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fei

financial executives international

committee on corporate reporting

July 30, 2004

Technical Director
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

RE: FILE REFERENCE 1099-001

Dear Sir/Madam:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") wishes to share its views on the Financial Accounting Standards Board's (the "Board") proposed interpretation of FASB Statement No. 143, *Asset Retirement Obligations* ("SFAS No. 143") relating to "Accounting for Conditional Asset Retirement Obligations" ("Proposed FIN"). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is a technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR and not necessarily the views of FEI.

We appreciate the efforts undertaken by the Board to interpret the recognition and measurement provisions of this complex standard and acknowledge that these provisions have led to diversity in practice. However, we fundamentally disagree with the Board's conclusion that the uncertainty surrounding the timing and method of settlement should be factored into the measurement of the liability at fair value, even when the retirement activity is conditional on a future event. In the examples cited by the interpretation, we believe that the conditional future event is the obligating event, not the act of contamination or the purchase of a property containing asbestos. Further, we believe that a liability is not reasonably estimable until the uncertainties surrounding timing and method of settlement are sufficiently clear that it is practicable to perform discounted cash flow scenarios with probabilities that are derived based on known facts, rather than on

speculation. The concerns we express now are consistent with those we provided to the FASB in the course of deliberations leading to SFAS No. 143 and we believe these difficulties could have been avoided if a narrower scope was initially adopted.

Absent a specific set of requirements, a company is not legally bound to hold assets for a determined period of time, nor is it obligated to demolish, renovate, or sell an asset. A company also has the option of simply abandoning the asset. The Proposed FIN makes the presumption that since long-lived assets do not last forever, and therefore their retirement is inevitable at some point in the future, recognition of a liability at fair value is appropriate at the present time due to the existence of potential legal or constructive retirement obligations. We believe that recognition is neither relevant to financial statement users nor reasonably estimable, absent an obligating event that renders the timing and amount of future cash outflows determinable with sufficient reliability that inclusion in financial statements is appropriate. In fact, there are many buildings that have been in existence for hundreds of years, and will likely continue to exist for the foreseeable future. With proper maintenance, upkeep and technological improvements, many productive assets and office facilities will never be retired within the context of the Proposed FIN.

We believe that such types of potential future events are more analogous to "contingent" obligations, as defined in FASB Statement No. 5, *Accounting for Contingencies* ("SFAS No. 5"), as opposed to being "conditional" events, as discussed in paragraph A17 of SFAS No. 143. Many of these obligations are contingent on a future, specific event occurring, most of which are fully within the control of the company owning the long-lived asset. We are troubled by the sentence in paragraph B14 of the Proposed FIN, which states "Consistent with a fair value measurement objective, the entity should consider the uncertainty surrounding the timing and method of settlement in the measurement of the liability, *regardless of whether the event that will trigger the settlement is partially or wholly under the control of the entity.*" [Emphasis added] In these circumstances, the actual date of retirement will likely be no more than a guess and, given that it often can be postponed indefinitely, the underlying assumptions are neither representationally faithful nor verifiable.

As a result, we do not believe that recognition of a liability associated with such speculative events, which might be triggered at some point in the future, should form the basis for recognition of an asset retirement obligation. These events would not meet the definition of a "present obligation" as required in FASB Concepts Statement No. 6, *Elements of Financial Statements* ("SFAC No. 6") because the obligating event has not yet occurred. Until such an event occurs, we do not believe a company "has little or no discretion to avoid the future sacrifice."

Regarding events that are not within the company's discretion, these activities may or may not qualify for treatment as an asset retirement obligation. The lack of current knowledge about potential future events underscores the point that these are not current obligations.

In addition to addressing the specific questions included in the Proposed FIN, we have included discussion of additional issues that we believe should be considered in the

Board's due process. We are particularly concerned with the threshold question of comparing the cost of implementation of the Proposed FIN with the assumed benefit to financial reporting. We believe the level of effort required to implement the Proposed FIN, including the record keeping, analysis and detailed level of review of assets and *potentially* applicable laws, will be extensive for most companies. However, we believe the actual effect on financial statements, considering the number of years that cash flows will be discounted back from, will be minimal for many companies, and therefore will not improve financial reporting.

