

August 2, 2004

Letter of Comment No: 29
File Reference: 1099-001

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Proposed Interpretation, *Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement 143*
File Reference No. 1099-001

We appreciate the opportunity to comment on the above-referenced proposed Interpretation. Overall, we support the issuance of the proposed Interpretation because we believe it provides helpful guidance for preparers and auditors in better understanding the scope of FASB Statement No. 143, *Asset Retirement Obligations* (Statement 143). However, we have several suggestions that we believe will improve its clarity and operability. Our detailed comments are provided below.

Scope of Proposed Interpretation

We agree with the Board that the uncertainty surrounding the timing and method of settlement of an asset retirement obligation should not affect whether a liability for the asset retirement obligation should be recognized, but should instead be factored into the measurement of the liability. We believe that this clarification to the scope of Statement 143 will improve the consistency of liability recognition for legal obligations associated with the retirement of tangible long-lived assets when the timing for performance of the retirement activity is conditional on a future event.

The proposed Interpretation appears to indicate in several places that the *performance* of the asset retirement activity itself is conditional on a future event, rather than the *timing* of performing the asset retirement activity. We believe the wording in those specific places should be modified to improve the consistency and clarity of the proposed Interpretation. For example, we believe that the first sentence of paragraph 3 of the proposed Interpretation should be modified to indicate, "A legal obligation to perform an asset retirement activity that where the timing of performance is conditional on a future event is within the scope of Statement 143." Another example can be found in Examples 1-3 in the proposed Interpretation. The first sentence of paragraphs A3, A5, and A7 should be modified to indicate, "Although the timing of performance of the asset retirement activity is conditional on...." We believe that these changes will further clarify the scope of the proposed Interpretation.

Examples in Proposed Interpretation

Overall, we believe that the examples contained in the proposed Interpretation should be expanded to provide more meaningful background facts and details in order to clearly understand the basis for the respective conclusions reached in each situation (for example, why one asset has an indeterminate useful life while another does not). If additional details are not provided, we believe that inconsistent application of the provisions of the proposed Interpretation will result. Our detailed comments on certain of the examples provided in the proposed Interpretation follow.

Example 1 addresses a legal obligation associated with the special handling and disposal of asbestos in a factory. In that example, it was determined that an asset retirement obligation liability should be recognized because, despite the owner's ability to defer settlement of the obligation for the foreseeable future, no building will last forever and, therefore, the asbestos will eventually need to be removed and disposed of in a special manner. It is our understanding that there are many other state and/or local laws that impose various legal obligations upon building owners. For example, in the event that a building is abandoned and/or is deemed to have fallen into a certain state of disrepair there may be requirements to raze the building and remove the rubble (e.g., due to public safety concerns). Although the building owner may have an ability to defer settlement for the foreseeable future, no building will last forever and, therefore, the building must be demolished and the rubble removed from the site at some point in the future. The building owner may choose to perform the settlement activities before they are required to be performed under local/state law (in other words, at the end of the building's life the building owner may commence demolition activities before the building falls into a condition that would trigger notification by the local municipality that their building has become a public safety issue). Nevertheless, plans to perform the asset retirement activities in advance of the legal requirement to do so would only affect the measurement of the asset retirement liability (i.e., timing of performance), and would not impact the requirement to recognize the liability. If it is the Board's intent to include obligations such as the example above within the scope of the proposed Interpretation, then we strongly encourage the Board to specifically address these types of obligations in the proposed Interpretation because they will be much more common in occurrence and, in many cases, larger in magnitude than the asbestos issue addressed in Example 1.

The fair value of the asbestos liability in Example 1 was estimated by reference to an observable marketplace price, as provided for in paragraph 17 of FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements* (CON 7). However, there were no additional details provided with respect to how the entity was able to determine the "present value embodied in the acquisition price." We understand that it is very uncommon, in practice, to have the ability to estimate the fair value of an asbestos obligation in a plant or building by reference to observable marketplace price. Therefore, we recommend that additional supporting details be provided to describe how the entity was able to determine the "present value

Mr. Lawrence W. Smith

August 2, 2004

embodied in the acquisition price" (i.e., what sources were used, etc.) instead of simply stating that fair value was determined this way. Alternatively, the more likely discounted cash flow approach could be demonstrated in this particular example and, if the Board wants to emphasize the fact that quoted marketplace prices should be used when they are available (a concept that is already clear from paragraph 7 of Statement 143), then this point could be made elsewhere in the proposed Interpretation.

Example 4 addresses a legal obligation associated with the dismantlement of an oil refinery. In that example, it was determined that an asset retirement obligation exists because existing legislation creates a duty or responsibility for the entity to dismantle the refinery in a special manner. However, in this case, the entity believes that the refinery has an indeterminate useful life because there is a "lack of objective evidence regarding the useful lives of refineries" as well as the entity's "maintenance and replacement activities." Therefore, a reasonable estimate of fair value could not be made and, accordingly, the entity did not recognize an asset retirement liability. Some may argue that these same characteristics could be used to support an indeterminate useful life conclusion in many other circumstances (i.e., manufacturing plants, office buildings, etc.). Therefore, we believe that this example, in particular, requires more detail to better understand the unique facts and circumstances that support the basis for the indeterminate useful life conclusion in this situation. Without additional details, we believe that inconsistent application of the provisions of the proposed Interpretation will result.

Other Observations

We believe that the proposed Interpretation highlights the need for more comprehensive guidance addressing the accounting for property, plant and equipment. For example, an entity acquires a building and assigns a 30 year useful life. This composite useful life is comprised of various components (e.g., 50 years for the "shell" of the building and 10-30 years for all other components). The building owner has a legal obligation to perform certain activities upon the demolition of the building. Therefore, an asset retirement obligation is recorded based on a present value calculation using a settlement date of 50 years (i.e., the useful life of the building shell). In this situation, the capitalized asset retirement cost will be amortized over the composite useful life assigned to the building (30 years) rather than the expected life of the component to which the asset retirement obligation truly relates (50 years). This example highlights the fact that, in many cases, the expected settlement date of the asset retirement obligation and the composite useful life assigned to the related asset will be different (and in some cases, significantly different).

In April 2004, the Board objected to the Statement of Position (SOP) that had been developed by the AICPA's Accounting Standards Executive Committee. That SOP would have addressed many, but not all, of the issues associated with property, plant and equipment. We urge the Board to consider placing a higher priority on providing guidance in this area.



■ Ernst & Young LLP

Mr. Lawrence W. Smith

August 2, 2004

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Sincerely,

Ernst + Young LLP