Governmental Accounting Standards Board (GASB) Statement No. 83,

Certain Asset Retirement Obligations
Issues Resolution Memo No. 83-1

BACKGROUND

GASB issued Statement No. 83 (GASB 83), to address accounting and financial reporting for certain asset retirement obligations (AROs). This Statement will enhance comparability of financial statements among University by establishing uniform criteria to recognize and measure AROs.

An ARO is a legally enforceable liability associated with the permanent retirement of a tangible capital asset from its normal operations. When the University has a legal obligation to perform future asset retirement activities related to its tangible capital asset, a liability for the retirement obligation should be recognized. A liability is recognized when it is both incurred and reasonably estimable. Liabilities are incurred at the occurrence of external and internal obligating events that obligate a University to perform asset retirement activities.

An external obligating event can include approval of law or regulation, creation of contract, or issuance of court judgment for which legally bind a University to perform asset retirement activities. An internal obligating event is an action taken by University that requires the University to apply legal requirements to the University specific circumstances.

This Statement requires the University to initially measure a deferred outflow of resources associated with an ARO at the amount of the corresponding liability when the ARO is incurred. The measurement of an ARO is the best estimate of the current value of outlays expected to be incurred to remediate the ARO. The estimate should include all the costs (including equipment, facilities, and services) required to perform the remediation activities at the end of the current reporting period.

Subsequent measurements should be performed at least annually to adjust the current value of the University's ARO. The evaluation should consider the effects of general inflation or deflation and the effect of any relevant factors to significant increases or decreases to estimated outlays associated with the ARO.

This Statement takes effect for financial statements for reporting periods beginning after June 15, 2018. University and its financial reporting entities will adopt GASB 83 starting on July 1, 2018 (fiscal year 2018-2019). Changes adopted to conform to the provisions of GASB 83 will be applied retroactively by restating the financial statements for all prior periods presented in the fiscal year 2018-2019 financial statements.

DEFINE ISSUES

The University must determine whether GASB 83 changes any existing financial reporting and disclosure requirements for any of the University's financial reporting entities.

AUTHORITATIVE GUIDANCE AND APPROACH

Under GASB 83, a University that has legal obligations to perform future asset retirement activities related to its tangible capital assets is required to recognize a liability and a corresponding deferred outflow of resources for ARO based on the best estimate of the current value of outlays expected to be incurred when the liability is incurred.

Introduction:

The University does not recognize a liability and a corresponding deferred outflow of resources for its tangible capital assets that are subject to legal obligations to perform future asset retirement activities. Implementation of GASB 83 will require the University to identify its tangible capital assets that are subject legal obligations to perform future asset retirement activities, recognize liabilities and corresponding deferred outflow of resources when the liabilities are incurred and reasonably estimable. Liabilities are defined as present obligations to sacrifice resources that the University has little or no discretion to avoid.

Asset Retirement Obligation (ARO):

An ARO is a legally enforceable liability associated with the permanent retirement of a tangible capital asset. A tangible capital asset is considered retired when it is permanently removed from service. The University can sale, abandonment, recycling, or disposal the tangible capital asset in some other manner; however, the temporary idling of a tangible capital asset does not encompass retirement.

The University has an ARO when it is compelled to permanently retire a tangible capital asset, dispose a replaced part that is a component of a tangible capital asset or perform environmental remediation associated with the retirement of a tangible capital asset that results from the normal operation of that capital asset.

GASB 83 does not apply to the following:

- Obligations that arise solely from a plan to sell or otherwise dispose of a tangible capital asset
- Obligations associated with the preparation of a tangible capital asset for an alternative use
- Obligations for pollution remediation, such as asbestos removal, that result from the other-than-normal operation of a tangible capital asset
- Obligations associated with maintenance, rather than retirement, of a tangible capital asset
- The cost of a replacement part that is a component of a tangible capital asset
- Landfill closure and postclosure care obligations, including those not covered by Statement No. 18, *Accounting for Municipal Solid Waste Landfill Closure and Postclosure Care Costs*
- Conditional obligations to perform asset retirement activities.

