

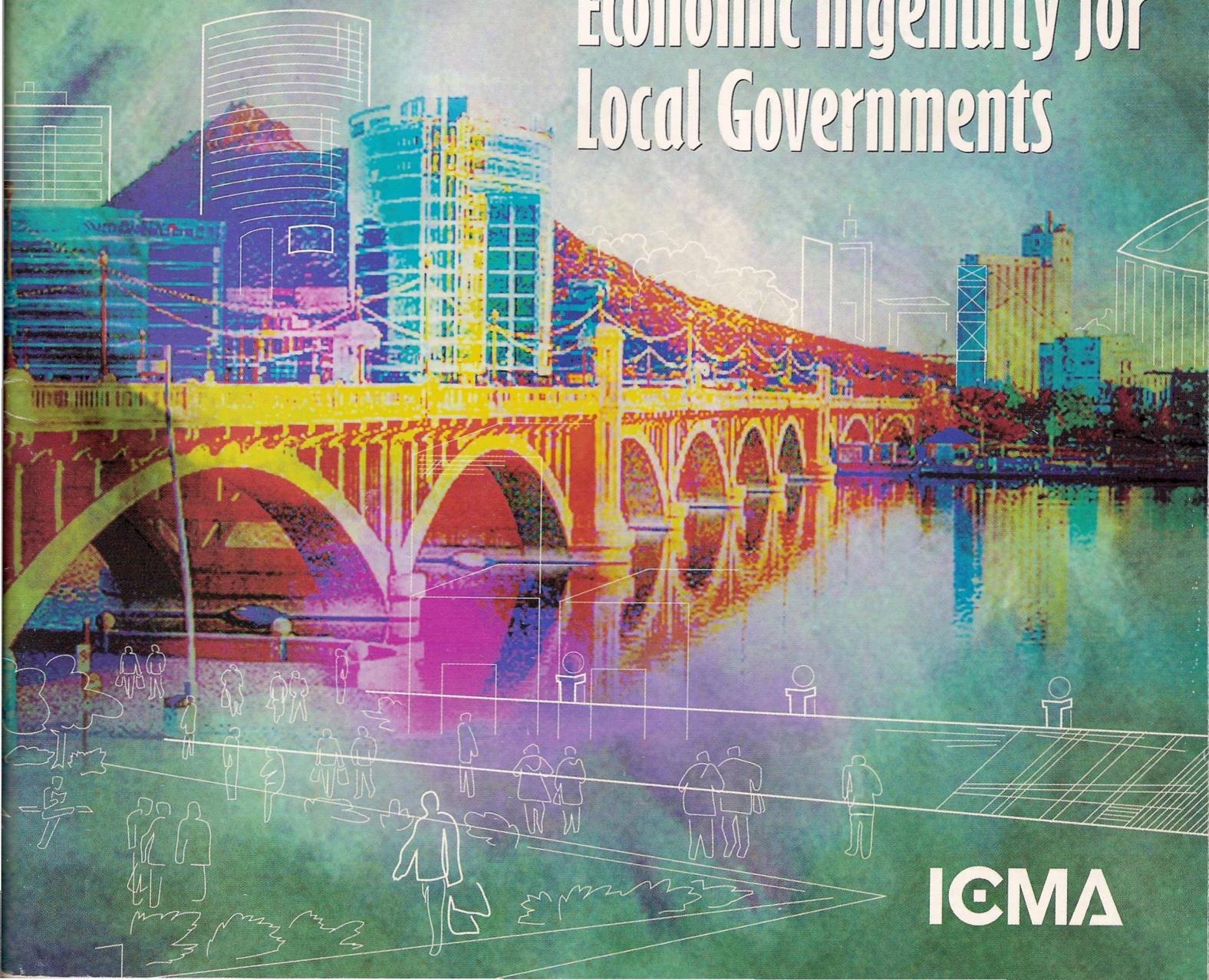
P M

OCTOBER 2008

ICMA
PUBLIC
MANAGEMENT

Celebrating 90 years!

The Arts Industry: Economic Ingenuity for Local Governments



ICMA

Pollution Remediation Costs on the Rise: GASB 49's New Requirements

by Kevin Harper and Olivier Flewellen

The pollution remediation costs your government must report in its annual financial statements may dramatically increase as a result of the new Governmental Accounting Standards Board Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations" (GASB 49). Pollution liabilities will likely be larger under GASB 49 than under current accounting standards (Statement of Financial Accounting Standards No. 5, "Accounting for Contingencies" [FAS 5]) because:

- The pollution remediation liability for each site will frequently be recorded earlier. FAS 5 does not require recognition until a liability becomes probable and measurable, whereas GASB 49 will require recognition at the time of an obligating event.
- The recorded amount of the pollution remediation liability for each site will frequently be larger. FAS 5 requires the liability to be reported at the low end of a range of estimated pollution remediation outlays when no amount within a range is a better estimate than any other amount. GASB 49 requires use of the expected cashflow technique, which is the probability-weighted average of projected future cash outlays.
- Remediation costs previously capitalized may be required to be expensed under GASB 49, which allows capitalization under limited circumstances.

