



UT System Administration Policy Library -- Policy

# UTS142.12 - Accounting and Financial Reporting for Pollution Remediation Obligations

Responsible Officer: Associate Vice Chancellor – Controller and Chief Budget Officer

Sponsoring Office: Office of the Controller

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Errors or changes to: [policyoffice@utsystem.edu](mailto:policyoffice@utsystem.edu)

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# POLICY STATEMENT

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GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, issued in November 2006, addresses accounting and financial reporting standards for pollution remediation obligations.

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## RATIONALE

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A pollution remediation obligation is an obligation to address the current or potential detrimental effects of *existing* pollution and contamination. These obligations will generally require the recognition and reporting of remediation liabilities and, in certain instances, will result in recognition and reporting of capital asset transactions at the time those assets are acquired. Remediation activities do not include pollution prevention or control obligations with respect to current operations, such as obligations to install air emissions controls, wastewater treatment systems, storm water runoff controls, or use environmental-friendly products.

The scope of Statement No. 49 *excludes* prevention or control obligations with respect to:

- current operations, and
- future remediation activities that are required upon retirement of an asset, such as landfill closure and post-closure requirements, nuclear reactor decommissioning, or closure of campus hazardous waste handling facilities.

Once any one of five obligating (or triggering) events specified below occurs, the University is required to estimate the components of expected remediation costs and determine whether costs for component activities should be (1) accrued as a liability or, if appropriate, (2) capitalized when goods and services are acquired.

Obligating (triggering) events include the following:

- The University is compelled to take remedial action because of an imminent endangerment to health and safety, or the environment;
- The University violates a hazardous materials-related permit or license, requiring corrective action (e.g. violation of Resource Conservation and Recovery Act, RCRA, permit or similar permits under state law requiring corrective action);
- The University is named, or evidence indicates that it will be named, by a regulator as a Responsible Party (RP-) or Potentially Responsible Party (PRP) for remediation, or as an entity responsible for sharing remedial costs;

- The University is named, or evidence indicates that it will be named, in a lawsuit to compel participation in remediation; or
- The University commences, or legally obligates itself to commence remediation (e.g. cleanup of leaking underground storage tanks or removal of friable asbestos-containing materials (ACMs)).

Most remediation costs do not qualify for capitalization and should be accrued as a liability and expense when a range of expected costs is reasonably estimable or as an expense upon receipt of goods and services used for pollution remediation activities. If the University cannot reasonably estimate the range of all components of the liability, it should recognize the liability as soon as the range of each component (e.g., legal services, site investigation, required post-remediation monitoring) becomes reasonably estimable. The liability should be recorded at the current value of the costs the University expects to incur to perform the work. This amount should be estimated using the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts, resulting in the estimated mean or average.

Remediation costs should only be capitalized if the costs are incurred (1) to prepare property for sale in anticipation of a sale, (2) to prepare property for use when the property was acquired with known or suspected contamination that was expected to be remediated, (3) to perform remediation that restores a contamination-caused decline in service utility that was recognized as an asset impairment, or (4) to acquire property, plant and equipment for use in remediation activities that also will have a future alternative use other than for remediation efforts.

For remediation obligations that are not common or similar to situations at other sites with which the University has experience, GASB Statement No. 49 includes a series of recognition benchmarks—steps in the remediation process—that the University should consider in determining when components of remediation liabilities are reasonably estimable. Thus, the measurable transactions and events that result in a remediation liability may be relatively limited at initial recognition, but would increase over time as more components become reasonably estimable. GASB Statement No. 49 also requires re-measurement of the liability (and its components) when new information indicates increases or decreases in estimated costs.

The measurement of the University's remediation liability should include remedial work that the University expects to perform for other parties; however, expected recoveries from those other parties, and insurance recoveries, reduce the measurement of the University's remediation expense when reasonably estimable (and reduce associated expenditures when the recoveries are measurable and available). If the expected recoveries are not yet realized or realizable, they also reduce the measurement of the University's remediation liability, if not provided for capitalized assets. If the expected recoveries are realized or realizable, they should be reported as recovery assets (e.g., cash or receivables). If the recoveries are realized or realizable and expected to result in capital assets, they are recorded as capital contributions rather than a reduction of expenditures.

For recognized remediation liabilities and recoveries, GASB Statement No. 49 requires the University to disclose the nature and source of remediation obligations, the amount of the estimated liability (if not apparent from the financial statements), the methods and assumptions

used for the estimate, the potential for changes in estimates, and estimated recoveries that reduce the measurement of the liability. The University is required to disclose a general description of the nature of remediation activities for liabilities (or components thereof) that are not reasonably estimable.

GASB Statement no. 49 does not apply to the following:

- Pollution prevention or control obligations with respect to current operations such as obligations to install air emissions controls, wastewater treatment systems, stormwater runoff controls, or use environmental-friendly products, or to fines, penalties and other non-remediation costs such as civil wrongs (toxic torts) arising from exposure to a toxic substance, litigation in support of potential cost recoveries, workplace health and safety costs, etc.
- Future remediation activities required upon retirement of an asset (asset retirement obligations, such as nuclear reactor decommissioning or hazardous materials handling facility closure) during the periods preceding the retirement. However, GASB Statement No. 49 applies to those activities at the time of the retirement if obligating events are met and a liability has not been recorded previously.
- Post-closure care obligations within the scope of GASB Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*. This is unlikely for the University in that GASB Statement No. 18 is based on the October 9, 1991, U.S. Environmental Protection Agency (EPA) rule, “Solid Waste Disposal Facility Criteria,” which establishes closure requirements for all municipal solid waste landfills (MSWLFs) that receive solid waste after October 9, 1991.
- Recognition of asset impairments or liability recognition for unpaid claims by insurance activities (see [UTS142.9, Policy for Accounting and Financial Reporting for Impairment of Capital Assets and Insurance Recoveries](#) for this topic).
- Accounting for non-exchange transactions, such as Brownfield redevelopment grants (see [UTS142.2, Policy for Accounting and Financial Reporting for Nonexchange Transactions](#) for this topic).

