Letter of Comment No: 26 File Reference: 1099-001

August 3, 2004

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

Re: June 17, 2004 Exposure Draft (ED) of a Proposed Interpretation, Accounting for Conditional Asset Retirement Obligations, an interpretation of Statement of Financial Accounting Standards (SFAS) No. 143, Accounting for Asset Retirement Obligations [File Reference 1099-001]

Dear Mr. Smith:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the above-referenced ED and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC supports the theory that all conditional asset retirement obligations should be recognized as balance sheet liabilities at fair value at inception and therefore does not support the indeterminate useful life exception noted in the ED. TIC finds practical problems in implementing the ED as written given the lack of guidance on the measurement of fair values for conditional obligations and the uncertainty concerning the applicability of FIN 45 to certain transactions.

TIC also recommends several amendments to the ED to improve the clarity of the final standard.

SPECIFIC COMMENTS

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 the liability. Do you agree with the Board's conclusion? If not, please provide your alternative view and the basis for it.

TIC supports the liability recognition provisions for conditional obligations of SFAS 143, as stated in paragraph A17:

Uncertainty about whether performance will be required does not defer the recognition of a retirement obligation; rather, that uncertainty is factored into the measurement of the fair value of the liability through assignment of probabilities to cash flows. Uncertainty about performance of conditional obligations shall not prevent the determination of a reasonable estimate of fair value.

SFAS 143 emphatically states that a reasonable estimate of fair value must be determined for every conditional obligation. TIC therefore disagrees with paragraph B19 of SFAS 143 and paragraph 4 of this ED, which provide a measurement exception for tangible assets with indeterminate useful lives. Given the huge sums that will likely be required to close down certain assets, such as refineries, TIC believes it is misleading to defer recognition of the asset retirement obligation for an unknown period of time in the future. Certain factors, such as alternative fuels or other regulatory changes, could adversely affect the oil industry thereby accelerating the necessary retirement of the refinery. There are indications, based on recent newspaper articles, that new oil refineries are not being built and that many older refineries have closed within the last twenty years or so. TIC is providing copies of these articles under separate cover for the Board's review. One article to be faxed is entitled "No Interest in New Oil Refineries," The Courier-Journal (Louisville, Kentucky), July 28, 2004, page D3. A second article is attached to this letter as a separate file and is entitled "No New Oil Refineries Planned in U.S.," Billingsgazette.com, July 11, 2004.

Comparability is compromised because liabilities would be understated compared to other industries. The proposed accounting also does not seem consistent with the recognition criteria established for other conditional liabilities.

TIC analyzed the measurement differential among long-lived assets. Once the estimated useful life of a tangible asset exceeds 60 years, the present value of the liability, which is the most significant element of the fair value, is very small. In other words, the FASB is allowing a recognition distinction without a material fair value difference. The ED should require the entity to use its judgment, based on facts and circumstances, in estimating fair value, the same as any other reporting entity.

TIC also noted that the rationale for the measurement exception is unclear and not well supported. Example 4 of the ED, paragraphs A8 and A9, justifies the indeterminate useful life "due to the lack of objective evidence regarding useful lives of refineries" and due to ongoing "maintenance and repair activities." Some could argue that the same justifications could be used to defer recognition of asset retirement obligations of other structures. TIC recommends that these paragraphs be revised if the indeterminate useful life exception is retained in the final standard, Smaller, non-public entities do not normally own oil refineries, so it is important for the example to better communicate why special accounting rules are warranted for these assets so that appropriate analogies may

be made to other assets. TIC's specific recommendations to improve the clarity of the ED are discussed below.

TIC believes implementation issues will arise in connection with the fair value measurement of the conditional asset retirement obligations. The Fair Value Measurements ED, paragraph D25(p), states that a high probability of non-enforcement can be one factor that affects the expected future cash outflows of a conditional asset retirement obligation. Neither ED addresses how fair value measurement is affected if enforcement is more certain but the estimated useful life is indeterminable.

If the Board finalizes the ED as written, another issue that may arise is whether unrecognized conditional performance obligations would trigger the accounting or disclosure under FASB Interpretation No. 45 (FIN 45), Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others.

TIC questions whether a company that has issued a guarantee to indemnify a surety for nonperformance under a surety bond relating to the closure of a tangible asset with an indeterminate useful life would have to record the "stand-ready" obligation under FIN 45, as well as provide the required disclosures. If the fair value of the asset retirement obligation cannot be determined and no liability is recognized, TIC believes the entity would have to recognize, at a minimum, a FIN 45 liability for the fair value of the obligation undertaken in issuing the guarantee. FIN 45 does not provide for an exception to recording this liability based on measurement uncertainties. Therefore, TIC believes the indeterminate useful life exception in the ED is inconsistent with FIN 45.

