to remove and dispose of asbestos in a special manner, and the obligating event occurs when the regulations are put in place. Therefore, an asset retirement obligation should be recognized when regulations are put in place if the entity can reasonably estimate the fair value of the liability. In this example, the entity believes that there is an indeterminate settlement date for the asset retirement obligation because the range of time over which the entity may settle the obligation is unknown or cannot be estimated. Therefore, the entity cannot reasonably estimate the fair value of the liability. Accordingly, the entity would not recognize a liability for the asset retirement obligation when regulations are put in place, but it should disclose (a) a description of the obligation, (b) the fact that a liability has not been recognized because the fair value cannot be reasonably estimated, and (c) the reasons why fair value cannot be reasonably estimated. The company would

recognize a liability in the period in which sufficient information is available to reasonably estimate its fair value.

Example 4

A11. An entity acquires a factory that contains asbestos. At the acquisition date, regulations are in place that require the entity to handle and dispose of this type of asbestos in a special manner if the factory undergoes major renovations or is demolished. Otherwise, the entity is not required to remove the asbestos from the factory. The entity has several options to retire the factory in the future including demolishing, selling, or abandoning it. At the acquisition date, it is not evident that the fair value of the obligation is embodied in the acquisition price of the factory because both the seller and the buyer of the factory believed the obligation had an indeterminate settlement date, an active market does not exist for the transfer of the obligation, and sufficient information does not exist to apply an expected present value technique. Ten years after the acquisition date, the entity obtains additional information based on changes in demand for the products manufactured at that factory. At that time, the entity has the information to estimate a range of potential settlement dates, the potential methods of settlement, and the probabilities associated with the potential settlement dates and potential methods of settlement. Therefore, at that time the entity is able to estimate the fair value of the liability for the special handling of the asbestos using an expected present value technique.

A12. Although timing of the performance of the asset retirement activity is conditional on the factory undergoing major renovations or being demolished, existing regulations create a duty or responsibility for the entity to remove and dispose of asbestos in a special manner, and the obligating event occurs when the entity acquires the factory.[11] Although the entity may decide to abandon the factory and thereby defer settlement of the obligation for the foreseeable future, the ability to defer settlement does not relieve the entity of the obligation. The asbestos will eventually need to be removed and disposed of in a special manner, because no building will last forever. Additionally, the ability of the entity to sell the factory does not relieve the entity of its present duty or responsibility to settle the obligation. The sale of the asset would transfer the obligation to another entity and that transfer would affect the selling price. Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and method of settlement.

A13. In this example, an asset retirement obligation is not recognized when the entity acquires the factory because the entity does not have sufficient information to estimate the fair value of the obligation. The entity would disclose (a) a description of the obligation, (b) the fact that a liability has not been recognized because the fair value cannot be reasonably estimated, and (c) the reasons why fair value cannot be reasonably estimated. An asset retirement obligation would be recognized by this entity 10 years after the acquisition date because that is when the entity has sufficient information to estimate the fair value of the asset retirement obligation.

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[11]In this example, regulations are in place at the date of acquisition that require the entity to handle and dispose of the asbestos in a special manner. Therefore, the obligating event is the acquisition of the factory. If regulations were enacted after the date of acquisition, the obligating event would be the enactment of the regulations. Refer to Example 3.

Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

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Appendix B

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

B1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Interpretation. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background

B2. Diverse accounting practices have developed with respect to the timing of liability recognition for legal obligations associated with the retirement of a tangible long-lived asset when the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. Some entities recognize the fair value of the obligation prior to the retirement of the asset with the uncertainty about the timing and (or) method of settlement incorporated into the liability's fair value. Other entities recognize the fair value of the obligation only when it is probable the asset will be retired as of a specified date using a specified method or when the asset is actually retired.

B3. The FASB staff issued a proposed FASB Staff Position (FSP) FAS 143-x, "Applicability of FASB Statement No. 143, *Accounting for Asset Retirement Obligations,* to Legislative Requirements on Property Owners to Remove and Dispose of Asbestos or Asbestos-Containing Materials," in July 2003. That proposed FSP concluded:

a. The enactment or existence of asbestos legislation creates a duty or responsibility to remove and dispose of asbestos.
b. If such legislation already exists, the obligating event is the acquisition (or construction) of the asset, or if the asset is owned when that legislation is enacted, then the enactment of the legislation is the obligating event.
c. An entity should recognize a liability for this obligation when the obligating event occurs.