GASB 49 REQUIREMENTS

GASB 49 specifies new accounting and financial reporting for pollution remediation obligations, and it is effective for financial statements with periods beginning after December 15, 2007. Pollution remediation obligations

are a government's expected costs (direct outlays for payroll and benefits, equipment, facilities, materials, legal, and other professional services) to mitigate existing pollution by performing pollution remediation activities.

These remediation activities include pre-cleanup activities (site assessment, site investigation, corrective measures feasibility study, and design of remediation plan); cleanup activities (neutralization, containment, removal and disposal of pollutants, and site restoration); external government oversight and enforcement-related activities (work performed by an environmental regulatory agency dealing with the site and chargeable to the government); and operation and maintenance of the remedy (required post-remediation monitoring).

When any one of five obligating events 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 (PRP) 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.
- 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 can be reasonably estimated. If a government cannot estimate the range of all components of the liability, it should recognize the liability as the range of each component (site investigation, feasibility study, removal of waste, installation of treatment equipment, required post-remediation monitoring, legal services) as it becomes reasonably estimable.

The liability must be recorded at the current value of the costs the government expects to incur in order to perform the remediation activities using the expected cashflow tech-

**GASB 49 specifies
new accounting and
financial reporting for
pollution remediation
obligations, and it is
effective for financial
statements with
periods beginning
after December 15,
2007.**

nique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts (the estimated mean or average).

Governments should consider these recognition benchmarks (steps in the remediation process) in determining when components of pollution remediation liabilities are likely to become reasonably estimable. Recognition benchmarks include:

- 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.
- As additional information and understanding become available throughout remediation design, implementation, and post-remediation monitoring.

It is expected that the pollution remediation liability related to many sites may be relatively limited at initial recognition owing to lack of information to estimate the liability's components and that the liability will increase over time as more information becomes available.

**DETERMINE WHETHER
YOUR GOVERNMENT HAS
POTENTIAL LIABILITY**

Does GASB 49 affect your government? If your government has polluted sites, form a work team composed of the individuals who are most knowledgeable about polluted sites, estimated costs to clean and monitor the sites, and legal or insurance claims and settlements that could offset those costs. The work team should collectively identify all polluted sites and compile such data as site description, location, regulatory actions taken to date, cleanup status, obligating events to date, and recognition benchmarks to date.

An example of a worksheet used to document information about contaminated sites is shown on page 34. The work team should meet periodically to review and update the status of the sites.

The work team also should determine for each polluted site whether an obligating event has occurred. When an obligating event has occurred, recognition of a related liability is mandatory. Polluted sites that have not yet triggered obligating events should remain on the government's list of polluted sites and be reviewed periodically to determine whether an obligating event occurs in

Sample Pollution Remediation Site Worksheet

Pollution Remediation Obligation

Status as of _____, 200__

SITE DESCRIPTION:

Name _____

Location _____

COST INFORMATION:

Project No. _____ Fund No. _____

Liability:

[Show calculation of liability]

Amounts Accrued:

Environmental: Account No. _____, Amount _____

Legal: Account No. _____, Amount _____

NARRATIVE:

[Describe pollution, responsible parties, cleanup activity to date, planned clean-up, timing]

RECOGNITION BENCHMARKS TO DATE:

[Description and date]

OBLIGATING EVENTS TO DATE:

[Description and date]

REGULATORY REQUIREMENTS:

[Law or legal document requiring remediation]

PROJECT MANAGER:

Name _____

Phone _____

the future. A liability should not be recognized prior to the occurrence of an obligating event.

ESTIMATING POLLUTION REMEDIATION LIABILITY

When an obligating event has occurred, the work team must determine the amount to record as a liability. Such amount accrued will be determined as the range of components of the liability becomes estimable. If the range of costs for some or all components can be estimated, the work team must estimate the current value of outlays using the expected cashflow

technique as described in this article.

If the range of the components is not reasonably estimable, no liability need be recorded at this time. The work team must record the liability for additional components as they become estimable, using recognition benchmarks as triggers for when the liability should be re-estimated.