GASB Statement No. 49:

- Generally prescribes new reporting requirements, rather than amending previous guidance.
- Is effective for FY 2008–09, with measurement of remediation liabilities required at August 31, 2008 so that beginning net assets can be restated. However, if the University has sufficient objective and verifiable information to apply the expected cash flow technique to measurements in prior periods, restatement of the University’s financial statements for prior periods will be required.

This document is prepared in order to outline the University’s approach to the application of GASB Statement No. 49 to the University’s financial statements.

In general, the transactions discussed in GASB Statement No. 49 may not necessarily be normal, ongoing operating transactions. The Controller's staff should review non-routine transactions or circumstances at year-end to determine that any obligating events that may result in remediation obligations are identified, evaluated and properly reported.

GASB Statement No. 49 may be ordered from the GASB's website at <http://gasb.org/>.

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## SCOPE

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All institutions and UT System Administration.

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## WEBSITE ADDRESS FOR THIS POLICY

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[http://www.utsystem.edu/policy/policies/uts142\\_12.html](http://www.utsystem.edu/policy/policies/uts142_12.html)

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## RELATED STATUTES, POLICIES, REQUIREMENTS OR STANDARDS

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| UT System Administration Policies & Standards  | Other Policies & Standards   |
|--|--|
| <ul style="list-style-type: none"><li>• <a href="#">UTS161 - Environmental Review for Acquisition of Real Property</a></li></ul> | <ul style="list-style-type: none"><li>• GASB Statement No. 49, <i>Accounting and Financial Reporting for Pollution Remediation Obligations</i>, issued in November 2006, addresses accounting and financial reporting standards for pollution remediation obligations.</li></ul> |

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## CONTACTS

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If you have any questions about UT System Administration Policy UTS 142.12, *Accounting and Financial Reporting for Pollution Remediation Obligations*, contact the following office(s):

| Subject | Office Name              | Telephone Number | Email/URL  |
|---------|--------------------------|------------------|--|
|         | Office of the Controller | 512-499-4526     | <a href="mailto:controllersoffice@utsystem.edu">controllersoffice@utsystem.edu</a> |

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## DEFINITIONS

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### **Current value**

The amount that would be paid if all equipment, facilities, and services included in the estimate were acquired during the current period.

### **Expected cash flow technique**

A technique that measures a liability as the sum of probability-weighted amounts in a range of possible estimated amounts—the estimated mean or average. This technique uses all expectations about possible cash flows.

### **Hazardous wastes; Hazardous substances**

Wastes and substances that are toxic, corrosive, ignitable, explosive, or chemically reactive, or appear on special U.S. Environmental Protection Agency lists. This includes wastes and substances listed in 33 U.S.C. §2701(23), and 42 U.S.C. §6903(5) and §9601(14). The definition of hazardous substance under the Superfund law is broader than the definition of hazardous wastes under RCRA. As used in this Statement, the terms hazardous waste and hazardous substance also include materials designated by state environmental regulators.

### **Outlays**

Expenses, expenditures, and capital acquisitions, as appropriate.

### **Pollution**

The U.S. Environmental Protection Agency provides the following discussion of the term pollution on its website: "Generally, the presence of a substance in the environment that because of its chemical composition or quantity prevents the functioning of natural processes and produces undesirable environmental and health effects. Under the Clean Water Act, for example, the term has been defined as the man-made or man-induced alteration of the physical, biological, chemical, and radiological integrity of water and other media."

### **Pollution remediation obligation**

An obligation to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities. For example, obligations to clean up spills of hazardous wastes or hazardous substances and obligations to remove contamination such as asbestos are pollution remediation obligations.

### **Potentially responsible party (PRP)**

An individual or entity—including owners, operators, transporters, or generators—that is held potentially responsible for pollution at a site. As used in this Statement, the term refers to a party that is held by law as potentially responsible for pollution at any site. It is not limited to parties associated with Superfund sites.

### **Remedial investigation and feasibility study (RI/FS)**

Extensive technical studies to investigate the scope of site impacts (RI) and determine the remedial alternatives (FS) that, consistent with the National Contingency Plan provisions of the federal Superfund law or similar state laws, may be implemented at a polluted site. An RI/FS may include a variety of on- and off-site activities, such as monitoring, sampling, and analysis.

### **Resource Conservation and Recovery Act (RCRA)**

A federal law that provides comprehensive regulation of hazardous wastes from point of generation to final disposal. All generators of hazardous waste, transporters of hazardous waste, and owners and operators of hazardous waste treatment, storage, or disposal facilities must comply with the applicable requirements of the statute.

### **Site assessment**

A site-specific baseline risk assessment that identifies hazards, assesses exposure to the hazards and their toxicity, and characterizes and quantifies the potential risks posed by the site. A site assessment may be noninvasive, involving inquiry into previous uses of a site, site reconnaissance, and interviews, or may involve invasive testing for pollution.