Recognition of an ARO:

GASB 83 requires that the recognition of the ARO when the liability is both incurred and reasonably estimable. The ARO is reasonably estimable if the best estimate of the costs expected to be incurred, if were to be paid at the end of the current reporting period, can be determined at a reasonable cost.

Incurrence of a liability is manifested by the occurrence of both an external obligating event and an internal obligating event resulting from normal operations.

Recognition of an ARO (continue):

An external obligating event is an event external to the University that establishes the legal enforceability of requirements to perform asset retirement activities. An external obligating event include the followings:

- Federal, state, or local laws or regulations are passed to require the University to perform asset retirement of a tangible capital asset. The obligating event date is the approval date of such law or regulation. Such examples include power plants in several campuses and medical centers and sewage treatment plant in one campus that subject to environmental regulations; laboratory and healthcare equipment that needs to be disposed of in a specific way due to radioactive material or waste generated by equipment regulated (e.g., nuclear medicine equipment – MRI, x-ray, CT/PET scanners).
- The University enters into a binding contract that has explicit provision requires the University to bear the cost to decommission the tangible capital asset (usually at the end of the term of the contract). The obligating event date is the effective date of the contract. Such examples include the University entered into a space lease agreement whereby the University did leasehold improvements to use the space as clean room labs, facility with a raised pool and is required to incur costs to remove the pool and install a new roof to restore the space to its previous use condition at end of lease term pursuant to the lease agreement.
- A court issues a judgement to order the University to fulfill ARO resulting from its normal operation of the asset. The obligating event date is the issuance of the court judgment.

An internal obligating event is an action taken by the University that requires the University to <u>apply legal requirements</u> to its specific circumstances. If the University voluntarily approves a plan to retire a tangible capital asset, this action is <u>not</u>, by itself, an internal obligating event.

An internal obligating event is one of the following:

- For contamination-related AROs, the event is the occurrence of contamination. For purposes of GASB 83, contamination refers only to contamination that (a) is a result of the normal operation of a tangible capital asset and (b) is not in the scope of GASB Statement 49 *Accounting and Financial Reporting For Pollution Remediation Obligations,* as amended (future remediation activities required upon retirement of an ARO is not covered by GASB Statement 49).
- For non-contamination-related AROs, the timing of the obligating event depends on the pattern of incurrence of the liability.
    - If the pattern of incurrence of the liability is based on the use of the tangible capital asset, the event is placing that capital asset into operation and consuming a portion of the usable capacity by the normal operations of that capital asset.
    - If the pattern of incurrence of the liability is not based on the use of the tangible capital asset, the event is placing that capital asset into operation. For example, the internal obligating event to recognize a liability for the retirement of sewage treatment plant is the place-in-service date.
    - If the tangible capital asset is permanently abandoned before it is placed into operation, the event is the permanent abandonment itself. For example, the internal obligating event to recognize a liability for the retirement of a tangible capital asset that is permanently abandoned during construction is the abandonment of the construction.

For ARO related to acquire tangible capital assets, the event is the acquisition of the tangible capital asset. For example, the internal obligating event to recognize a liability for an acquired nuclear medicine equipment with an existing ARO is the acquisition of the equipment. The internal obligating event date is the acquisition date of the equipment.

Initial Measurement of an ARO and Deferred Outflow of Resources:

The measurement of an ARO should be based on the best estimate of the current value of outlays 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 at the end of the current reporting period. The best estimate should be determined using all available evidence. This approach requires probability weighting of potential outcomes when sufficient evidence is available or can be obtained at reasonable cost. When probability weighting cannot be accomplished at reasonable cost, the most likely amount in the range of potential outcomes should be used. The determination of that amount should take into consideration all other available evidence that can be obtained at reasonable cost, including the potential for higher or lower outcomes.