B4. The FASB staff evaluated the comment letters received on that proposed FSP. Because of the diverse views expressed and constituents' concerns that there is a broader issue underlying the issue addressed in the proposed FSP, the FASB staff withdrew that proposed FSP. The FASB staff confirmed the diversity in practice with a questionnaire to selected constituents. Because of the diversity in practice and constituents' concern about the broader nature of this issue, the Board added a project to its agenda to address the issue of whether Statement 143 requires an entity to recognize a liability for a legal obligation to perform asset retirement activities when

the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity and, if so, the timing of that recognition.

B5. On June 17, 2004, the Board issued an Exposure Draft, *Accounting for Conditional Asset Retirement Obligations*. The Board received 34 comment letters on the Exposure Draft. The Board considered all comments and concerns raised by respondents and constituents during its redeliberations of the issues addressed by the Exposure Draft in a public meeting in August 2004. This Interpretation reflects the results of those deliberations. The Board received comments requesting that the Board reconsider Statement 143 in its entirety. At a public meeting in January 2005, the Board decided not to reconsider Statement 143. The Board decided to provide additional guidance for evaluating whether sufficient information is available to reasonably estimate the fair value of an asset retirement obligation.

Objective of This Interpretation

B6. The objective of this Interpretation is to clarify that the term *conditional asset retirement obligation* as used in Statement 143 refers to a legal obligation to perform an asset retirement activity in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. In this situation, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Accordingly, an entity should recognize a liability for the fair value of a conditional asset retirement obligation when incurred if the fair value of the liability can be reasonably estimated. This Interpretation also clarifies when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation.

Scope

B7. Statement 143 applies to legal obligations associated with the retirement of a tangible long-lived asset that result from the acquisition, construction, or development and (or) the normal operation of a long-lived asset, except as explained in paragraph 17 of Statement 143. As used in Statement 143, a legal obligation is an obligation that a party is required to settle as a result of an existing or enacted law, statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel. As discussed in paragraphs A2–A5 of Statement 143, whether a legal obligation exists will usually be unambiguous. However, questions arose about whether a liability should be recognized when a legal obligation exists but the timing and (or) method of settlement are conditional on future events. Based on diversity in practice and the broad nature of this issue, the Board decided that this Interpretation should apply to all entities that have legal obligations to perform asset retirement activities in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity.

B8. During the redeliberations of this Interpretation, questions also arose about when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. Paragraph A20 of Statement 143 states that "it is expected that uncertainties about the amount and timing of future cash flows can be accommodated by using the expected cash flow technique and therefore will not prevent the determination of a reasonable estimate of fair value." Some constituents believe paragraph A20 contradicts paragraph 3 of Statement 143, which states that "if a reasonable estimate of fair value cannot be made in the period the asset retirement obligation is incurred, the liability shall be recognized when a reasonable estimate of fair value can be made." As a result, the Board decided that this Interpretation should clarify that uncertainties about the amount and timing of future cash flows can be accommodated by using the expected cash flow technique when sufficient information exists. The Board decided to provide additional guidance in this Interpretation for evaluating whether sufficient information is available to reasonably estimate the fair value of an asset retirement obligation.

Recognition of a Liability for a Conditional Asset Retirement Obligation

Characteristics of a Liability

B9. FASB Concepts Statement No. 6, *Elements of Financial Statements,* 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." *Probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in FASB Statement No. 5, *Accounting for*

Contingencies), 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. Its inclusion in the definition is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty. The Board concluded that all asset retirement obligations within the scope of Statement 143 that meet the definition of a liability in Concepts Statement 6 should be recognized as liabilities if the fair value of the liabilities can be reasonably estimated.

