MINUTES

To:	Board Members		
From:	Duke (ext. 297)		
Subject:	Minutes of the March 9, 2005 Board Meeting: Potential Agenda Project on the Reconsideration of the Accounting for Contingent Environmental Liabilities under Statement 5	**Date:**	March 15, 2005
cc:	Smith, Bielstein, Petrone, Golden, Leisenring, Polley, Gabriele, Sutay, Larson, Duke, Allen, Bean, Mahoney, Getz, Thompson, FASB Intranet		

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic:	Potential Agenda Project on the Reconsideration of the Accounting for Contingent Environmental Liabilities under Statement 5
Basis for Discussion:	Memorandum dated March 9, 2005
Length of Discussion:	10:50 a.m. to 11:15 a.m.
Attendance:	
Board members present:	Herz, Batavick, Crooch, Schipper, Seidman, and Young
Board members absent:	Trott
Staff in charge of topic:	Larson
Other staff at Board table:	L. Smith, Golden, and Duke
Outside participants:	Leisenring (IASB)

Summary of Decisions Reached:

The Board discussed an agenda request made by The Rose Foundation to add a project to its technical agenda to reconsider the accounting and reporting for contingent environmental liabilities. Specifically, the Board considered whether contingent environmental liabilities that meet the recognition criteria in paragraph 8 of FASB Statement No. 5, *Accounting for Contingencies*, should be recognized at expected value and whether contingent environmental liabilities of a similar nature should be aggregated for purposes of assessing materiality. The Board decided not to add a project that addresses these issues to the agenda for the following reasons:

1. The Board does not desire to reconsider Statement 5 and FASB Interpretion No. 14, *Reasonable Estimation of the Amount of a Loss*, solely in the context of environmental liabilities.
2. The current project to reconsider the conceptual framework may result in changes to the accounting and reporting of contingent liabilities. Reconsidering the guidance in Statement 5 prior to substantial completion of this project is not desirable.
3. The Board believes that the current accounting literature addresses the concerns raised in the agenda request regarding disclosures and questions whether problems identified are related to compliance with the literature, rather than deficiencies in the literature.
4. A separate project is currently being considered by the staff to address the broader issue of disclosures of risks and uncertainties in financial statements, and the staff plans to bring a proposal for that separate project to the Board at a later date.

Objective of Meeting:

The objective of the Board meeting was for the Board to decide whether it will add a project to its agenda to reconsider the accounting for contingent environmental liabilities. In particular, the Board will consider whether contingent environmental liabilities that meet the probable threshold under paragraph 8(a) of Statement 5 should be reported at expected value and whether contingent liabilities of a similar nature should be aggregated for purposes of assessing materiality.

Matters Discussed and Decisions Reached:

1. Mr. Larson started the discussion by stating that the purpose of the meeting was for the Board to consider adding a project to its technical agenda to re-consider the accounting for contingent environmental liabilities. In March 2004, the Board received a White Paper from The Rose Foundation outlining what their research demonstrated as the consistent underreporting of environmental liabilities in financial statements of public companies.

2. Mr. Larson stated that the notion of underreporting in the White Paper refers to both the undervaluing of estimated contingent environmental liabilities and the lack of recognition or disclosure of such liabilities as a result of methods used by companies to assess materiality.

3. Mr. Larson stated that the accounting for contingent environmental liabilities is governed by the provisions of Statement 5 and its interpretive guidance, including Interpretation 14, AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*, as well as various EITF Issues and SEC Staff Accounting Bulletin No. 92, *Accounting and Disclosures Relating to Loss Contingencies*. In Interpretation 14, the Board concluded that when a loss contingency meets the probable criteria in paragraph 8(a) of Statement 5 and the reasonable estimate of the loss is within a range of possible losses, it is deemed that the amount of the loss can be reasonably estimated and an amount shall be accrued for that loss. The Board further concluded that when no amount within the range is a better estimate than any other amount, the minimum amount of the range shall be accrued. Constituents have raised concerns that allowing enterprises with exposures to environmental risks to

recognize liabilities at the minimum amount of an estimable range results in the gross underreporting of these liabilities in financial statements.

4. Mr. Larson stated that the constituents recommend that the Board re-consider Statement 5 and Interpretation 14 to require that recognized contingent environmental liabilities be measured in accordance with the American Society for Testing and Materials 2001, *Standard Guide for Estimating Monetary Costs and Liabilit*ies *for Environmental Matters [E2137-01]*. This standard provides that in most instances enterprises should measure their contingent environmental liabilities at expected value.

5. Mr. Larson stated that concerns also were raised in the White Paper regarding the application of the materiality threshold in assessing environmental obligations for accrual or disclosure and suggested that in practice enterprises analyze environmental obligations on a piecemeal basis. They believe that this practice results in the underreporting of environmental liabilities for those enterprises that have obligations that may be immaterial on an individual, site-by-site basis, but collectively may be material to the enterprise as a whole.

6. Mr. Larson stated that the constituents recommend that the Board reconsider Statement 5 to require the use of the American Society for Testing and Materials 2001, *Standard Guide for Disclosure of Environmental Liabilities [E2173-01]*, in assessing the materiality of contingent environmental liabilities for recognition and disclosure. This standard advises enterprises on how to aggregate environmental liabilities so that shareholders and other financial statement users have a better understanding of the aggregate environmental liabilities enterprises face.