The expected cashflow technique measures the sum of the probability-weighted amounts in a range of estimated amounts. Upon receiving notification by the state that your government is responsible for remediating certain toxic substances at

a landfill (an obligating event), for example, the government's environmental engineer estimates that outlays to conduct a site assessment and corrective measures feasibility study will range from \$50,000 to \$100,000, with all amounts in this range considered to be equally likely.

The liability for this component will be \$75,000 $(\$50,000 + \$100,000) / 2$. Under prior accounting standards, the lower end of the range (\$50,000) would have been accrued for this component. Outlays to clean the site could range from \$100,000 to \$2 million to remediate. If there is no amount within that range that is more likely than another, the liability for this component will be \$1,050,000 $(\$2 \text{ million} + \$100,000) / 2$. Under prior accounting standards, the lower end of the range (\$100,000) would have been accrued for this component.

As another example, upon being named as a potentially responsible party by a regulator (an obligating event), your only knowledge of the remediation costs is that there is a 5 percent chance that remediation costs will total \$1 million and a 95 percent chance that there will be no costs. The liability to be recorded under GASB 49 is \$50,000 $(5 \text{ percent} \times \$1 \text{ million})$. Under prior accounting standards, no liability would have been recorded because it would not have been considered to be "probable."

Remediation work expected to be performed for other parties must be included in the estimated liability. Remediation obligations must not include pollution prevention or pollution control costs (treating effluent, installing smokestack scrubbers), fines, penalties, workplace safety outlays, and litigation support involving potential recoveries. Indirect costs can be included if desired.

The estimated pollution remediation liability is reduced by any amounts expected to be received from insurance recoveries or from other responsible parties. The government's legal department is likely the best source for determining anticipated recoveries.

Under limited circumstances, 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.

POLICY AND REPORTING ISSUES

The comprehensive list of contaminated sites and basic information on each site that is collected by the work team can assist management in making such policy decisions as:

- How aggressively to pursue claims and suits against PRPs 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.

- Wording in sales or lease agreements related to contaminated property.

GASB 49 requires these note disclosures in your government's 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.
- 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. Litigants also 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 work team should be subject to attorney-client privilege. Senior management should consider the level of detail shared at public meetings.

CONCLUSION

Simply stated, pollution remediation costs will likely be rising owing to implementation of GASB 49. Your government should immediately assemble a work team to analyze the impact of GASB 49 on each site. The work team should:

- Identify polluted sites.



When the economy takes a turn, who will you turn to?

NIGP's professional consulting services.

Achieving the greatest value from the tax dollar becomes even more important as tax revenues decline and budgets are stretched to their limit.

NIGP's consultants have an average of 18 years direct experience in government purchasing. They understand the challenges facing executive leaders in public entities seeking greater operating efficiencies and improved practices.

Whether assessing the effectiveness of your procurement and contracting operations or implementing a new ERP or e-Procurement solution, look to NIGP's professional consulting services.

Learn how your agency can take a turn for the better, call NIGP today at 800-367-6447 x261



PUBLIC POLICY AND ADMINISTRATION

NORTHWESTERN GRADUATE PROGRAM

The Master of Arts in Public Policy and Administration program explores public policy issues, applications and analysis, and the administrative systems necessary to implement policy at all levels of government. The program is designed to be of particular benefit to early to mid-career managers and executives working in local, state, and federal government agencies, foundations, and associations. Non-degree options are also available. Courses are offered on the Chicago Lakefront and Loop campuses.



NORTHWESTERN
UNIVERSITY

SCHOOL OF
CONTINUING
STUDIES

APPLY TODAY

312-503-4682

www.scs.northwestern.edu/grad

- Determine whether obligating events have occurred.
- If so, determine whether the range of components of the liability are estimable.
- For those components that are estimable, estimate the current value of outlays, which should be net of both estimated settlements and any portion that can be capitalized.
- Record the liability in the financial statements.
- Disclose the required information in the notes to the financial statements.
- Remeasure the liability as new information becomes available. **PM**

Kevin Harper, CPA, is managing partner, Kevin W. Harper CPA & Associates, Union City, California (kharper@kevinharpercpa.com). Olivier Flewellen is director of finance, Port of Oakland, California (oflewellen@portoakland.com). For questions or assistance in implementing GASB 49, contact Kevin Harper at 510/324-1022 or by e-mail; the first consultation is at no charge.



The emergency management field is constantly changing.

Lives depend on whether I am prepared. American Public University helped me stay current on best practices. I also found the networking with fellow students — peers in the industry — extremely valuable.

Bill McGann

*Master's Degree, Emergency and Disaster Management
FEMA Program Specialist*

Push your mind. Advance your career.

Leading online master's degree programs:

Emergency & Disaster
Management

Public Administration

Homeland Security

Transportation &

Logistics Management



www.apu.apus.edu
or 877.777.9081

American Public University