
THE NEXT REPORTING CHANGE

Disclosure of Unfunded Liability of Maintenance, Renewal Backlogs Can Impact Corporate Bottom Line

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Chief Financial Officers (CFO's) are coming to grips with the fact that they have the ultimate responsibility for financial information provided to investors, creditors and auditors. Measuring costs and reporting liabilities resulting from defined benefit pension plans have been sources of accounting controversy for many years – in 1966 the Accounting Principles Board (APB) concluded that improvements in pension accounting were necessary even if it was considered not practical at the time.

In 1995, FASB (Financial Accounting Standards Board) issued Statement No. 123; Accounting for Stock-Based Compensation, which mandated that expense recognition for the fair value of employee stock options granted was the preferable approach. It permitted the continued use of existing methods with disclosure in the footnotes to the financial statements of the pro forma effect on net income and earnings per share as if the preferable, expense recognition method had been applied.

Pressure to adopt the preferable method has dramatically increased in recent years. Several major U.S. companies have announced their intentions to change their method of accounting for employee stock options to an approach that recognizes an expense for the fair value of the options granted in arriving at reported earnings.

In addition, public pressure and congressional oversight have dramatically changed the way pension funding and stock options are reported, and even the process of reporting sales. The impact, for example, of Enron and several other major corporations having to restate their earnings on investors' confidence has been dramatic.

Now, the next area in which CFOs may be held accountable is in the reporting or more precisely the non-reporting of the negative impact of a growing backlog of needed repairs and maintenance. Sarbanes Oxley and Executive Order 13327 (which requires all federal agencies to improve real property inventory data and establish performance metrics and goals for facility maintenance operations) have both added pressure to government agencies and public corporations to account for the value of the investment in facilities and the stewardship of that investment.

Corporations typically have facility assets that represent 20 to 40 percent of their net worth and the requirement for funding proper stewardship of that asset commonly estimated to be four percent of replacement value. This requirement is viewed by management as subjective and deferrable. Corporate reported earnings could be artificially inflated by simply not funding or under-funding this significant requirement, thus creating a backlog of maintenance and repair. The resultant liability can be more significant than any of the reporting issues FASB has recently addressed.

Current accounting practices do not account for this liability and permit the reporting of inflated earnings. While currently the standard practice, this non-reporting of a significant liability flies in the face of the spirit and intent of both FASB and the AICPA

Until recent advances in facility asset management technology, the decisions to defer maintenance and repair were made under pressure to increase near term profits and reduce reported costs and without auditable data exposing the impact on future earnings. The increasing use of auditable facility asset management technology now captures the extent of the backlog, creates a database of deficiencies that comprise the backlog and more importantly calculates the significant short and long-range impact on shareholder value.

The CFO now has the opportunity to regain the trust of corporate investors by not only following the letter of financial laws, but by taking the additional steps of embracing the concept of stewardship of the investment shareholders have made in the facility asset. This will result in dramatic saving in Total Ownership Costs over the life cycle of facilities

Open reporting of unfunded maintenance and replacement requirements could very well become the next financial reporting change.

EDITOR'S NOTE: James R. Watson is Director of Federal Programs for NexDSS, a MACTEC company. The firm's flagship product, *Vertex*, is an integrated suite of software modules that helps facility owners and managers document facility assets, evaluate current facility conditions, forecast asset deterioration and develop budgets for building systems life-cycle costs. Contact Mr. Watson at (734) 453-9463, jrwatson@mactec.com. Also log on to www.nexdss.com for additional information.