B10. Concepts Statement 6 states that a liability has three essential characteristics. The first characteristic of a liability is that an entity has a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand. A duty or responsibility becomes a present duty or responsibility when an obligating event occurs that leaves the entity little or no discretion to avoid a future transfer or use of assets. A present duty or responsibility does not mean that the obligation must be satisfied immediately. Rather, if events or circumstances have occurred that give an entity little or no discretion to avoid a future transfer or use of assets, that entity has a present duty or responsibility. If an entity is required by current laws, regulations, or contracts to settle an asset retirement obligation upon retirement of the asset, that requirement imposes a present duty.

B11. The second characteristic of a liability is that the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice. The ability of an entity to indefinitely defer settlement of an asset retirement obligation does not provide the entity discretion to avoid the future sacrifice, nor does it relieve the entity of the obligation. Implicit in this conclusion is the belief that no tangible asset will last forever (except land) and, accordingly, the asset retirement activities will eventually be performed. Furthermore, the ability of an entity to sell the asset prior to its disposal does not relieve the entity of its present duty or responsibility to settle the obligation. In paragraph B47 of Statement 143, the Board noted that "if the asset for which there is an associated asset retirement obligation were to be sold, the price a buyer would consent to pay for that asset would reflect an estimate of the fair value of the asset retirement obligation. Because that asset retirement obligation meets the definition of a liability, however, the Board believes that reporting it as a liability with a corresponding increase in the carrying amount of the asset for the asset retirement costs, which has the same net effect as incorporating the fair value of the costs to settle the liability in the valuation of the asset, is more representationally faithful and in concert with Concepts Statement 6."

B12. The third characteristic of a liability is that the event obligating the entity has already occurred. The definition of a liability distinguishes between present obligations and future obligations. Only present obligations are liabilities under the definition, and they are liabilities of a particular entity as a result of the occurrence of transactions or other events affecting the entity. Identifying the obligating event may be difficult in situations that involve a series of transactions or other events affecting the entity. For example, in the case of an asset retirement obligation, a law or an entity's promise may create a duty or responsibility, but that law or promise in and of itself may not be the obligating event that results in an entity having little or no discretion to avoid a future transfer or use of assets. Statement 143 states that the obligating event is the acquisition, construction, or development and (or) the normal operation of the long-lived asset when a law or promise exists that creates a duty or responsibility relating to the retirement of the asset. At this point, the obligation cannot be realistically avoided if the asset is operated for its intended use. The obligating event does not depend on the ultimate retirement of the asset.

B13. A number of respondents to the Exposure Draft questioned the view that conditional asset retirement obligations require "probable future sacrifices of economic benefits." Although Concepts Statement 6 does not use the Statement 5 definition of probable in its definition of a liability (as discussed in paragraph 5 of Statement 143), these respondents suggested that a Statement 5 definition be used for evaluating when an asset retirement obligation should be recognized. The Board considered this issue in both its deliberations and its redeliberations of Statement 143 and decided not to use the Statement 5 definition for the same reasons discussed in paragraph B17 of this Interpretation. In addition, in developing Statement 143, the Board decided that incorporating uncertainty in the measurement attribute (fair value) results in higher quality financial reporting than incorporating uncertainty into the timing of the recognition of the asset retirement obligation, if sufficient information exists to develop a reasonable estimate of fair value.

B14. Other respondents suggested that the obligating event, and therefore the recognition of a conditional asset retirement obligation, occurs when a decision or event provides more certainty about the timing and method of settlement of the obligation. In deliberating Statement 143, the Board considered the following alternatives for the obligating event: (a) the existence of law or an entity's promise to do something, (b) the creation of the situation that the law or promise relates to (for example, contamination or acquisition of the asset), and (c) events that would trigger the settlement of the obligation (for example, demolishment). The Board decided that the existence of a law or promise, combined with the creation of the situation that the law or promise relates to, provides the obligating event as described in paragraph B31 of Statement 143. Thus, if sufficient information exists, any uncertainty about the timing of the event that would trigger the settlement of the obligation should affect the measurement of the liability rather than the timing of recognition of the obligation. Although the timing and (or) method of settlement of the asset retirement obligation may depend on events that will occur after the obligating event has occurred, an obligation still exists. Therefore, conditional asset retirement obligations are within the scope of Statement 143 as discussed in paragraphs A17 and A18 of Statement 143, and a liability must be recognized before the event that requires performance occurs. This Interpretation clarifies that point.