The University should initially measure a deferred outflow of resources associated with an ARO at the amount of the corresponding liability upon initial measurement.

Journal entry - Initial recognition of ARO and deferred outflow of resources:

Debit	*Deferred Outflows-ARO*
Credit	*Liabilities-ARO*

If a tangible capital asset is permanently abandoned before it is placed into operation, the University should immediately report an outflow of resources (for example, an expense) rather than a deferred outflow of resources when an ARO is recognized.

Journal entry - Recognition of ARO and outflow of resources:

Debit	*Other Non-Operating Expenses*
Credit	*Liabilities-ARO*

Subsequent Measurement and Recognition of an ARO:

Subsequent to initial measurement, the University should at least annually adjust the current value of its ARO for the effects of general inflation or deflation and evaluate all relevant factors to determine whether the effect of one or more of those factors is expected to significantly increase or decrease the estimated outlays associated with the ARO.

Re-measurement of the ARO is required only when the results of the evaluation indicate there is a significant change in the estimated outlays. Factors that may lead to a significant change in the estimated outlays include, but are not limited to the following:

- Price increases or decreases due to factors other than general inflation or deflation for specific components of the estimated outlays
- Changes in technology
- Changes in legal or regulatory requirements resulting from changes in laws, regulations, contracts, or court judgments
- Changes in the type of equipment, facilities, or services that will be used to meet the obligations to retire the tangible capital asset.

Subsequent Measurement and Recognition of an ARO (Continue):

Changes in the estimated outlays should be recognized as an increase or decrease in the carrying amount of the ARO in one of the following ways:

- For a liability that increases or decreases before the time of retirement of the tangible capital asset, the University should adjust the corresponding deferred outflow of resources.

Journal entry – Adjustment for increase in estimated ARO prior to the retirement of capital asset (if decrease, reverse Debit and Credit)

Debit	*Deferred Outflows-ARO*
Credit	*Liabilities-ARO*

- For a liability that increases or decreases at or after retirement of the tangible capital asset, at which time the corresponding deferred outflow of resources has been fully recognized as outflows of resources, the University should recognize an outflow of resources or an inflow of resources in the reporting period in which the increase or decrease occurs.

Journal entry – Adjustment for increase in estimated ARO prior to the retirement of capital asset

Debit(1)	*Other Non-Operating Expenses*
Credit(2)	*Liabilities-ARO*
Credit(3)	*Deferred Outflows-ARO*

(1) Credit Other Non-Operating Revenue if estimated ARO decreases.

(2) Debit Liabilities-ARO if estimated ARO decreases.

(3) Ensure ending balance of Deferred Outflows is zero.

Subsequent Measurement and Recognition of Deferred Outflow of Resources:

Upon initial measurement of a deferred outflow of resources for an ARO, the University should recognize a reduction of the deferred outflow of resources as an outflow of resources (for example expense) in a systematic and rational manner over a period of time, in one of the following ways:

- For a deferred outflow of resources initially reported at the beginning of a tangible capital asset's estimated useful life, the reduction of the deferred outflow of resources should be recognized as an outflow of resources (for example, expense) over the entire estimated useful life of the tangible capital asset.
- For a deferred outflow of resources initially reported after a tangible capital asset has been placed into operation, but before the end of its estimated useful life, the reduction of the deferred outflow of resources should be recognized as an outflow of resources (for example, expense) over the remaining estimated useful life of the tangible capital asset, starting from the point at which the deferred outflow of resources is initially recognized.

Journal entry – Amortization of deferred outflow of resources

Debit	*Other Non-Operating Expenses*
Credit	*Deferred Outflows-ARO*

Initial and Subsequent Measurement - Exception for a Minority Owner:

A University may have a minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset-

- in which a nongovernmental entity is the majority owner and reports its ARO in accordance with the guidance of another recognized accounting standards setter

  or

- in which no joint owner has a majority ownership, and a nongovernmental joint owner that has operational responsibility for the jointly owned tangible capital asset reports the associated ARO in accordance with the guidance of another recognized accounting standards setter.

