

Government Finance Review

GOVERNMENT FINANCE OFFICERS ASSOCIATION

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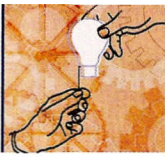
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Effective Cash Management



The Rising Cost of Pollution

Implementing GASB Statement 49 at the Port of Oakland

By Kevin W. Harper and Olivier Y. Flewellen

The process of
implementing GASB 49
gave port staff
comprehensive
information that helped
them understand
what actions needed
to be taken.

As you thumb through the recent accounting standard, Governmental Accounting Standards Board Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, a vague feeling of uneasiness comes over you. You suspect that the financial impact on your government might be significant, but you do not have enough information about the government's polluted sites to be sure. This article discusses how the Port of Oakland approached implementing GASB 49.

THE PORT OF OAKLAND

The port, which is situated along 19 miles of waterfront, operates an international container seaport; a passenger, cargo, and general aviation airport; and waterfront property for commercial and recreational purposes. It is an autonomous department of the City of Oakland, California, under the control of the Board of Port Commissioners, which is appointed by the City Council. The Port owns various polluted sites with contaminated soil and groundwater, buildings containing asbestos and lead-based paint, and sites with underground storage tanks. Prior to the implementation of GASB 49, the port had recorded liabilities totaling approximately \$13.3 million related to 18 polluted sites. Liabilities have historically been recorded only after receiving a regulatory notice to perform a site assessment or a site cleanup.

The Environmental Programs and Planning Division manages the port's environmental remediation program. The Port of Oakland's Attorney's Office manages the legal aspects of the environmental remediation program, including negotiations with other responsible parties and insurance carriers. Both divisions provide estimates to the Financial Services Division to record as a liability in the general ledger. Historically, port labor (including in-house legal costs) has not been accrued, a comprehensive list of polluted sites has not been readily available, and no recurring reports about pollution remediation status were provided to senior management.

IMPLEMENTATION OF GASB 49 AT THE PORT

The Financial Services Division took the lead in forming a team comprising the individuals who were most knowledgeable about the port's polluted sites, the estimated costs to clean and monitor the sites, and the legal or insurance claims and settlements that could offset those costs. The team included representatives of the Financial Services Division, the Port Attorney's Office, and the Environmental Programs and Planning Division. An overview of GASB 49 was presented, and the team was asked to determine the liability to be recorded under GASB 49 and establish procedures to obtain and update the necessary information

Exhibit 1: Sample Pollution Remediation Site Worksheet

Pollution Remediation Obligation

Status as of June 30, 2008

Site Description

Name: Hummingbird Site
Location: Wharf 108

Cost Information

Project No. 743

Liability Calculation:

	Probability 50 percent	Probability 50 percent	Total Expected Cash Flows
Consultants — Monitoring	\$287,040	\$287,040	
Outside Legal	322,884	322,884	
Port Labor — Legal	75,000	75,000	
Port Labor — Non-legal	200,000	200,000	
Expected Recoveries	(0)	(0)	
Expected Liability	\$884,924	\$1,084,924	\$984,924

Amounts Accrued

Environmental: Account No. 1324
Amount \$587,040
Legal: Account No. 5768
Amount \$397,884

Narrative

In January 2002, the Port, along with other potentially responsible parties, received an order from the Regional Water Quality Control Board (RWQCB) requiring investigation and remediation of releases of gasoline, jet fuel, and other contamination into the groundwater at the Hummingbird Site. Other responsible parties are taking the lead with various compliance activities; however, due to the bankruptcy filing of one of the parties, the port is taking the lead on other compliance activities required by the RWQCB order. The port has spent approximately \$3.4 million to monitor the environmental work performed by the other responsible parties.

Obligating Events to Date

An order issued by RWQCB
in February 2002.

Recognition Benchmarks to Date

A revised order issued by RWQCB
in December 2007.

Project Manager

Name: P. Manager
Phone: (510) xxx-xxxx

about polluted sites. The port's legal and environmental staff began by developing a comprehensive list of all polluted sites.