Uncertainty and the Fair Value Measurement Objective

B15. This Interpretation is consistent with the fair value measurement objective of Statement 143. During the deliberations of Statement 143, the Board concluded that the initial measurement objective for an asset retirement obligation is fair value. The Board acknowledged that liability recognition under a fair value measurement objective differs from recognition under Statement 5, which requires an entity to consider uncertainty in its determination of whether to recognize a liability. In contrast, Statement 143 requires an entity to consider uncertainty in its fair value measurement of the liability when sufficient information exists to develop a reasonable estimate. Because of the Board's decision that the initial measurement objective is fair value and, therefore, uncertainty is considered in the measurement of the liability, the guidance in Statement 5 is not applicable.

B16. To assist in understanding the differences between the fair value approach and the Statement 5 approach, the Board provided the following explanation in paragraph B36 of Statement 143:

> The objective of recognizing the fair value of an asset retirement obligation will result in recognition of some asset retirement obligations for which the likelihood of future settlement, although more than zero, is less than probable from a Statement 5 perspective. A third party would charge a price to assume an uncertain liability even though the likelihood of a future sacrifice is less than probable. . . . Thus, this Statement does not retain the criterion . . . that a future transfer of assets associated with the obligation is probable for recognition purposes. [Footnote reference omitted.]

B17. Additionally, the Board specifically addressed conditional obligations in paragraph A17 of the implementation guidance for Statement 143 and concluded, consistent with the fair value measurement objective, that an entity should recognize a liability for a legal obligation to perform asset retirement activities in which the timing and (or) method of settlement are conditional on a future event. The implementation guidance for Statement 143 also provides an example in which a third party has the right to require an entity to perform asset retirement activities; however, uncertainty exists as to whether the third party will require performance. Some have interpreted that example to mean that the Board intended for conditional obligations to be recognized only when a third party could require performance, not when the timing and method of settlement are at least partly under the control of the entity. However, the Board concluded that although the timing and method of settlement of the retirement obligation may depend on future events that may or may not be within the control of the entity, a legal obligation to stand ready to perform retirement activities still exists. The entity should consider the uncertainty about the timing and method of settlement in the measurement of the liability, consistent with a fair value measurement objective, regardless of whether the event that will trigger the settlement is partially or wholly under the control of the entity.

B18. A number of respondents questioned why the Board believes that financial reporting is improved by incorporating uncertainty in measurement by recording the liability initially at fair value, rather than by using as the recognition trigger a high probability that a transfer or use of assets will occur, combined

with the ability to measure the ultimate settlement amount of the retirement obligation. Fair value is not an estimate of the ultimate settlement amount or the present value of an estimate of the ultimate settlement amount. Paragraph 7 of Statement 143 states that "the fair value of a liability for an asset retirement obligation is the amount at which that liability could be settled in a current transaction between willing parties, that is, other than in a forced or liquidation transaction." Fair value reflects uncertainty, as of the initial recognition date, about the timing, method, and ultimate amount of the asset retirement settlement. A single best estimate of the settlement outcome, or the bottom of a range of possible ultimate settlement outcomes as required by Statement 5 and FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* does not reflect that uncertainty. Using a higher level of certainty as to the ultimate settlement amount as a trigger for recognition in the balance sheet (and consequently in the income statement) would delay recognition of the asset retirement obligation, and thereby reduce the information content of the financial statements. Uncertainty about the timing and method of settling the existing obligation is information that should be reflected in the amounts recognized in the financial statements. In developing Statement 143, the Board concluded that not recognizing the liability and providing the Statement 5 disclosures for a contingent loss is not an adequate substitute for recognizing the fair value of the obligation.

Uncertainty about the timing and method of settlement

B19. Some respondents to the Exposure Draft of Statement 143 questioned whether asset retirement obligations with indeterminate settlement dates or asset retirement obligations with multiple methods of settlement are within the scope of the Statement. In developing Statement 143, the Board decided that uncertainty about the timing and (or) method of settlement does not change the fact that an entity has a legal obligation. The Board acknowledged in paragraph A16 of Statement 143 that measurement of an existing obligation might not be possible if insufficient information exists about the timing and method of settlement of that obligation. However, information about the timing and method of settlement of an asset retirement obligation will become available as time goes by. The Board decided that an entity should measure and recognize the fair value of an asset retirement obligation when enough information is available to develop assumptions about the potential timing and amounts of cash flows.