In both situations, the University's minority share of an ARO should be reported using the measurement produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, without adjustment to conform to the liability measurement and recognition requirements of GASB 83. The measurement date of such an ARO should be no more than one year and one day prior to the University's financial reporting date.

Effects of Funding and Assurance Provisions:

A University may be obligated by legal requirements to provide funding and assurance that they will be able to satisfy their AROs when the obligation become due. For example, the University may be required to set up a separate trust and place assets in the trust to fund its ARO. If the University is subject to legal, regulatory, or contractual requirements to provide funding and assurance for its ARO by setting aside assets restricted for payment of the ARO, the University should disclose the followings:

- How any legally required funding and assurance provisions associated with ARO are being met; for example, surety bonds, insurance policies, letters of credit, guarantees by other entities, or trusts used for funding and assurance
- The amount of assets restricted for payment of the liabilities, if not separately displayed in the financial statements
- How any legally required funding and assurance provisions associated with the University's minority share of an ARO are being met; for example, surety bonds, insurance policies, letters of credit, guarantees by other entities, or trusts used for funding and assurance
- The amount of assets restricted for payment of the University's minority share of the ARO, if not separately displayed in the financial statements.

Providing funding and assurance that the University will be able to satisfy its ARO does not satisfy or extinguish the related liabilities, nor should the assets restricted for payment of ARO be used to offset the related liabilities. Any costs associated with complying with funding and assurance provisions should be accounted for separately from the ARO.

Journal entry – Funding for ARO

Debit	*Investment Held by Trustee*
Credit	*Cash*

Disclosure to Financial Statements:

The University is required to disclose the following information related to its ARO except for its minority share of an ARO:

- A general description of the ARO and associated tangible capital assets, as well as the source of the obligations (whether they are a result of federal, state, or local laws or regulations, contracts, or court judgments)
- The methods and assumptions used to measure the liabilities
- The estimated remaining useful life of the associated tangible capital assets
- How any legally required funding and assurance provisions associated with ARO are being met; for example, surety bonds, insurance policies, letters of credit, guarantees by other entities, or trusts used for funding and assurance
- The amount of assets restricted for payment of the liabilities, if not separately displayed in the financial statements.

If an ARO or portions thereof has been incurred by the University but is not yet recognized because it is not reasonably estimable, the University should disclose that fact and the reasons therefor.

Disclosure to Financial Statements - Minority Owner:

If the University has minority share (less than 50 percent) of ownership interest in a jointly owned tangible capital asset that has ARO, the University is required to disclose the following information about its minority share:

- A general description of the ARO and associated tangible capital asset, including:
  - The total amount of the ARO shared by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, other minority owners, if any, and the University
  - The University's minority share of the total amount of the ARO, stated as a percentage
  - The dollar amount of the reporting University's minority share of the ARO
- The date of the measurement of the ARO produced by the nongovernmental majority owner or the nongovernmental minority owner that has operational responsibility, if that date differs from the University's reporting date
- How any legally required funding and assurance provisions associated with the University's minority share of an ARO are being met; for example, surety bonds, insurance policies, letters of credit, guarantees by other entities, or trusts used for funding and assurance
- The amount of assets restricted for payment of the University's minority share of the ARO, if not separately displayed in the financial statements.

CONCLUSION:

Presentation of ARO will be applied to the University's financial statements by retroactively by restating financial statements, if practical, for all periods presented.

Any future additions or changes to the University's ARO and deferred outflow of resources will be assessed for reporting presentation using standards in GASB 83, as needed.

