Reserve Reporting in 10-Ks in the Utility, Energy and Industrial Sectors

THE EVOLUTION OF ENVIRONMENTAL LIABILITY REPORTING

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An article in Barron's reported recently that "an environmental liability appears to be keeping a lid on gains in several stocks."[1] We found this observation to be consistent with our understanding that reserving for environmental liabilities is top-of-mind for many of our Utility, Energy and Industrial clients.

Mazars is seeing an evolutionary change in how environmental liabilities are recognized, estimated and disclosed in 10-K reports. The shift underway is from "minimum-value" reporting to a more comprehensive "fair-value" approach for environmental reserve estimating and disclosure. Mazars has teamed up with The TBLS Group, environmental liability valuation experts, to take a deeper look into the current trends in environmental reserve reporting.

The following interview conducted with TBLS provides insight into how environmental consultants and their industry counterparts are establishing a mutual framework for estimating and disclosing liabilities that involves both GAAP and ASTM Standards.

A. What is TBLS's involvement with environmental liabilities in the Utilities and Energy space?

As an invited member of the ASTM International Subcommittee E50.05 on environmental risk management, as well as ASTM's newly formed PFAS committee, TBLS regularly participates with our Energy, Utility and Industrial sector peers in writing and reviewing environmental standards that apply to financial matters.

In addition, TBLS currently serves as settlement consultant for global energy/petroleum companies and as an expert witness in a large litigation involving emerging contaminants, including perfluoroalkyl substances (PFAS). In recent years, TBLS has conducted due diligence and environmental liability valuation for over 25 M&A transactions, including for companies in the water, nuclear, and coal-fired utilities, as well as other energy sectors.

B. How does the work TBLS conducts as environmental specialists integrate with a company's financial reporting?

TBLS follows ASTM standards when appropriate in our work valuing environmental liabilities. With three new and revised ASTM environmental standards now in place, ASTM compliance relating to environmental reserves now ties more closely to applicable GAAP requirements.

Chief Financial Officers and corporate accountants may want to become conversant with the new ASTM standard, ASTM E-3123-18 – Standard Guide for Recognition and Derecognition of Environmental Liabilities. This standard provides the guidance and structure for determining if a liability exists, whether an "Obligating Event" is material, and what the Fair Market Value of the liability might be. The standard outlines five categories of environmental liabilities that provide this consistent structure, including:

(1) Asset Retirement Obligations ("ARO")
(2) Regulatory and other Obligations
(3) Commitments
(4) Contingencies
(5) Guarantees

Each category includes corresponding FASB, GASB and IASB accounting standards, making it easier for financial officers, environmental personnel and auditors to coordinate and make disclosure decisions.

A revised standard, ASTM Standard E-2137-17 – Estimating Monetary Costs and Liabilities for Environmental Matters, deepens the new correlative relationship between environmental costing practice and applicable accounting principles. Prior to revisions in 2017, the E-2137-17 standard permitted environmental consultants to respond to CFO requests for estimates of liability costs based on a single, "minimum-value" estimate. In contrast, the new and revised ASTM Standards may require that environmental consultants include accounting metrics such as Material Costs and "Fair Market Value" Estimates including a "range of costs."

The third ASTM standard impacting 10-K disclosures is E-2173-16 – Standard Guide for Disclosure of Environmental Liabilities. We are seeing the effects of this standard in the evolutionary change taking place in how companies are disclosing environmental liabilities. For example, one company was sued by its investors for not disclosing over $40 million of liability. The company's response in its 2018 10-K was an enhanced disclosure as to the environmental reserve, which included short- and long-term costs, payments-to-date data and a description of the overall status of the liability.

C. Who are the stakeholders most concerned with environmental reporting?

Concern is shared by Chief Financial Officers, who are accountable for signing off on the accuracy of financial statements; investors mindful of the impacts of environmental liabilities on company performance and market valuation; and underwriters of corporate risk such as financial institutions, private equity, and insurance carriers.

In addition, business development professionals, CFOs and attorneys responsible for bankruptcy proceedings, M&A deals and liability transfers usually need to have environmental liabilities accurately assessed and accounted for, and properly disclosed, in order to complete transactions. Whether environmental liabilities are reported, and how they are quantified, can have significant financial consequences. For example, we were able to assist a client that was seeking to acquire an operating paper mill to identify and quantify Asset Retirement Obligations (AROs) and other long-tail liabilities, which enabled the client to negotiate a $10 million discount from the seller's initial asking price.

[1] Al Root, "Sizing Up an Environmental Liability for 3M and Others." *Barron's*, Aug. 1, 2019 at 6:00 am ET.

Customers and community stakeholders who are impacted also often track reporting of environmental liabilities, and view disclosures as an important part of evaluating a company's Environmental, Social and Governance (ESG) standing and Sustainability rating.

D. What do you see coming down the road? What are the emerging risks the industry will face in the future?

We see continuing litigation, regulatory enforcement and timing risks relating to environmental liabilities. In terms of emerging contaminants, we view PFAS as the biggest developing environmental risk. PFAS are "forever" chemicals that are being found in drinking water, groundwater and air that have been identified as potential carcinogens. Corporate manufacturers of PFAS are reserving billions of dollars to cover current and anticipated damage awards and litigation costs. Meanwhile, many water utilities across the country are reserving for expensive filtration systems to protect customers from potential exposure.

E. Mazars is working on a joint study with The TBLS Group regarding trends in environmental liability reporting, which will come out later this year. Could you tell us a little bit about why you think the study is relevant, and what we can expect to see in the study once it is released?

The study will provide utility sector clients with a focused look at reporting environmental matters, and managing their "spend" relative to environmental ARO, obligations, guarantees, and contingencies. The study will also accumulate year-over-year trends in business risks related to environmental disclosures. We are very much looking forward to sharing the results of the study later this year.

For further information about the TBLS Group and environmental liability valuation, please contact Frances Schlosstein, President: Office:973.750.1500, cell: 646.431.7605 or Fschlosstein@theTBLSGroup.com.

About Mazars USA LLP
Mazars USA LLP is a high-performing accounting, tax and consulting firm with significant national presence in strategic US geographies. Since 1921, our dedicated professionals have leveraged technical industry expertise to develop customized solutions for clients, create value, and optimize their performance. We offer a broad array of industry specialists providing services to growth-oriented enterprises and individuals. As the independent US member firm of Mazars Group, we deliver seamless access to the expertise of 23,000 professionals in 89 countries.

About The TBLS Group
The TBLS Group is an environmental liability valuation advisory. The company focus is on monetizing environmental matters to support environmental reserve reporting, due diligence in merger and acquisition, bankruptcy and commercial real estate transactions and as expert witness related to the settlement of complex environmental matters. TBLS frequently speaks about ASTM standards, NRD and sediment valuation and allocation. Recent presentations include: Environmental Bankers Association, New Jersey State Bar Association, (NJSBA) and Pollack Environmental Inns of Court,; National Association of Regulatory Utility Commissioners (NARUC), October 2018; Air and Waste Management Association of Oregon (AWMA), November 2018; Commerce and Industry Association of NJ (CIANJ) and numerous law firms.

About the Authors
Jeff Andrilenas, PG, LG, LEG is Executive Vice President and Environmental Lead at The TBLS Group. Mr. Andrilenas serves as a member of Subcommittee E50.05 of ASTM International and is responsible with other industry experts for writing and revising ASTM standards relating to environmental risk management and PFAS matters. This article was prepared in collaboration with Chase Drossos, Mazars USA, Frances Schlosstein, President and CEO of The TBLS Group, and Kenneth B. Furry, Esq. as counsel to the TBLS Group.