The team compiled data for each site such as location, pollution source and description, regulatory actions taken to date, cleanup status of site, *obligating events* to date, *recognition benchmarks* to date, responsible or potentially responsible parties, key dates (e.g. pollution dates, legal notices received, mandated action deadlines) and anticipated management actions. An example of a worksheet that can be used to document information about contaminated sites is shown in Exhibit 1. Polluted sites that have not yet triggered *obligating events* were placed on a "watch list." The work team agreed to meet periodically to review and update the status of the sites, including identification of additional *obligating events* that occur in the future. Periodic review is critical because a liability should not be recognized prior to the occurrence of an *obligating event* and must be recognized upon the occurrence of an *obligating event*.

For the sites identified with an *obligating event*, the team determined the amount to record as a liability. For the Hummingbird Site described Exhibit 1, the *obligating event* was the receipt of an order from a regulatory agency. The range of costs for *components* of the liability were able to be estimated, so the team estimated the current value of outlays using the *expected cash flow technique*, as shown in Exhibit 1. There were no *components* of the liability that were not reasonably estimable. In future meetings, the team will continue to consider the appropriateness of

the liability, using *recognition benchmarks* as triggers for when the liability should be re-estimated.

The estimated pollution remediation liability should be reduced by any amounts expected to be received from insurance carriers or potentially responsible parties. The government's legal department is likely the best source for determining anticipated recoveries. There were no expected recoveries from other parties related to the Hummingbird Site.

POLICY ISSUES

Information compiled by the team about each polluted site was posted on a shared drive to be easily available to appropriate port staff. This information can assist management in making policy decisions such as:

- How aggressively to pursue claims and suits against potentially responsible parties and insurers;
- How to estimate and minimize future costs related to environmental remediation and related legal costs;
- The level of insurance needed to cover contaminated property; and
- Wording in sales or lease agreements related to contaminated property.

The port's Financial Services Division decided that a high-level report of the status of polluted properties should be prepared semi-annually for review by senior staff. This report is currently under development and will list all polluted sites and the amount spent on remediation year-to-date and life-to-date. It will also highlight those sites that have approaching deadlines for remediation and those whose pollution are a matter of public safety.

Pollution is a growing public concern and a government's existing pollution and remediation plans should be disclosed to its stakeholders. Having a better understanding of pollution and related costs will assist the government in making strategic decisions. That said, the level of detail to provide at public meetings should be carefully considered. Information about polluted sites that are the subject of claims and litigation could jeopardize the government's legal position, so close coordination with the government's legal staff is essential.

GASB 49's requirements are related only to the accounting and reporting for pollution remediation obligations. The standard does not address whether the liability should be funded by paying all or a portion of the estimated liability into an irrevocable trust. Governments that have a significant pollution remediation obligation should consider whether funds should be set aside to pay for the obligations as they come due. For example, it is common for governments to prefund retirement obligations, but compensated absence obligations are typically funded on a pay-as-you-go basis. Similar to the way they handle obligations related to post-retirement health benefits, governments should make the determination on whether to set aside funds based on the relative size of the liability. Without prefunding, governments with a large pollution remediation liability will show substantially lower negative net assets.

FINANCIAL STATEMENT DISCLOSURES

If the pollution remediation costs are large in comparison with other expens-

es, the government should report them on a separate line item on its operating statements. In addition, GASB 49 requires the following note disclosures in the annual financial report:

- Nature and source of pollution remediation obligations;
- Amount of estimated liability;
- Methods and assumptions used for estimating the liability;
- Potential for changes in the estimates;
- Estimated recoveries that reduce the measurement of the liability; and
- General description of the nature of pollution remediation activities for liabilities that are not reasonably estimable.

Detailed disclosures about pollution liabilities and related expected settlements in the annual financial statements could compromise the government's position in potential or existing litigation. In addition, litigants may be able to identify the probability assigned to recovery of costs for a specific site through information that can be subpoenaed or obtained through public records or sunshine laws. Legal staff should, therefore, be consulted relating to the wording of disclosures and whether any information collected by the team should be subject to attorney-client privilege. The government's executive officer should consider the level of detail shared at public meetings.

After the team completed its site inventory and estimated pollution remediation costs, the number of the port's polluted sites for which a liability needed recognition under GASB 49 increased to 35 sites, from 18 sites under previous accounting standards.

