



On the Radar

Environmental Obligations and Asset Retirement Obligations

Environmental obligations can arise from the improper operation, retirement, or closing, or from the current or former ownership, of a facility at or near a contaminated site. Entities that have incurred a legal obligation to remove or remediate pollution or contaminants from environmental media such as soil, sediment, groundwater, and surface water are required to recognize an environmental remediation liability in their financial statements.

An asset retirement obligation (ARO) is a legal or contractual obligation associated with the retirement of a tangible long-lived asset that results from the acquisition, construction, development, or normal operation of that long-lived asset.

The FASB has established specific guidance on accounting for environmental obligations and AROs in ASC 410.

An ARO that results from the normal operation of a long-lived asset and is associated with the retirement of that asset

ASC 410-20 applies.

Environmental remediation liabilities resulting from the improper operation of a long-lived asset

ASC 410-30 applies.

Environmental Remediation Liabilities

The FASB's guidance on accounting for environmental remediation liabilities is codified in ASC 410-30, whose recognition and disclosure guidance is principally based on the framework outlined by the guidance on loss contingencies in ASC 450-20. Environmental remediation liabilities are a specific type of contingent liability that arises from federal, state, and local environmental regulations — or, in some instances, international treaties — related to contamination in soil, sediment, groundwater, and surface water.

The U.S. Environmental Protection Agency (EPA) is the primary environmental regulator in the United States, but it does not regulate all environmental concerns. Other federal, tribal, state, or local agencies may also have authority to regulate environmental programs. The guidance on accounting for environmental liabilities classifies laws into two categories: (1) environmental remediation liability laws and (2) laws intended to control or prevent pollution. The following are some of the main federal regulations that serve as drivers of environmental liabilities:

- The Clean Air Act of 1970 (CAA).
- The Clean Water Act of 1972 (CWA).
- The Toxic Substances Control Act of 1976 (TSCA).
- The Resource Conservation and Recovery Act of 1976 (RCRA).
- The Comprehensive Environmental Response, Compensation, and Liability Act of 1980 (CERCLA or the "Superfund").

As with other contingent liabilities, an environmental remediation liability is recognized when it is probable that such a liability has been incurred and the amount of the liability can be reasonably estimated. There is often uncertainty about whether and, if so, when a legal obligation for environmental remediation has been incurred. The existence and amount of an environmental remediation liability often become determinable over a continuum of events and activities. A typical environmental remediation process consists of the following steps:



ASC 410-30 provides specific benchmarks for an entity to consider when evaluating the probability of a loss and the extent to which any loss is reasonably estimable. One such benchmark requires recognition of an environmental liability once a feasibility study is substantially complete, which is no later than when the PRPs recommend a proposed course of action to the EPA. It is possible that the EPA will perform and complete its own feasibility study in lieu of, or in addition to, a PRP-conducted feasibility study. Thus, a PRP-recommended course of action may not always take place, or it may occur after the EPA's completion of a feasibility study and related recommended course of action.

We believe that if the EPA completes a feasibility study for a particular site before the PRPs have recommended their proposed course of action, the ASC 410-30 recognition benchmark is met and a liability must therefore be recognized at the time the EPA completes the feasibility study.

When the recognition criteria are met, entities initially measure environmental remediation liabilities at the estimated cost of remediating the site; generally, those liabilities are not discounted unless certain conditions are met. Estimated remediation costs are continually updated, and the recorded liability is adjusted prospectively until the obligation is settled.

In a manner consistent with the guidance in ASC 450-20 and ASC 275 on other loss contingencies and uncertainties, entities are required to disclose the existence of environmental remediation loss contingencies when it is at least reasonably possible that a loss has been incurred regardless of whether the loss is reasonably estimable. Additional disclosure requirements exist for recognized environmental remediation loss contingencies.

Asset Retirement Obligations

An ARO exists when an entity has an unconditional obligation associated with the retirement of a tangible long-lived asset. Like environmental obligations, AROs can arise from an existing or enacted law. However, unlike many environmental obligations, AROs can also arise from statute, ordinance, or written or oral contract or by legal construction of a contract under the doctrine of promissory estoppel.

Entities should evaluate the existence of legal obligations on the basis of current laws, regulations, contractual obligations, and related interpretations and facts and circumstances and should not forecast changes in laws or interpretations of such laws and regulations. The impacts of changes in laws or regulations should be considered in the period in which such laws or regulations are enacted.

An ARO is recognized at fair value when incurred or when a reasonable estimate of its fair value can be made. Entities capitalize the asset retirement cost by increasing the associated long-lived asset's carrying value. The asset retirement cost is later depreciated over the useful life of the long-lived asset. Accretion of the ARO liability due to the passage of time is recognized as a component of operating expense while revisions to the estimated timing or amount of cash flows associated with the retirement activities are recognized as an increase or decrease in the carrying amount of the ARO and the related long-lived asset.

Entities often incorporate the use of internal resources into their remediation plans. The guidance in ASC 410-20 requires the amounts included in the ARO cash flow estimate to reflect the costs that a third party would incur to conduct the retirement activities. Therefore, in addition to internal resources, entities need to consider incremental costs (e.g., overhead, equipment charges, profit margin) to ensure that the amounts included in the ARO cash flow estimate reflect the costs that a third party would incur. Accordingly, the incorporation of third-party and marketplace assumptions into the estimate of ARO cash flows and the initial measurement of the ARO will most likely result in the recognition of gains upon the settlement of the ARO if the entity settles the obligation by using its own resources.

Application of the guidance in ASC 410-20 can be complex and requires significant management estimates and judgment. For example, determining whether a legal obligation to retire a long-lived asset has been incurred may not always be clear and unambiguous. If an entity makes a promise to a third party, including the public at large, about its intentions to undertake asset retirement activities, significant judgment may be required in the determination of whether the entity has created a legal obligation under the legal doctrine of promissory estoppel, which is defined in ASC 410-20-20 (citing *Black's Law Dictionary*, seventh edition) as the "principle that a promise made without consideration may nonetheless be enforced to prevent injustice if the promisor should have reasonably expected the promisee to rely on the promise and if the promisee did actually rely on the promise to his or her detriment."

Regulatory Landscape

Driven by investor demand, stakeholder pressures, and, more recently, regulatory attention, companies are increasingly focused on climate-related and environmental matters. In addition, climate change has been a central topic of U.S. policy discussions in many government departments and agencies. Examples of the federal government's heightened attention to this matter include:

- President Biden's day-one action to rejoin the Paris Climate Agreement.
- The directive of then SEC Acting Chair Allison Herren Lee instructing the SEC Division of Corporation Finance to enhance its focus on climate-related disclosures in public-company filings.
- SEC Chairman Gary Gensler's recent statement that the SEC has the necessary authority to move forward with rulemaking on climate, human capital, and other environmental, social, and governance (ESG) disclosures.

In the forthcoming regulatory environment, it will be essential for companies to closely monitor their environmental obligations under new or changing laws and regulations.

Many companies are also publicly committing to achieve environmental goals related to climate change and sustainability. Public commitments about intentions to undertake a certain course of action with respect to asset retirement activities can result in an entity's incurrence of an ARO that must be recognized in the financial statements under the doctrine of promissory estoppel. Companies should carefully monitor and evaluate their public commitments and work closely with legal counsel to evaluate their own specific circumstances in determining whether legal obligations have been incurred.

Deloitte's Roadmap *Environmental Obligations and Asset Retirement Obligations* comprehensively discusses the recognition, measurement, presentation, and disclosure guidance in ASC 410-20 and ASC 410-30.

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