Further, we believe the Proposed FIN is not operational and conflicts with the Board's definition of "operational" as provided in the July 2004 response to the U.S. Securities & Exchange Commission's Study on the Adoption of a Principles-Based Accounting System. Given the uncertainties regarding the timing of an obligating event and many other unknown factors, including the cost of removal/remediation of a long-lived asset, it is not possible in many cases to reasonably estimate the fair value of a potential asset retirement obligation. Further discussion is provided in the "Additional Information" section of this letter.

We strongly urge the Board to reconsider issuing the Proposed FIN. In our opinion, many asset retirement obligations are attributable to a specific event or management decision that will be made at some point in the future. As the event has not yet occurred, we believe it would be inappropriate to record a liability until those obligating events occur.

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We appreciate the Board's consideration of these matters and welcome the opportunity to discuss any and all related matters. If you have any questions regarding this letter, please feel free to call me at (989) 636-1541.

Regards,

Frank H. Brod
Chair, Committee on Corporate Reporting
Financial Executives International

Responses to Issues

Issue 1: The Board concluded that the uncertainty surrounding the timing and method of settlement should not affect whether the fair value of a liability for a conditional asset retirement obligation would be recognized but rather, should be factored into the measurement of a liability. Do you agree with the Board's conclusion? If not, please provide your alternative view and the basis for it.

We do not agree with the Board's conclusion. We believe the Board appears to be attempting to redefine the concept of a liability for a specific set of circumstances, rather than using the conceptual framework currently in place. We do not believe the Board should be altering the conceptual framework as it applies to liabilities. Recognition of liabilities before their occurrence is probable (as defined in SFAS No. 5) would not improve financial reporting. We believe the Proposed FIN would not only require recognition of liabilities that are not yet probable, but would require measurement of their values based on nothing more than a guess.

In reference to the existing framework, paragraph 36 of SFAC No. 6 provides three essential characteristics of a liability: "(a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened." We do not believe the requirements of the Proposed FIN would meet the first two of these characteristics.

The first characteristic states that a liability "embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand." We agree with the Board's basis for conclusion that this characteristic implies that a present duty exists if the entity has little or no discretion to avoid such a future transfer. However, we disagree with the Board that the existence of a law, regulation or statute provides sufficient evidence of a "present duty." As discussed in the main body of the letter, most, if not all, of the "conditional" obligations addressed are potentially triggered by some future event. Until the specific condition has been met, we believe the present duty has not yet occurred.

The second characteristic is that the "duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice." We agree that once the contingent event has occurred, it is likely that the company has little or no discretion to avoid the liability. However, depending on the nature of the long-lived asset and the nature of the legal requirement, a company may have several options that would allow a long-lived asset to continue on productively, not triggering the legal retirement obligation. A company often has the ability to hold an asset, sell it or demolish it. All of these situations are made at the company's discretion and any of them meet the definition of "retirement" of the asset. Depending on the method selected for retirement, legal

obligations may not be applicable. We believe this reinforces the belief that a company has the ability to avoid the future sacrifice, until a separate contingent event occurs.

We believe that clearly the first two characteristics would not be met in the situations defined by the Proposed FIN. Therefore, as a company would not have a present duty, nor would it have little or no discretion to avoid the future sacrifice, it would be inappropriate to record a liability.

The Board noted a similar concern with recognition of a liability related to FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ("SFAS No. 146"). Such exit or disposal activities are also contingent on a company's actions in connection with a future event. In paragraph 4 of SFAS No. 146, the Board concluded that, "a liability for a cost associated with an exit or disposal activity is incurred when the definition of a liability is met." Further, the Board stated, "an exit or disposal plan, by itself, does not create a present obligation to others for costs expected to be incurred under the plan; thus, an entity's commitment to an exit or disposal plan, by itself, is not the requisite past transaction or event for recognition of a liability."

The Board determined that an entity's plan for exit activities, regardless of the likelihood of occurrence, was insufficient to meet the definition of a liability. Further action is required to be taken by the entity in order to trigger recognition of that liability. As stated in paragraphs B16 and B17, this would resolve the apparent conflict between recognition of a liability based on a contingent future event and measurement of that liability at fair value.