### **Superfund**

A federal law (the Comprehensive Environmental Response, Compensation, and Liability Act of 1980 [CERCLA], as amended by the Superfund Amendments and Reauthorization Act of 1986 [SARA], which together are referred to as Superfund) that provides the U.S. Environmental Protection Agency with broad authority to order liable parties to remediate polluted sites or use Superfund money to remediate them and then seek to recover its costs and additional damages.

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## **RESPONSIBILITIES**

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### **UT Institution and UT System Office of Risk Management**

- Informs the UT System Office of the Controller if an obligating event occurs.

- Completes appropriate Exhibit and Footnote information required by the UT System Office of the Controller.

### **UT System**

- Comply with GASB Statement No. 49 reporting requirements including footnote disclosures.

### **UT System Office of the Controller**

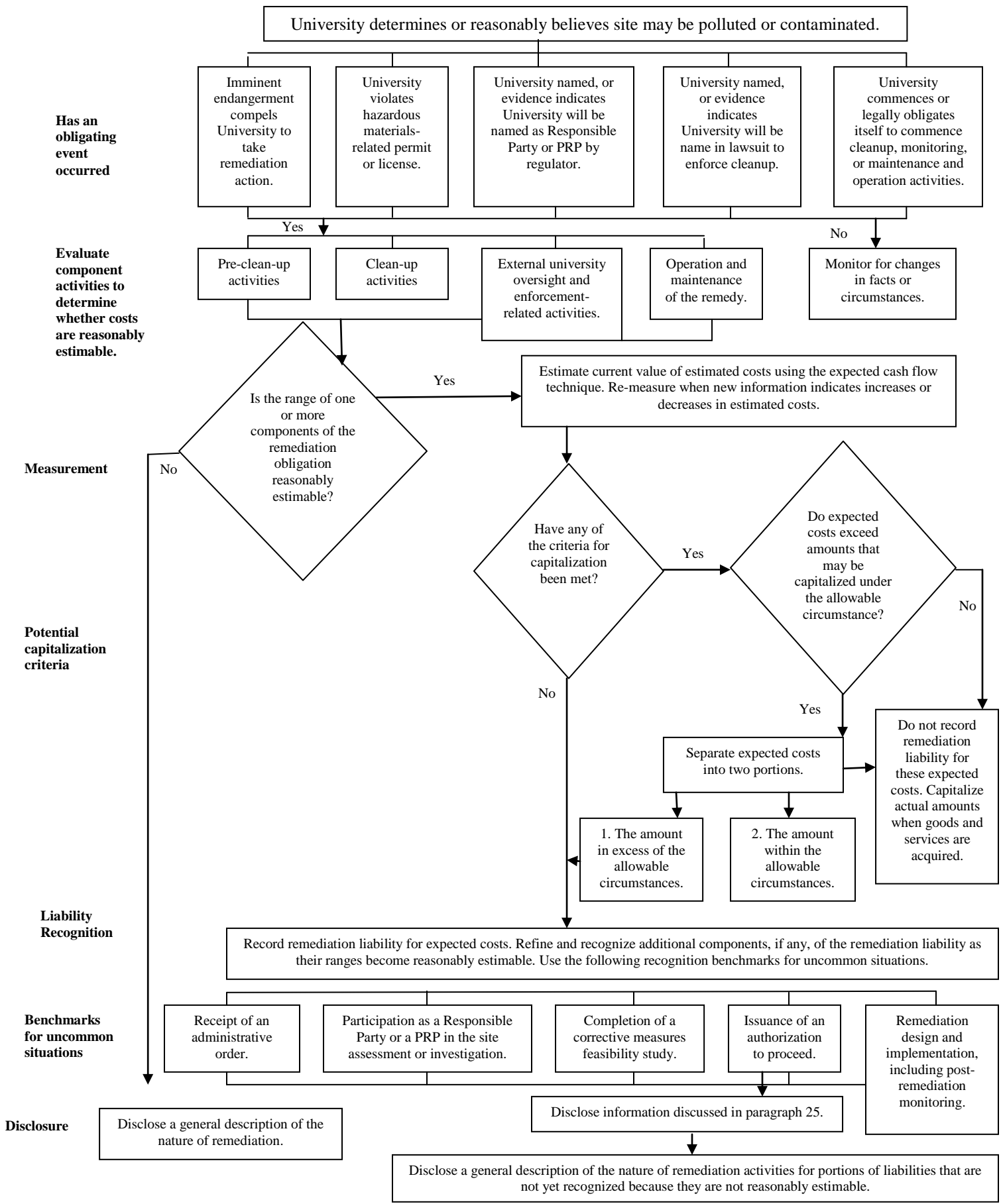
- Interprets this policy and is responsible for revising it as necessary to meet the changing needs of The University of Texas System and any statutory requirements.

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## **PROCEDURES**

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# Overview of Recognition and Measurement Framework



## What Are Obligating (Triggering) Events?

When University management knows or reasonably believes that a facility or site is contaminated, the financial staff, in consultation with environmental health and safety and risk management staff, must determine whether one or more components of a remediation obligation are recognizable as a liability when *any* of the following events occurs:

- The University is compelled to take remedial action because contamination creates an imminent endangerment to public health or welfare or the environment, leaving it little or no discretion to avoid remedial action. This criterion applies to events that compel the University to take remedial action even if no law requires such action.
- The University is in violation of a hazardous materials-related permit or license requiring corrective remedial action (i.e. Resource Conservation and Recovery Act (RCRA) permit or similar permits under state law).
- The University is named, or evidence indicates that it will be named, by a regulator as a Responsible Party (RP) or a Potentially Responsible Party (PRP) for remediation, or as an entity responsible for sharing remedial costs.
- The University is named, or evidence indicates that it will be named, in a lawsuit to compel it to participate in remediation. There is a presumption that a lawsuit can be excluded from consideration if it is substantially the same as a lawsuit previously determined to be without merit in relevant judicial determinations.
- The University commences, or legally obligates itself to commence, cleanup activities or monitoring or operation and maintenance of the remediation effort. If these activities are voluntarily commenced and none of the other obligating events have occurred relative to the entire site, the amount recognized should be based on the portion of the remediation project that the University has initiated and is legally required to complete.