B20. Some respondents to the Exposure Draft of the Interpretation requested specific criteria for determining when it would not be possible to reasonably estimate the fair value of an asset retirement obligation. The Board decided to provide general guidelines rather than specific criteria because the determination of whether a reasonable estimate can be made is a matter of judgment. Additionally, each situation is unique and providing specific criteria would not encompass all possible situations. The Board discussed situations that might lead to a conclusion that sufficient information does not exist to estimate the fair value of an asset retirement obligation.

B21. The Board believes that an entity would have sufficient information to apply a present value technique if the timing and method of settlement are specified by others. In these situations, the only uncertainty is whether performance will be required. As explained in paragraphs A17 and A18 of Statement 143, uncertainty about whether performance will be required does not defer the recognition of an asset retirement obligation because a legal obligation to stand ready to perform the retirement activities still exists, and that uncertainty does not prevent the determination of a reasonable estimate of fair value.

B22. For situations where the timing and method of settlement are not specified by others, the Board decided that an asset retirement obligation would be reasonably estimable if information is available to estimate the settlement date or the range of potential settlement dates, the method of settlement or potential methods of settlement, and the probabilities associated with the potential settlement dates and methods of settlement. Judgment is involved in determining whether uncertainties about the timing and method of settlement would prevent an entity from reasonably estimating the fair value of an asset retirement obligation. The Board believes that uncertainty about future methods of settlement that have yet to be developed should not prevent an entity from reasonably estimating fair value because methods may change as time goes by. The Board does not believe it is appropriate to delay recognition until all potential methods of settlement are known. This Interpretation provides examples of information (some of which are based on entity-specific assumptions) that is expected to provide a basis for forming expectations about the potential settlement dates, potential methods of settlement, and associated probabilities.

The Board believes that entity-specific assumptions may be used in the absence of information that a marketplace participant would use about the timing and method of settlement of the asset retirement obligation as long as no contrary data indicates that marketplace participants would use different assumptions. If such data exist, the entity must adjust its assumptions to incorporate that market information.

B23. The Board also discussed whether sufficient information might not be available to estimate a range of potential cash flows associated with the potential methods of settlement that are currently available to the entity. The Board concluded that an entity would generally have the ability to estimate a range of potential cash flows based on the current costs to perform the asset retirement activities under different methods of settlement that are currently available to the entity.

B24. Some respondents to FSP FAS 143-x questioned whether an obligation to perform asset retirement activities is within the scope of Statement 143 if an entity has alternatives to retiring the asset without settling the obligation. This Interpretation reiterates the conclusions reached during the deliberations of Statement 143:

> . . . an unambiguous requirement that gives rise to an asset retirement obligation coupled with a low likelihood of required performance still requires recognition of a liability. Uncertainty about the conditional outcome of the obligation is incorporated into the measurement of the fair value of that liability, not the recognition decision. [Statement 143, paragraph A24]

The Board believes that if a current law, regulation, or contract requires an entity to perform an asset retirement activity when an asset is dismantled or demolished, there is an unambiguous requirement to perform the retirement activity even if that activity can be indefinitely deferred. At some time deferral will no longer be possible, because no tangible asset will last forever (except land). Therefore, the obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement.

B25. If an entity entered into a contract to pay another entity to assume the asset retirement obligation, there would be little dispute that the contract provides the measurement of the obligation that should be reported in the financial statements, even if the cash payment to the other entity had not been made at the reporting date. Also, the amount demanded by the other entity would incorporate uncertainty about the timing, method, and ultimate amount of the settlement. Statement 143 requires that the asset retirement obligation be recognized and measured in the financial statements using the perspective of participants currently negotiating such a hypothetical contract.

B26. A number of respondents stated that an entity should recognize a liability for a legal obligation when it can reasonably estimate the fair value of the asset retirement obligation and that fair value cannot be reasonably estimated unless it is probable the entity will have to perform the asset retirement activities as of a specific time. The Board believes that an inability to reasonably estimate the fair value of the liability is a measurement issue rather than a recognition issue. When there is an unambiguous requirement to perform asset retirement activities upon the removal of a long-lived asset from service, an asset retirement obligation exists.