We believe an analogy can be drawn between the circumstances described in the Proposed FIN and those in SFAS No. 146. In both cases, the transfer of assets at some undetermined point in the future will be based on specific actions taken by a company. However, in SFAS No. 146, the Board determined it would be inappropriate to recognize a liability until that action had been taken. The Proposed FIN would apply a considerably different result to an analogous set of circumstances.

We believe such events should be treated as contingent obligations, similar to other contingencies accounted for under SFAS No. 5. Those types of contingencies include whether it is probable that the company will incur the cost (using the definition of "probable" as contained within SFAS No. 5). Recognition of an associated liability is based on the probability of that contingent event taking place. Once management has committed to retiring an asset in a method that will leave it little or no discretion to avoid the legal obligation, we believe it would be consistent to recognize a liability at fair value. However, we believe that until that event has occurred (or it becomes "probable" within the definition of SFAS No. 5), it would be inappropriate to recognize a liability.

Issue 2: The Board concluded that all retirement obligations within the scope of Statement 143 that meet the definition of a liability in Concepts Statement 6 should be recognized as liabilities. Concepts Statement 6 states that a liability has three essential characteristics.

The second characteristic of a liability is that the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice. The Board decided that the ability to indefinitely defer settlement of an asset retirement obligation or the ability to sell the asset does not provide the entity discretion to avoid the future sacrifice, nor does it relieve the entity of the obligation. Are there instances where a law or regulation obligates an entity to perform retirement activities but allows the entity to permanently avoid settling the obligation? If so, please provide specific examples.

We believe that there are instances where laws or regulations may obligate an entity to perform retirement activities at some point in the future, but many of these laws are contingent upon a specific event occurring. As examples, we believe that alternative views exist for all of the examples included in Appendix A to the Proposed FIN.

In example one, the assumption is made that at some point in the future, a company will be required to either undergo a major renovation or demolition of an asbestos-containing facility in the course of retirement of that facility. The National Emissions Standards for Hazardous Air Pollutants ("NESHAP") require removal and disposal of asbestos when a building is either renovated or demolished. However, a company may retire an asset (as defined in footnote 2 to paragraph 2 of SFAS No. 143) through abandonment or other similar circumstances. A facility may be retired without disturbing asbestos, thereby avoiding the NESHAP requirements. In addition, in the event that a company elects to perform a major renovation to a facility, it is still possible to execute that renovation while the facility is temporarily idled. Such activity is outside of the scope of SFAS No. 143.

In example two, much of the chemical treatment to the wood in the telecommunications poles is intended to extend/preserve the life of the poles. As stated in the example, unless a company elects to remove the poles from the ground, the event triggering the asset retirement obligation has not yet occurred. In this example, if the company has determined that removal and replacement of the poles is required to maintain a certain level of service, then that choice would be the triggering event. However, a company may still elect to maintain the same pole structure and merely make repairs to existing poles. If that choice is made, and proper maintenance and upkeep is performed, it would be possible that those poles could continue to be in existence. We would agree that at the point a company committed to replacing the poles, leaving it little or no discretion to avoid the legal obligation, the triggering event would occur. However, we do not believe the event has occurred up until that point.

In example three, the use of bricks in an aluminum smelter are consistent with the use of a catalyst in several manufacturing processes. The replacement of bricks in the kiln should be considered an operating cost and built into the cost of smelting the aluminum, whether through capitalizing the replacement costs in inventory or recognizing the costs in a company's cost of sales. Assuming the bricks are treated as long-lived assets and the cost to replace them is not treated as maintenance costs, a company has an additional alternative in retiring the bricks, however. The treatment at a hazardous waste site is predicated on removal of the bricks from the kiln. A company also has the option of abandoning the kiln and not removing the bricks. The option exists to build another kiln or operating the

smelting activities through another method. As a result, similar to the facility containing asbestos in example one, we believe that retirement can be achieved without disturbing the bricks. Therefore, the legal obligation would not be triggered.