This specific obligating event normally does not include pre-cleanup activities, such as environmental due diligence site assessments that may be undertaken voluntarily by the University. However, the GASB believes that if the University legally obligates itself to commence pre-cleanup activities, those activities also should be included in the measurement of a remediation liability.

If the University voluntarily assumes a remediation obligation, it may not need to record a liability for the entire cleanup effort. For example, if the University sells land and voluntarily obligates itself to clean part of the site in the sales agreement, or if the University voluntarily signs a consent decree making itself a responsible party for cleanup activities, the University would be required to recognize a liability for only that work that the University had legally obligated itself to do. This could be significantly less than the cost the University would expect to incur to clean the entire site.

If the University voluntarily decides to remove non-friable asbestos-containing materials (e.g. vinyl flooring), this is NOT considered an obligating event. However, if the removal activity causes the asbestos to become friable, this invokes an obligating event.

In addition, if the University determines that any asbestos-containing materials pose an imminent threat to health and safety, then related asbestos removal is considered an obligating event.

If the University purchases a facility, and in the course of due diligence determines that it will voluntarily remediate contamination or remove hazardous substances, there would be an obligating event under this Statement for the remediation effort when the University commences the clean up activity, not at the time management makes the decision that they will voluntarily enter into the remediation work. The University only has an obligation to complete the expected cost of completing the removal work that has been started. If all remediation work that has started has been completed at year end, there is not any remediation obligation to accrue or to disclose.

***How should we determine whether an obligating event has occurred?***

In making a determination of whether an obligating event has occurred, campus financial staff should discuss potential events with campus environmental health and safety and risk management staff. The System Administration Controller's Office will also discuss with the System Office of Risk Management when preparing for year-end and for preparation of the footnotes.

***What is required if it is determined there are no obligating events?***

If the campus and the System determines there are no obligating events during the year, that conclusion should be documented based upon the campus and System's discussions with the appropriate staff. No further work is necessary.

***What is the next step if it is determined there is an obligating event(s)?***

If the campus determines an obligating event(s) has occurred, the campus financial staff must (1) consider the types of expenses or capital acquisitions that are involved in the various component activities, (2) evaluate the costs associated with various component activities to determine whether they are reasonably estimable, (3) follow the required approach to the measurement of the estimated costs, and (4) determine whether any of the allowable circumstances apply that would result in a cost being capitalized.

**What Component Activities Constitute Remediation Obligations?**

Once a determination is made that any one of five specified obligating events has occurred, the University is required to evaluate and estimate the cost of the component activities of expected remediation costs and determine whether costs for those components should be either (1) accrued as a liability or, if appropriate, (2) capitalized when goods and services are acquired.

A remediation obligation is an obligation to address the current or potential detrimental effects of existing contamination by participating in remediation activities. For example, obligations to clean up spills, hazardous wastes, or hazardous substances and obligations to remove hazardous substances such as asbestos are remediation obligations. Remediation obligations may include costs associated with the following primary component activities:

- *Pre-cleanup activities*, such as performance of a site assessment, site investigation, and corrective measures feasibility study, and the design of a remediation plan. A site assessment is a site-specific baseline risk assessment that identifies hazards, assesses exposure to the hazards and their toxicity, and characterizes and quantifies the potential risks posed by the site. A site assessment may be non-invasive, involving inquiry into previous uses of a site, site reconnaissance, and interviews, or may involve invasive testing for contamination. Legal costs may be involved.
- *Cleanup activities*, such as neutralization, containment, or removal and disposal of pollutants, and site restoration.
- *External government oversight and enforcement-related activities*, such as work performed by an environmental regulatory authority dealing with the site and chargeable to the University.
- *Operation and maintenance of the remedy*, including required monitoring of the remediation effort (post-remediation monitoring).

Not all remediation obligations will involve all of the above activities. For example, asbestos removal typically will not involve post-remediation monitoring.

Remediation obligations do *not* include pollution prevention or control obligations with respect to current operations, such as obligations to install air emissions controls, wastewater treatment systems, stormwater runoff controls, or use environment-friendly products.

### **What Expenses or Capital Acquisitions Must be Considered in Estimating the Cost of a Remediation Component Activity?**

Remediation expenses or capital acquisitions include all direct expenses or capital acquisitions attributable to remediation activities (e.g., payroll and benefits, equipment and facilities, materials, legal and other professional services) and may include estimated indirect expenses (including general overhead). Expenses or capital acquisitions related to natural resource damage (e.g., revegetation outlays) are included only if incurred as part of a remediation effort.

Expenses or capital acquisitions for operation and maintenance of a remedial action, including post-remediation monitoring required by a remedial action plan, are part of remediation activity rather than a separate future obligation. However, post-remediation monitoring estimates should take into account that such outlays are not likely to extend indefinitely. Estimates should be reassessed periodically.

Remediation obligations generally will result in recognition and reporting of remediation

liabilities. In certain instances, an obligation to participate in remedial activities will result in recognition and reporting of capital asset transactions at the time those assets are acquired.