Summary of GASB 49 Requirements

GASB 49 specifies new accounting and financial reporting for pollution remediation obligations. Pollution remediation obligations are a government's expected costs (e.g., direct outlays for payroll and benefits, equipment, facilities, materials, legal, and other professional services) to mitigate existing pollution by performing "pollution remediation activities." Pollution remediation activities include pre-cleanup activities (e.g., site assessment, site investigation, corrective measures feasibility study, and design of remediation plan), cleanup activities (e.g., neutralization, containment, removal and disposal of pollutants, and site restoration), external government oversight and enforcement-related activities (e.g., work performed by an environmental regulatory agency dealing with the site and chargeable to the government), and operation and maintenance of the remedy (e.g., required post-remediation monitoring).

Once an *obligating event* occurs, a government is required to estimate the *components* of expected pollution remediation outlays. An *obligating event* has occurred if the government:

- Is compelled to take remediation action because pollution creates an imminent endangerment to public health or welfare or the environment, leaving it little or no discretion to avoid remediation action;
- Is in violation of a pollution prevention-related permit or license;
- Is named, or evidence indicates that it will be named, by a regulator as a responsible party or potentially responsible party for remediation, or as a government responsible for sharing costs;
- Is named, or evidence indicates that it will be named, in a lawsuit to compel the government to participate in remediation; or
- Commences, or legally obligates itself to commence, cleanup activities or monitoring or operation and maintenance of the remediation effort.

After an *obligating event* occurs, pollution remediation outlays should be accrued as a liability and expense (or capitalized in limited circumstances) when a range of expected outlays is reasonably estimable. If a government cannot reasonably estimate the range of all *components* of the liability, it should recognize

the liability as the range of each *component* (e.g., site investigation, feasibility study, removal of waste, installation of treatment equipment, post-remediation monitoring) becomes reasonably estimable. The liability must be recorded at the current value of the costs the government expects to incur to perform the remediation activities using the *expected cash flow technique*.

Remediation work expected to be performed by the government for other parties must be included in the estimated liability. Remediation work performed by other parties on government property should not be included. Remediation obligations must not include pollution prevention or pollution control costs (e.g., treating effluent, installation of smokestack scrubbers), fines, penalties, workplace safety outlays, and litigation support involving potential recoveries. Indirect costs such as overhead can be included if desired.

Under limited circumstances, pollution remediation costs can be capitalized. Specifically, such costs can be capitalized to prepare property in anticipation of a sale, to prepare property for use when it was acquired with known or suspected pollution that was expected to be remediated, or to acquire assets that have a future alternative use.

Governments should consider the following *recognition benchmarks* in determining when *components* of pollution remediation liabilities are likely to become reasonably estimable.

- Receipt from a regulatory agency of an administrative order compelling it to take a remediation action;
- Participation as a responsible party in a site assessment or investigation;
- Completion of a corrective measures feasibility study;
- Receipt from a regulatory agency of an authorization to proceed with remediation activity; and
- As additional information and understanding become available throughout remediation design, implementation, and post-remediation monitoring.

Pollution remediation liability may be relatively limited at initial recognition due to lack of information and will increase over time as more information becomes available.

The total liability required under GASB 49 was determined to be \$18.9 million, whereas only \$13.3 million was recorded under previous accounting standards. This large increase in the pollution remediation liability will not affect the port's expenses in the year of implementation because GASB 49 requires restatement of opening net assets for the cumulative effect of this accounting change.

CONCLUSIONS

The port's GASB 49 team learned that preparing accurate cost estimates requires the involvement of personnel who have the proper experience and training. Even though the port has experts in its environmental programs and planning division, it used outside

consultants to help estimate future costs for some of the projects. In addition, involving the port's outside auditors early on helped with interpreting the complex requirements of GASB 49 and made it easier to demonstrate to auditors that the amounts presented were reasonable.

The process of implementing GASB 49, including preparing a report on the status of polluted properties and distributing it to the team, gave port staff comprehensive information that helped them understand what actions needed to be taken and the clean up cost for the polluted sites. Specifically, the process helped by:

- Encouraging the team to compile, for the first time, a list of all known polluted sites.

- Conveying the extent of the required cleanup, along with the estimated costs.
- Creating a common understanding of the estimated pollution remediation costs that would need to be budgeted and financed in the future.

While implementing GASB 49 might have been time consuming for the port, the resulting insights made the effort worthwhile. ■

KEVIN HARPER is managing partner of Kevin W. Harper CPA & Associates. He can be reached at kharper@kevinharper-cpa.com. OLIVIER Y. FLEWELLEN is director of finance of the Port of Oakland. He can be reached at oflewellen@portoakland.com.

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