7. Mr. Larson stated that the staff recommends that the Board not add this project to its technical agenda at this time. The staff notes the following in support of its recommendation:

a. With respect to the concerns raised regarding the measurement of contingent environmental liabilities, in light of the far reaching effects of Statement 5 and Interpretation 14, the staff sees no basis for reconsidering the accounting and reporting of contingent environmental liabilities in isolation. Further, the staff believes that there should be no established difference between the measurement attribute of contingent environmental liabilities and the measurement attribute of other contingent liabilities recognized in the financial statements.

b. With respect to the concerns raised regarding application of the materiality concept, the staff believes that adhering to both the letter and the spirit of the existing literature provides adequate and reasonable disclosures of environmental liabilities in audited financial statements.

8. Mr. Crooch stated that it appears constituents are not following GAAP in this area. He believes the Board should not address the issue at this time. He added that if the Board decides to reconsider Statement 5, the Board should reconsider all of Statement 5, not just this specific issue.

9. Mr. Herz stated that the measurement issue is expected to be addressed in the conceptual framework project. He then asked if current literature allowed a company to assess materiality on a site-by-site basis or if the literature required a company to measure materiality on an aggregate basis. For example, one site may be immaterial, but aggregated with the hundred other sites that are very similar—the aggregated effect is material.

10. Mr. Larson stated that he did not believe the current literature allows a company to assess materiality to the individual sites without taking into consideration the aggregate effect. He added that while it may be difficult to apply the recognition criteria of Statement 5 and SOP 96-1 to an aggregated amount—once applied individually and then aggregated—he did not see any part of the literature that allowed an entity to not disclose the information in the financial statements.

11. Mr. Smith stated that when there is only one immaterial site, it may not be disclosed in the financial statements or in the notes; however, when there are many similar sites, the entity should evaluate whether it is reasonably possible that a number of the sites would have environmental liabilities associated with them that when aggregate have a material effect.

12. Mr. Golden stated that the issue is broader than Statement 5. He explained that the immaterial items box is looking at the aggregate impact of the standard on all transactions within the scope of the standard.

13. Mr. Batavick stated that at his former employer, service stations sites were aggregated. All of the peer companies also aggregated the service station sites to come up with an environmental liability for service stations. He added that he could not say what smaller companies were doing, but that if they were not reporting the impact at an aggregated level that, in his opinion, they were violating GAAP. In that case, the problem is an audit and enforcement issue.

14. Mr. Leisenring stated that the accounting implications would be huge if issues were addressed site-by-site. He stated that companies who get sued frequently generally list all of the claims in the disclosures and state that it is reasonably possible that a number of the cases would not go their way. They also would report the aggregate amount of the recognized liability.

15. In response to a question about whether the wording of paragraph 8 in Statement 5 would allow a company to not aggregate, Mr. Larson responded that in paragraph 1 a contingency also was defined as “a set of circumstances,” which could be interpreted to mean that all similar sites should be aggregated.

16. Mr. Young asked whether unrelated environmental contingencies that have no interrelationship should be aggregated and disclosed, when individually they are not material.

17. Mr. Larson stated that the overall exposure to environmental contingency liabilities should be disclosed, citing Statement 5, AICPA Statement of Position 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, and the nature of consolidated financial statements.

18. Mr. Young asked if what the staff believes to be adequate disclosure is consistent with what users would describe as adequate. As he understands Statement 5, a company with a material exposure that cannot reasonably estimate timing or measurement can get away with not disclosing the contingency. He stated his primary concern in this area is disclosure, not recognition and measurement.

19. Mr. Smith stated that Statement 5 does not allow a company to not disclose a contingent liability just because there is a wide range of potential outcomes. He added that the staff is working on issues with SOP 94-6, which in his view, is one of the most ignored documents in accounting literature. A staff member has been assigned to research the issues and then come to the Board with a potential recommendation to address risks and uncertainties on a broader level. This recommendation would address Mr. Young's concerns.

20. Ms. Seidman agreed with the staff's recommendation. She believes that the comment letters the staff will receive when the Board issues an exposure draft on business combinations (where the Board will propose that contingent liabilities acquired in a business combination be measured at fair value) will highlight the issues that will need to be addressed when the Board takes up the broader issue of contingent liabilities.

21. Mr. Leisenring stated that reviewing the comment letters from the Exposure Draft to modify IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*, also may be instructive; while IAS 37 does not directly relate to enivironmental contingencies, the issues surrounding recognition and measurement may be useful.

22. Mr. Batavick said that because of the reasons the staff has stated and the broader research being conducted on uncertainties, he agreed with the staff's recommendation.

23. Mr. Herz stated that Mr. Trott agreed with the staff's view. Mr. Herz's concerns are that while what the White Paper describes as current practice may be true, the Board considers the concerns raised by the paper to be compliance issues rather than deficiencies in the literature.

24. Mr. Golden stated that he would contact the SEC and discuss today's deliberations and the Board's view. He stated that he would inform the Board of the SEC's view.

25. Ms. Schipper clarified that the discussion with the SEC should focus on cross-sectional aggregation of environmental contingent liabilities and whether homogenous and heterogenous liablilities are or should be aggregated similarly.

Follow-up Items:

None.

General Announcements:

None.