***What expenses are not to be considered in estimating the cost of a remediation activity?***

Pollution prevention or control expenses with respect to current operations such as air and water pollution controls, fines, penalties and other non-remediation costs such as civil wrongs (toxic torts) arising from exposure to a toxic substance, litigation in support of potential cost recovery, workplace health and safety costs, etc. are not part of performing remediation and should not be included.

**When Does a Cost Become Reasonably Estimable and How Must Recognition Benchmarks be Used in Uncommon Situations?**

As mentioned previously, the campus financial staff must evaluate and recognize the costs associated with various component activities once:

- An obligating event has occurred, and
- As the ranges of the various component activities become reasonably estimable.

Measurement of the costs in the range *must use the expected cash flow technique*.

In some cases, the University may have insufficient information to reasonably estimate the ranges of all of the various component activities of its liability. In these cases, the University should recognize remediation liabilities as the range of each of the component activities of the liability (e.g., legal services, site investigation, or required post-remediation monitoring) becomes reasonably estimable. In other cases, the University may be able to reasonably estimate a range of all of the various component activities of its liability early in the process because the site situation is common, or is similar to situations at other sites with which the University has experience (e.g., leaking underground storage tanks). In such cases, the entire estimated liability should be recognized at this stage.

The range of an estimated remediation liability often will be defined and periodically refined, as necessary, as different stages in the remediation process occur.

***How do the guidelines for cost and liability recognition and measurement under GASB Statement No. 49 differ from Financial Accounting Standards Board Statement No. 5?***

**It is important to realize that guidelines for accrual of a loss contingency under FASB Statement No. 5 do not apply to recognition of remediation costs and liabilities.**

The guidelines articulated in FASB Statement No. 5 where a loss must be probable, reasonably estimable and reported at the lower end of a range when no best estimate is available is *not* controlling for recognition of pollution remediation costs and liabilities. The recognition and measurement concepts in GASB Statement No. 49 are fundamentally different than those required under FASB Statement No. 5.

Accruing for the cost and liability for remediation situations is based upon the following criteria:

- **Recognition** that a remediation liability exists is predicated on whether an obligating event has occurred. If an obligating event has occurred, the University is required to measure the estimated costs. This differs from the recognition criteria in FASB Statement No. 5 in that it is predicated on whether a loss contingency is “probable.”
- **Measurement** of the remediation cost and liability must be based upon the expected cash flow technique which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts. This differs from the measurement criteria in FASB Statement No. 5 in that it requires accrual of the low end of the estimated range of costs.

***How should recognition benchmarks be used in the estimation process in what may likely be very uncommon situations for the University?***

Certain stages of a remediation effort or process and of Responsible Party (RP) or Potentially Responsible Party (PRP) involvement provide benchmarks that should be considered when evaluating the extent to which a range of potential outlays for a remediation effort or process is reasonably estimable. Benchmarks should not, however, be applied in a manner that would delay recognition beyond the point at which a reasonable estimate of the range of a component of a liability can be made.

The recognition benchmarks that follow typically apply to remediation obligations that are not common or similar to situations at other sites with which the University has experience. At a minimum, the estimate of remediation costs and liability should be evaluated as each of the following benchmarks occurs (see additional language in GASB Statement No. 49 if necessary).

- *Receipt of an administrative order.* The University may receive an administrative order compelling it to take a response action at a site or risk penalties. Such response actions may be relatively limited or they may be broad. The ability to estimate outlays resulting from administrative orders varies with factors such as site complexity and the nature and extent of the work to be performed. The benchmarks that follow should be considered in evaluating the ability to estimate such outlays insofar as the actions required by the administrative order involve these benchmarks. The costs associated with performing the requisite work generally are estimable within a range, and recognition of a remediation liability for this work generally should not be delayed beyond this point.
- *Participation, as a Responsible Party (RP) or a PRP, in the site assessment or investigation.*
- *Completion of a corrective measures feasibility study.* At substantial completion of the corrective measures feasibility study, both a range of the remediation outlays and the University’s allocated share generally will be reasonably estimable.
- *Issuance of an authorization to proceed.* At this point, the regulatory authority has issued its determination (e.g., an EPA record of decision) specifying a preferred remedy.

- *Remediation design and implementation, through and including operation and maintenance, and post-remediation monitoring.* During the design phase of the remediation, the University develops a better understanding of the work to be done and is able to provide more precise estimates of the total remediation costs.

## **HOW MUST THE COSTS ASSOCIATED WITH A REMEDIATION COMPONENT ACTIVITY BE MEASURED?**

As previously discussed, once a determination has been made that an obligating event has occurred, remediation liabilities should be measured based upon the remediation costs expected to be incurred to settle those liabilities. In addition, the component activities of the remediation liability should initially be recognized when the range of the obligation in total, or for any element of each component activity, becomes reasonably estimable.

In terms of measurement, remediation costs and liabilities must:

- Be based upon the current value of costs expected to be incurred; and
- Be measured using the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts.

### ***What does it mean that measurement of remediation costs and liabilities must be based upon the current value of costs expected to be incurred?***

Current value is the amount that would be paid if all equipment, facilities and services included in the estimate were acquired during the current period, rather than their present value. The GASB believes that projecting uncertain remediation cash flows to specific future periods, and then discounting those cash flows, will add more subjectivity than relevance to the measurement.

Because settlement of a remediation liability is not always possible in the current period, settlement can involve future events. The current value of a remediation liability should be based on reasonable and supportable assumptions about future events that may affect the eventual settlement of the liability. For example, the current value of a remediation liability should be based on applicable federal, state, or local laws or regulations that have been approved, regardless of their effective date, and the existing technology expected to be used for the cleanup.

