Annual Reassessment of Asset Retirement Obligations

Background

In 2005, a Brink's subsidiary recorded asset retirement obligations related to several building leases. After 2005, the subsidiary entered into certain lease addendums extending the lease terms; however, the AROs were not updated to account for the change in timing of anticipated payment of the AROs at the end of the lease term. Additionally, the estimated costs of the AROs had not been reassessed since 2005. Upon this discovery, the subsidiary performed a high level reassessment of the timing of settlement as well as the estimated costs required to restore the properties to their original conditions noting costs had increased for some properties and decreased for other properties. As a result, out of period adjustments were required to ARO assets, ARO liabilities, depreciation expense and accretion expense.

Guidance

Whenever a lease is renewed or terminated, the estimated AROs associated with the leases should be reviewed. In addition to reviewing leases upon renewal or termination, AROs in excess of USD 50,000 (prior to discounting to present value) should be reviewed at least annually to determine if there has been a change in circumstances that would affect the amount of the recorded liability. Examples include, but are not limited to:

- An expectation that the future cost will be more or less than the previous estimate of future cost
- An expectation that the obligation will be settled sooner or later than originally estimated, and/or
- A change in lease terms affecting the asset or future obligation.

If Brink's identifies one or more changes resulting in an adjustment to the ARO calculation, only those adjustments of USD 50,000 or more (prior to discounting to present value) should be recorded. If a change in the estimated ARO is less than USD 50,000, no adjustments are required.

Upward revisions

Increases in cost estimates are treated as an additional ARO layer. The present value of the increase in cost is recorded as an additional ARO Asset and ARO Liability based on a revised current period discount rate. If the expected settlement date has not changed (lease was not renewed or shortened), no change is required to the original asset and liability layer. If the settlement date has changed, resulting in the upward revision of costs (due to additional inflation during the extended period), the previous layer(s) must also be updated to reflect the new settlement date. The previous layer is updated using the original discount rate. See ARO templates provided to CFOs as part of the CFO Reminder and Certification Instructions for sample calculations.

Downward revisions

Decreases in cost estimates require a reduction in the ARO liability. The revised cost estimate of undiscounted cash flows should be discounted using the original discount rate. The reduction in the liability should be recorded first as a reduction in the ARO asset (through increasing accumulated depreciation). If a downward revision results in a decrease to the ARO liability that is greater than the remaining book value of the ARO asset, a reduction to depreciation expense should be recorded for the difference. The asset and accumulated depreciation should not be written off until the entity exits the lease since the ARO asset is linked to the leasehold improvements.

Settlement of obligation

When a lease is terminated and payments are made to restore the leased premises to original condition, the related ARO liability must be updated. When an ARO liability is settled, HFM Account 2040_300 ST Asset Retirement Obligation should be debited (to reduce the liability to 0, if the entire obligation has been fulfilled), HFM Account 1100 Cash should be credited (for the amount paid to settle the obligation) and HFM Account 6400_100 or 7100_100 Accretion expense should be credited (assuming there is excess of estimated ARO cost over actual payments).

Lessons Learned

At the time of a lease renewal or termination, any related ARO should be reassessed for proper accounting treatment. Additionally, on an annual basis, the estimated costs of AROs greater than USD 50,000 should be reviewed for appropriateness and documentation should be retained to support such cost estimates. These reviews will detect required changes in ARO obligations on a timely basis resulting in fewer out of period adjustments to the financial statements.