ASPE AT A GLANCE

Section 3110 - Asset Retirement Obligations

January 2013

Section 3110 – *Asset Retirement Obligations*

Effective Date
Fiscal years beginning on or after January 1, 2011

SCOPE

Applies to:

- Legal obligations associated with the retirement of a tangible long-lived asset that results from its acquisition, construction, development or normal operation.

Does not apply to:

- Obligations arising solely from a plan to sell or otherwise dispose of a long-lived asset subject to Section 3475.
- Obligations that result from the improper operations of an asset.

ASSET RETIREMENT OBLIGATION

- A legal obligation associated with the retirement of a tangible long-lived asset that an entity is required to settle as a result of an existing or enacted law, statue, ordinance or written or oral contract or by legal construction or a contract under the doctrine of promissory estoppels.

RECOGNITION

- In the period in which an asset retirement obligation is incurred, an entity must recognize a liability when a reasonable estimate of the amount of the obligation can be made.
- However, when a reasonable estimate of the obligation cannot be made in the period in which an asset retirement obligation is incurred, the liability must be recognized when a reasonable estimate of the amount of the obligation can be made.
- When a tangible long-lived asset with an existing asset retirement obligation is acquired, a liability for the obligation is recognized at the asset's acquisition date as if the obligation was incurred on that date.

CONDITIONAL OBLIGATIONS

- Uncertainty about whether performance of a retirement activity will be required, does not defer the recognition of an asset retirement obligation.
- Instead, the uncertainty is factored into the measurement of the amount of the asset retirement obligation by assigning probabilities to cash flows.
- When there are only two outcomes for the conditional aspect and there is no information available about which one is more probably, a 50 percent likelihood is assigned to each outcome until additional information becomes available. More information about the ultimate outcome will likely be obtained closer to the time for notification. Thus, the amount of the liability recognized may change from reassessment of the timing, amount and probabilities associated with the expected cash flows.

OBLIGATIONS CREATED BY NEW STATUTORY OR REGULATORY REQUIREMENTS

- When a newly enacted statute or regulation imposes a new asset retirement obligation on an entity as a result of its past activities, the liability and related asset retirement cost are recognized when the obligation is first imposed.
- The prior period financial statements presented for comparative purposes are not restated.

RECOVERIES OF ASSET RETIREMENT COSTS

- In circumstances where an entity may be entitled to recover asset retirement costs from another party, the asset retirement obligation is accounted for without considering the recovery.

MEASUREMENT

- The best estimate of the expenditure required to settle the present obligation at the balance sheet date must be the amount recognized as the asset retirement obligation.
- The best estimate is the amount an entity would rationally pay to settle the obligation or to transfer it to a third party at the balance sheet date.
- Management's judgment, experience with similar transactions and potentially reports from independent experts are used to determine the estimate of the expenditure required to settle the present obligation.
- When there is sufficient evidence future events that may affect the amount required to settle an obligation will occur, these events are reflected in the measurement of the obligation.
- Similarly when sufficient evidence exists that new legislation is virtually certain to be enacted, the effect of this possible new legislation is taken into consideration in the measurement of an existing obligation.
- At each balance sheet date, asset retirement obligations are reviewed and adjusted to reflect the current best estimate.

PRESENT VALUE TECHNIQUE

- Often, the best available technique to estimate the expenditure required to settle the present obligation at the balance sheet date is the present value technique.
- It can be determined using the following elements:
  - An estimate of the future cash outflows expected with regard to the obligation;
  - Expectations about possible variations in the amount or timing of those cash outflows; and
  - The time value of money, represented by the current market risk-free rate of interest, for maturity dates that coincide with the expected cash flows.
- An entity starts to determine the best estimate of the expenditures required to settle the present asset retirement obligation at the balance sheet date by, making an estimate of the future cash outflows that reflect an assessment of the cost and timing to perform the required retirement activities.
  - When estimating these cash outflows an entity develops and incorporates specific assumptions, to the extent possible, about:
    - Costs the entity will incur in carrying out the tasks necessary to retire the asset; and
    - Other amounts, such as inflation, overhead, equipment charges and the effects of advances in technology.
- There are two approaches to calculating present value:
  - Traditional approach – in which adjustments for uncertainties of the amount and timing of cash flows are embedded in the discount rate; and
  - Expected cash flow approach – in which adjustments for uncertainties of the amount and timing of cash flows are reflected in the risk-adjusted cash flows.
- Since uncertainties regarding the amount and timing of future cash flows can typically be provided for in the present value calculation, these uncertainties do not prevent the determination of a reasonable estimate of the amount of the asset retirement obligation.

RECOGNITION AND ALLOCATION OF AN ASSET RETIREMENT COST

- When a liability for an asset retirement obligation is initially recognized, an entity also recognizes an asset retirement cost by increasing the carrying amount of the related long-lived asset by the same amount as the liability.
- The asset retirement cost is then subsequently allocated to expense over its useful life using a systematic and rational method.
- In subsequent periods, an entity recognizes period-to-period changes in the liability for an asset retirement obligation resulting from:
  - The passage of time; and
  - Revisions to either the timing, amount of the original estimate of undiscounted cash flows or the discount rate.
- Changes due to the passage of time are measured and incorporated into the carrying amount of the liability before an entity measures changes resulting from a revision to the timing or amount of the estimated cash flows.
- The related expense is classified as an operating item in the income statement, not as interest expense, and is referred to as "accretion expense" or a similar description.

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