RESOURCES:

Appendix A: Flowchart

Appendix B: Practice Aid

Frequently Asked Questions

Addendum to IRM No. 83-1

FREQUENTLY ASKED QUESTIONS

1. ***What accounting codes should I use when recording these?***

   New Codes:
   AGC164805- CL- Asset retirement obligations
   AGC165595- NL- Asset Retirement Obligations
   AGC161365- Deferred Outflows-Asset Retirement Obligations
   Other existing codes:
   AGC208410- Other Non-Operating Revenue
   OC7800- Other Non-Operating Expenses

2. ***If the federal, state, or local law and regulation passes that requires special disposal of a tangible capital asset, but any assets made before the law and regulation was put in place are exempt, is an ARO either for the old asset or for any replacement asset need to be recognized?***

   The University is not required to recognize an ARO for an existing old tangible capital asset that is exempt from the law and regulation, however, when the tangible capital asset is replaced and a new one is purchased, then the University is required to recognize an ARO associate with the new tangible capital asset if the conditions of recognizing an ARO in GASB 83 are all met.

3. ***Does materiality judgment apply to this statement?***

   Yes, materiality applies to all GASB statements.

   The University has determined $100,000 as the initial threshold amount for recognizing an ARO associated with a tangible capital asset. Tangible capital assets that (i) are placed-in-service at the same time, (ii) have the same useful lives and (iii) are expected to be retired at the same time during the same obligating events can be treated in aggregate as a group of assets.

4. ***Do the obligations that arise solely from a plan to sell or otherwise dispose of a tangible capital asset or obligations with the preparation of a tangible capital asset for an alternative use or conditional obligations to perform asset retirement activities meet the definition of an obligating event?***

   No, GASB 83 applies to ARO result from the normal operations of tangible capital asset, whether acquired, constructed that are subject to legally enforceable liabilities associated with all of the following activities:

   - Approval of federal, state, or local laws or regulations
   - Creation of a legally binding contract
   - Issuance of a court judgment

   If a lessee's liability as a result of obtaining the right to use an underlying asset is incorporated into the lessee's lease payments, then the University does not need to recognize an ARO associated with the lease, otherwise, the University is required to recognize an ARO in accordance with GASB 83.

5. ***A medical center approves the retirement plan of a building used for patient care by 2030 to be in compliance with state seismic safety requirement pursuant to Senate Bill 1953. Does the medical center need to recognize an ARO associated with the retirement of the building?***

Yes, the medical center needs to recognize an ARO if the best estimate of costs associated with the retirement of the building can be determined. Senate Bill 1953, initially passed in 1994, is a program of seismic safety building standards for certain hospitals constructed on and after March 7, 1973. The external obligating event is the passage of the bill into a law. The medical center's building is required to be in compliance with the existing laws and regulations. When the medical center has a plan to demolish a building by 2030 to comply with Senate Bill 1953, an internal obligating event has occurred. If the costs associated with the retirement of the building can be reasonably estimated, the medical center will need to recognize an ARO accordingly.

6. ***Should the California or national general inflation or deflation rate to adjust the change in estimated outlays associated with the ARO subsequent to initial measurement? Should the general inflation or deflation rate be as of a specific date or for a specific period?***

   Use current industry estimates for cost inflation, if available for inflation or deflation to adjust the estimates. If industry estimates are not available, the percentage of change of the corresponding California "Fiscal Year Averages" Consumer Price Index (CPI) at the link below can be used to determine the general inflation or deflation rate as of the date of measurement (fiscal year end).

   California CPI: http://www.dof.ca.gov/Forecasting/Economics/Indicators/Inflation/

7. ***An ARO is measured based on the best estimate of the current value of outlays expected to be incurred. GASB 83 requires the probability weighting of potential outcomes when sufficient evidence is available or can be obtained at reasonable cost. How should we determine the best estimate when probability weighting cannot be accomplished at reasonable cost?***

   According to GASB 83, when probability weighting cannot be accomplished at reasonable cost, the most likely amount in the range of potential outcomes, i.e. the best estimate, should be used, and the best estimate must be at least the lowest amount in the range of potential outcomes.