In example four, we agree that the company cannot reasonably estimate the fair value of the obligation due to the indeterminate useful life of the refinery. The same argument holds true for many manufacturing facilities that have been in operation for decades and are expected to continue to be in operation for decades into the future, or for real estate structures. Many buildings have been standing for hundreds of years, even thousands of years in Europe. The uncertainty as to when and how a structure will be retired and the technology available at that point in the future to remediate any legal obligation is impossible to estimate from a cost perspective. Using the same logic as examples one through three, until a company makes the decision to end production at the refinery, the legal obligation will not be triggered.

In each case, we believe alternatives exist that would allow for retirement of long-lived assets, but would not necessarily trigger the legal obligations. Therefore, we believe it would not be appropriate to recognize a liability for such obligations.

Additional Considerations

Contingent Future Events

Implicit in the notion asserted in the Proposed FIN is that companies should be able to predict events in the future that may impact them with both a high degree of reliability and at a very detailed level. This includes the prediction of when an asset will be retired, the type of event that may occur that would enforce a legal obligation (as defined in SFAS No. 143), and the likelihood of that event actually occurring. In addition, a company would need to predict these types of events with enough certainty to allow for a calculation of the estimate for the fair value of an obligation, even to the point of estimating what the cash flows will be potentially decades in the future.

The recordkeeping required to be able to track this level of precision would require that each asset be categorized among the various types of laws currently in effect that *might* be applicable at the time of an asset retirement and assigning a probability to each one as to possible occurrence. The detailed level of recordkeeping required could include following all regulations that might relate in the future to such items as cars, tires, batteries, underground tanks for gas stations and any variety of assets.

In addition, that type of predictability is both complicated and unreliable, since it will likely require making predictions well into the future. In many cases, most, if not all, of the predictions regarding probability, future cash flows, technological improvements affecting the retirement, discount rates and other criteria required to calculate the fair value of the liability per the requirements of the Proposed FIN would be nothing more than pure guesses. After that level of effort, once discounting has occurred, we expect that the impact to a company's balance sheet is likely to be minimal (as many of these types of obligations will likely occur many years in the future). Without a triggering event occurring, thereby providing some guidance as to timing and probability of requiring the legal retirement obligation, the fair value of such an obligation is not reasonably estimable.

The Proposed FIN is not operational. In the Board's July 2004 response to the U.S. Securities & Exchange Commission's Study on the Adoption of a Principles-Based Accounting System, "operational" is defined in terms of three requirements: "a provision/standard is comprehensible by a reader who has a reasonable level of knowledge and sophistication; the information needed to apply the provision/standard is currently available or can be created; and "the provision/standard can be applied in the manner in which it was intended." The lack of reliable information needed to apply the standard, including uncertainties regarding the timing of an obligating trigger and the multitude of unknowns regarding the possible future cost of removal/remediation of a long-lived asset, would greatly impair the ability of a company to estimate a fair value of a potential liability. In addition, we believe that this would result in a large number of different approaches taken by companies to estimate any number of variables and predict their likelihood far into the future. We believe that the variance in methods and the inaccuracies involved in such speculative future activities would make financial statements less, rather

than more comparable. We do not believe this would result in application of the standard in the manner in which it would be intended.

As a result, we believe the costs associated with the implementation and maintenance of this Proposed FIN would far exceed any benefit that might be obtained in terms of financial reporting.

Definition of "Probable"

We are also troubled with the separation of the definition of "probable" as used in accounting for contingencies in SFAS No. 5 with the concept used in the Proposed FIN. Requiring the detailed level of precision in predicting the future, as included in the Proposed FIN, leads to other possible conclusions that would be inconsistent with the current GAAP framework. Basing a balance sheet on activities that have not occurred and using a different threshold or definition of probable among various sources of authoritative guidance could reduce the consistency of financial statement presentation of such liabilities.

This proposed interpretation of asset retirement obligations is the only instance in GAAP that we are aware of which would require the recognition of a liability for an event that is not probable of occurring. The lack of probability builds inherent subjectivity and inaccuracy into the financial statements. We do not believe such recordings are reliable or auditable. If this is the Board's intention with regards to SFAS No. 143, we ask the Board to reconsider this approach.