The meaning of reasonable and supportable assumptions is subject to judgment; however, it is not limited to a virtually-certain-to-occur belief and is not necessarily related to the degree to which evidence can be verified objectively.

### ***What does it mean to use the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amount?***

The expected cash flow technique uses all expectations about possible cash flows and is the sum of probability-weighted amounts in a range of possible estimated amounts, resulting in the estimated mean or average.

Reasonable estimates of ranges of possible cash flows may be limited to a few discrete scenarios or a single scenario, such as an amount specified in a contract for remediation services.

If the potential liability is not significant, one or two discrete scenarios may be sufficient for purposes of estimating the cost and liability. For practical reasons, the University may choose to use only a limited number of potential outcomes (data points) for calculating the expected cash flow. The University may choose to use only best case, worst case, and most likely potential cash flows. If the campus does not have a reasonable basis for specifying the probability and amount of a most likely potential cash flow, it may use only two data points. For example, if potential remediation costs in a particular component activity range from \$1 million to \$3 million and no amount within the range is considered to be a better estimate than any other amount, a liability of \$2 million would be reported, calculated as follows:  $(\$1 \text{ million} \times 50\%) + (\$3 \text{ million} \times 50\%)$ .

If the potential liability is significant, a limited number of discrete scenarios and probabilities should be developed that capture the array of possible cash flows, even in cases in which the University has access to only limited data about the possible cash flows within a range. In developing those scenarios, the University could use actual cash flows for other remediation projects, if available, adjusted for changes in circumstances. Each application of the expected cash flow technique will differ based on the facts and circumstances of each measurement situation, available information and judgments applied. For example, if the best case scenario is \$150,000 with a 30% probability, most likely case is \$320,000 with a 60% probability, and worst case is \$450,000 with a 10% probability, a liability of \$282,000 would be reported, calculated as follows:

$$(\$150,000 \times 30\%) + (\$320,000 \times 60\%) + (\$450,000 \times 10\%) = \$282,000$$

***What is the University's obligation to re-measure, update and adjust the costs and liabilities?***

There is a requirement to continue to evaluate and update the costs until the remediation obligation has been entirely satisfied. The University should continue to refine its estimate of its liability as this additional information becomes available, and at least annually in conjunction with the year-end close and preparation of its financial statements. The portion of the liability expected to be paid within one year should be recorded as a current liability.

Further information likely will become available at various points until site remediation work is completed, subject only to post-remediation monitoring. Additional information may include changes in the remediation plan or operating conditions, or to the type of equipment, facilities, and services that will be used, price increases or reductions for specific cost elements such as ongoing monitoring requirements, changes in technology and changes in legal or regulatory requirements.

Recoveries that would result in expenses being reduced below zero (therefore a gain) are not reflected since to do so would recognize revenue prior to it being realized or realizable.

***How should expected recoveries from insurance companies, or others, if any, be incorporated into the measurement using expected cash flow technique?***

Expected recoveries from other parties, and expected insurance recoveries from policies that indemnify the University for its remediation obligations should in all cases be included in the

measurement by reducing the expense. Insurance recoveries should be recognized only when either realized or realizable. Clearly, if insurance proceeds have been received, the recovery must be recognized and recorded. In addition, if the insurance company has admitted or acknowledged coverage, an insurance recovery would be realizable and should be recorded. Without such acknowledgement or recognition, the recovery is considered to be unrealized. If the insurer has denied coverage, the insurance recovery generally is not recognizable.

The remediation liability may, or may not, be affected as follows:

- If the expected recoveries are not yet realized or realizable, the affected liability should be reduced, i.e. the expected recovery is net against the liability (debit liability and credit expense).
- However, if the expected recoveries are realized or realizable as outlined in paragraphs 21 and 22 of GASB Statement No. 42, they should be recognized separately from the liability as recovery assets (e.g., debit cash or receivables and credit expense). For example, if expected outlays are \$10,000 and expected recoveries of \$3,000 are realized or realizable, the pollution remediation expense would be \$7,000, the recovery asset would be \$3,000, and the pollution remediation liability would be \$10,000. If the pollution remediation liability had previously been recorded at a net amount of \$7,000 because the recovery was not yet realized or realizable, the liability would be increased by \$3,000 when the recovery asset is recorded because it becomes realized or realizable.

Under the expected cash flow technique, the measurement of the University's remediation liability should include all remediation work that the University expects to perform, including work expected to be performed for other Responsible Parties or PRPs, whether or not the University is required to do that work. Expected recoveries from those other parties and expected insurance recoveries from policies that indemnify the University for its remediation obligations also should be included in the measurement by reducing the expense and affecting the liability as follows:

- Expected recoveries from other Responsible Parties, PRPs and insurers should be measured consistently with the related remediation outlays based on their current value and using the expected cash flow technique.
- If recoveries become expected in periods following the completion of all remediation work, such that a remediation liability no longer exists, those transactions should be recorded, for example, as revenue and cash or accounts receivable when they are realized or realizable.

## **WHAT ARE THE ALLOWABLE CIRCUMSTANCES FOR CAPITALIZING REMEDIATION COSTS?**

Most pollution remediation outlays, including costs for property, plant, and equipment, should be reported as an expense when a liability is recognized. For example, a pump-and-treat system to be installed for pollution remediation generally would be reported as an expense at the time a liability is recognized. Some projects (e.g., land improvements or remodeling), for which the primary objective is other than remediation, may include remediation activities. Except for the

allowable circumstances provided below, incremental costs attributable to remediation activities (costs that would not be incurred absent pollution) should be reported as an expense when a remediation liability is recognized.