B27. As stated in paragraph B19 of Statement 143, the Board decided that asset retirement obligations with indeterminate settlement dates should be included within the scope of Statement 143. Uncertainty about the timing of the settlement date does not change the fact that an entity has a legal obligation. The Board acknowledged that although there is an obligation, measurement of that obligation might not be possible if insufficient information exists about the timing of settlement. However, information about the timing of the settlement of a retirement obligation will become available as time goes by. The Board decided that an entity should measure and recognize the fair value of an obligation when information is available to develop various assumptions about the potential timing of cash flows.

Effective Date and Transition

B28. The Board decided that this Interpretation should be effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). The Board considered four alternatives for the effective date of this Interpretation. The three other alternatives were for financial statements issued for fiscal years (a) ending after December 15, 2004, (b) beginning after December 15, 2004, and (c) beginning after December 15, 2005. During its deliberations of the effective date requirements, the Board weighed the need to provide entities with sufficient time to make the necessary measurements with the need to provide

investors, creditors, and others with information that is relevant to the assessment of the effects of asset retirement obligations.

B29. Some respondents expressed concern over the effective date requirements in the Exposure Draft. Specifically, they stated that retrospective application promotes inconsistent treatment of interim financial information. The Board agreed with those respondents and decided to permit, but not require, retrospective application of interim financial information during any period of adoption. Early adoption of the Interpretation is encouraged.

B30. While deliberating the transition provisions for Statement 143, the Board reasoned that although some entities may have access to data and assumptions related to measurements that are already being made (for example, under the provisions of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*), they may not have access to sufficient information to retroactively apply the fair value measurement approach required by Statement 143. Furthermore, while deliberating the transition provisions for this Interpretation, the Board acknowledged that some entities that are required to apply the provisions of Statement 143 have not been accounting for conditional asset retirement obligations. The Board concluded that it would be costly and difficult, if not impossible, to reconstruct historical data and assumptions without incorporating the benefit of hindsight.

B31. The Board decided that the provisions for recognition of transition amounts of this Interpretation should be consistent with the recognition provisions of Statement 143. While deliberating the transition provisions for Statement 143, the Board discussed whether a cumulative-effect approach and retrospective application provide equally useful financial statement information. The Board acknowledged that retrospective application would provide more useful information because prior-period balance sheet amounts and prior-period income statement amounts would be restated to reflect the provisions of Statement 143. However, during the deliberations of Statement 143, some rate-regulated entities expressed concern that if retrospective application resulted in recognition of additional expenses in prior periods, those expenses might not be recovered in current or future rates. The Board decided for this Interpretation that a cumulative-effect approach would provide sufficient information if, in addition to disclosing the pro forma income statement amounts, an entity also disclosed on a pro forma basis, for the beginning of the earliest year presented and for the ends of all years presented, the balance sheet amounts for the liability for asset retirement obligations as if this Interpretation had been applied during all periods affected.

Benefits and Costs

B32. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a standard will fill a significant need and that the costs imposed to apply that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—and other users of financial information benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

B33. The Board's assessment of the benefits and costs of clarifying Statement 143 was based on discussions with preparers and auditors of financial statements and on consideration of the needs of users for more consistent application of that Statement. The Board acknowledges that this Interpretation may increase the costs of applying Statement 143. The expected benefit of this Interpretation is improved financial reporting resulting from a more consistent application of Statement 143 to conditional asset retirement obligations. Financial statements of different entities will be more comparable because all asset retirement obligations that are within the scope of this Interpretation and their related asset retirement costs will be recognized using a clearer threshold. Asset retirement obligations in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity will be recognized as liabilities when they are incurred if the fair value of the liabilities can be reasonably estimated. Application of this Interpretation will result in (a) more consistent recognition of liabilities for asset retirement obligations, (b) more information about expected future cash outflows associated with those obligations, and (c) more information about investments in long-lived assets because additional asset retirement costs will be recognized as part of the carrying amounts of the assets.