Remediation costs should only be capitalized when goods and services are acquired (capitalized costs are not recognized until they are incurred) for any of the following four circumstances, and only to the extent allowable in each circumstance:

- **To prepare property in anticipation of a sale.** In this circumstance, the University should capitalize only amounts that would result in the carrying amount of the property not exceeding its estimated fair value upon completion of the remediation. If costs exceed the estimated fair value upon completion of the remediation, they must be recorded as an expense and liability in the measurement process.
- **To prepare property for use when the property was acquired with known or suspected contamination that was expected to be remediated.** In this circumstance, the University should capitalize only those remediation costs expected to be necessary to place the asset into its intended location and condition for use as discussed in paragraph 18 of GASB Statement 34.

In the case of preparing purchased contaminated property for use and restoring contamination-impaired property, the GASB considered and rejected a strict fair value cap for this category because the University may, as a matter of public policy, invest more into land and facilities than their fair value.

In determining costs expected to be necessary to place an asset into its intended location and condition for use, the University should consider that not all increases in expected costs are appropriately considered to be necessary. For example, if a remediation project would not have been initiated had anticipated costs been as high as those actually incurred, the University generally should not capitalize all of the costs. In certain circumstances, the costs originally expected to be incurred may be indicative of the amount necessary to place the asset into its intended location and condition for use.

- **To perform remediation that restores a contamination-caused decline in service utility that was recognized as an asset impairment.** In this circumstance, the University should capitalize only those remediation costs expected to be necessary to place the asset into its intended location and condition for use as discussed in paragraph 18 of GASB Statement 34. In the case of restoration of an impaired asset, the outlays necessary to obtain a similar unimpaired asset, less the book value of the impaired asset, may be indicative of the amount necessary to place the asset into its intended location and condition for use.
- **To acquire property, plant, and equipment that have a future alternative use for other than remediation purposes.** In this circumstance, costs should be capitalized only to the extent of the estimated service utility that will exist after remediation activities uses have ceased. For example, the acquisition of unpolluted land generally would be fully capitalized.

Capitalized pollution remediation outlays are not recognized until the costs are incurred, they are not accrued. Capitalization is appropriate only if the costs take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively, or are delayed, but the delay is beyond the University's control.

#### Example of a Capitalization Situation

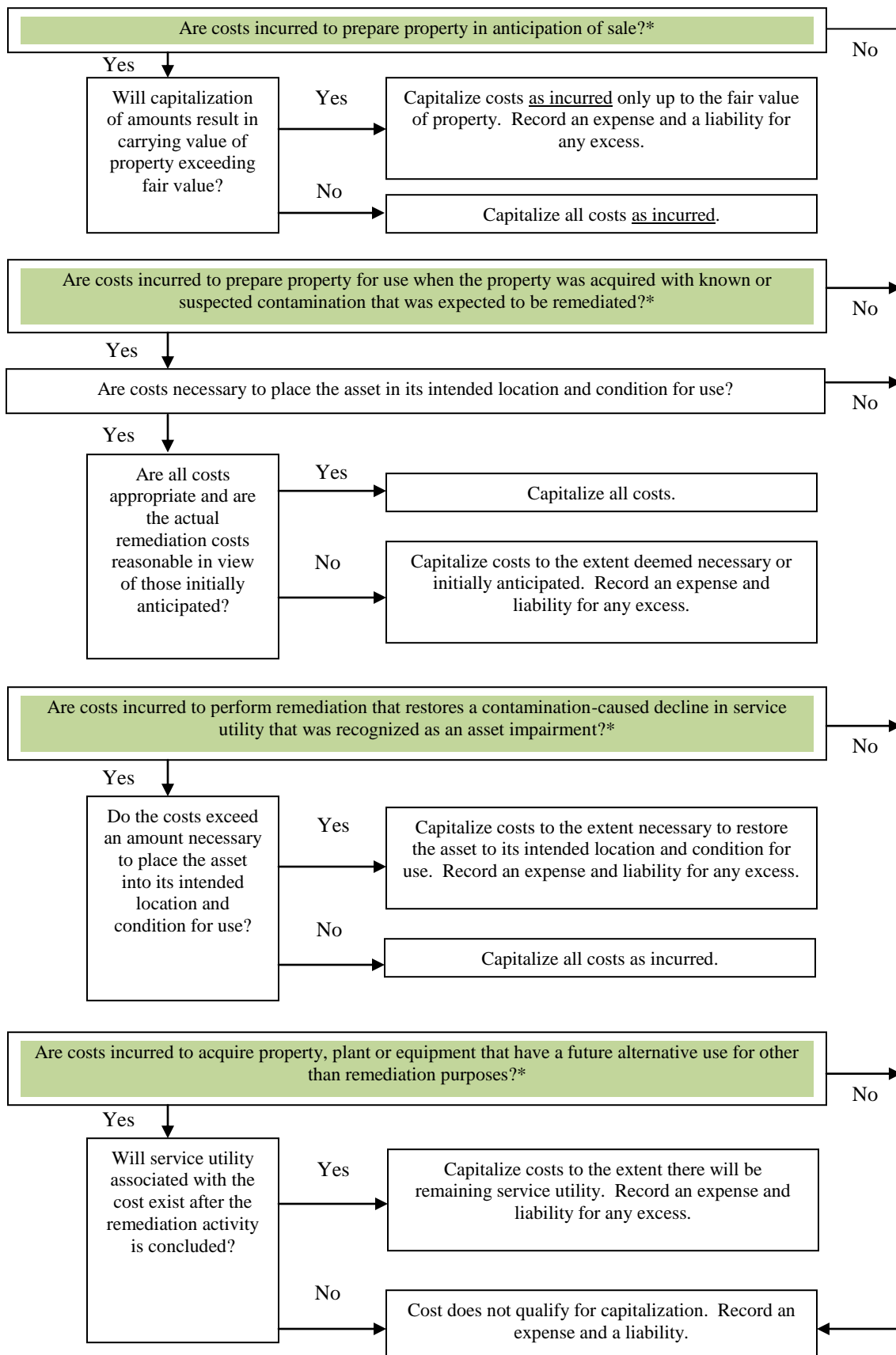
In August an institution purchased a building and land for \$100,000 with the expectation of cleaning up the site for resale, at expected outlays of \$130,000 to \$170,000. No amounts within the range are considered better estimates. The institution has a potential buyer for \$245,000. The pollution remediation liability is measured as:

$$(\$130,000 \times 50\%) + (\$170,000 \times 50\%) = \$150,000$$

The purchase price and expected pollution remediation outlays (\$100,000 + \$150,000) exceed the fair market value (\$245,000) by \$5,000.

Because amounts exceeding fair market value cannot be capitalized, the institution would record a pollution remediation liability and expense for \$5,000. No amount is recorded for the expected pollution remediation that would be capitalized because those outlays would not be recognized until they are incurred.

The flow chart on the following page summarizes the accounting treatment for outlays that are to be capitalized:



\*Implicit in the criteria is that costs will take place within a reasonable period prior to the expected sale or following acquisition of the property, respectively. If not, record an expenses and a liability.

## HOW SHOULD REMEDIATION COSTS BE RECORDED IN THE STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS?

If the conclusion is that remediation costs and a liability should be recognized as a result of an obligating event, and the amount is estimable and measured and does not meet the criteria for capitalization, it must be reported in the University's statement of revenues, expenditures and changes in net assets in one of three categories: an operating remediation loss, a special remediation loss, or an extraordinary remediation loss.

- *Operating remediation cost.* All remediation losses, or revenue, must be recorded as an operating activity unless they specifically meet the definition of a special or extraordinary loss (see below).
- *Special remediation cost.* The special cost category includes remediation costs that are associated with circumstances within the control of campus or University management and are either unusual in nature or infrequent in occurrence (GASB Statement No. 34, ¶56).
- *Extraordinary remediation cost.* The extraordinary remediation cost category includes costs that are not within the control of campus or University management and are both unusual in nature and infrequent in occurrence (GASB Statement No. 34, ¶55).

In the case of either a special or extraordinary loss, the loss is classified within the Other Changes in Net Assets section of the University's statement of revenues, expenses and changes in net assets. The distinguishing features between an operating loss and either a special or extraordinary loss depends on whether the event or circumstance is either unusual, infrequent, or both. Generally, recording remediation costs as special and/or extraordinary is highly unlikely and difficult to justify.

Events or circumstances that are considered to be unusual in nature should possess a high degree of abnormality and be of a type clearly unrelated to, or only incidentally related to, the ordinary and typical activities of the University, taking into account the environment and physical location in which the University operates. Unusual in nature is not established by the fact that an event or transaction is beyond the control of management.

Events or circumstances that are considered to be infrequent in occurrence would not reasonably be expected to recur in the foreseeable future, taking into account the environment and physical location in which the University operates. Paragraphs 20-22 of APB 30 provide a more detailed definition of unusual in nature and infrequency in occurrence.

The distinguishing features between a special loss and an extraordinary loss depend on whether the event or circumstance is within the control of campus or University management.

Recognizing that differences among the three categories may be subtle, the UT System Controller's Office can assist in researching the appropriate categorization to use in any given situation. In any event, if the cost is recorded as an operating cost, it must also be recorded by the function that used the polluted capital asset requiring remediation. If the cost is recorded as a special or extraordinary cost, there is no need to identify the cost by function.

## **WHAT ARE THE DISCLOSURE REQUIREMENTS?**

For disclosure purposes, the UT System Controller's office will need the information on remediation costs and liabilities in order to disclose in the University's footnotes the following information:

- The nature/type of contamination and source of the remediation obligation (e.g., federal, state, or local laws or regulations);
- The amount of the estimated liability (if not apparent from the financial statements);
- The methods and assumptions used for the estimates;
- The potential for changes due to, for example, price increases or reductions, technology or applicable laws or regulations; and
- Estimated recoveries reducing the liability.

For remediation liabilities, or portions thereof, that are not yet recognized because they are not reasonably estimable, the University should disclose a general description of the nature of the remediation activities.

When pollution remediation outlays qualify for capitalization under the provisions of GASB 49, the following considerations should be made:

- Land Improvements – no dollar threshold for capitalization. Land Improvements include the removal of underground storage tanks and the complete demolition of a contaminated building
- Building improvement – total outlays must be greater than \$100,000 to qualify for capitalization. Building improvements include the costs associated with cleaning up asbestos or other contaminants.

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## **SPECIAL INSTRUCTIONS FOR INITIAL IMPLEMENTATION**

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The provisions of this statement are effective for financial statements for periods beginning after December 15, 2007, or fiscal year 2009 for the UT System.

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## **FORMS AND TOOLS/ONLINE PROCESSES**

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None

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## **APPENDIX**

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None

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Keywords: pollution, environment, hazardous waste

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