Recommendations for Improvement in the Clarity of the ED:

TIC appreciated the illustrative examples of the recognition provisions. However, the ED forces the reader to derive the key principles of recognition from the examples. TIC believes that the concepts underlying the conclusions reached in the ED should be explicitly articulated first, letting the examples illustrate the key accounting differences.

For example, a common thread through all of the examples is the fact that the retirement obligation originates from the normal operation of the asset and that special activities of some kind must be performed upon closure. Stating these premises is essential to understanding why the accounting for the closure of the refinery is different from the accounting for the removal of asbestos from a building. Without the key principles, Footnote 6 in Example 3 of the ED does not seem to make sense. The footnote states, in part:

In this example, the liability would include only the expected costs to dispose of the bricks at the special hazardous waste site and should not include costs associated with maintaining the kiln or removing and replacing the bricks.

Since the company must remove the bricks to dispose of them at the hazardous waste site, the exclusion of these costs from the asset retirement obligation does not seem logical until we see the fact that the liability recognition is limited to only those special activities that are unique to the closure of the facility. The disposal at a hazardous waste site is done only at closure whereas bricks would have to be removed to replace them as a matter of routine maintenance.

Example 1, paragraph A2, last sentence needs further explanation to understand the meaning of the phrase ...using the present value embodied in the acquisition price." It is vague as written.

Example 4 should point out that the periodic upgrading and maintenance (including component replacements) do not require special activities. It is only at the conclusion of the site's usage that the special activities will be performed. For Examples 1-3, the distinction seems to be one of specificity, that is, the specific asset will eventually physically deteriorate and require special activities.

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.

Technically speaking, TIC believes that if one is allowed to permanently avoid settling an obligation, then one is not "obligated" to begin with. Notwithstanding, one TIC member is aware of pre-1977 federal law concerning properties in the coal industry. If the company disturbs the site, it must remediate the site. If it does not disturb the site, remediation is never required.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen M. McEachern, Chair PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees

http://www.billingsgazette.com/index.php?id=1&display=rednews/2004/07/11/build/bus iness/40-new-refineries.inc

July 11, 2004 (Key points highlighted in yellow marker.)

Business

No new oil refineries planned in U.S.

By JOCELYN PARKER Knight Ridder News

DETROIT - With the United States consuming record amounts of gasoline, there's never been a more dire need to build new oil refineries.

But don't hold your breath.

There hasn't been a major new refinery in the United States since 1976, and experts say none is on the horizon. Refineries are expensive, and nobody likes having a big, smelly refinery near his or her back yard. But another reason you won't see any refineries springing up soon is that oil companies like things the way they are: Their refineries are operating near capacity, so they sell practically every drop of fuel they make.

Consumption surge

Consumers' driving habits and vehicle choices don't make things better.
Consumption has jumped 24 percent since 1990, thanks in part to the surge in the number of sport utility vehicles on the road. And the government expects another 48 percent increase by 2025.



There aren't enough domestic refineries to do the job. As a result, the amount of gas that's imported has gone from a mere 4 percent of consumption in 1995 to about 10 percent today.

Insufficient inventories of domestically refined gasoline contribute to high prices and spark fears about gas shortages, as they did last month.

Refining makes up roughly 14 percent of the cost of a gallon of gasoline, and in recent weeks gas prices reached record highs. Because demand for gasoline is greater than what the refineries can produce in many cases, refineries can charge more for gasoline.

Domestic refineries decline

The soaring gas costs are bringing more attention to the limited refining capacity in the United States. The number of domestic refineries is declining. In 1980, there were more than 300 U.S. refineries. At the end of 2003, there were 149, roughly a 50 percent decrease. Through early June, those refineries cranked out 8.5 million barrels of gasoline a day, up 4 percent from last

year. Some are running at close to 100 percent of their capacity just to keep pace with demand, so it's tough to further boost production.

The chance of new ones being built is slim. The last major U.S. oil refinery was built in 1976, and stringent pollution controls and the overall public distaste for refineries make it nearly impossible for oil companies to build more, oil experts say.

"No one wants one," said Anthony Sabino, associate business professor at St. John's University in New York. "Building a refinery is very expensive. It's a multibillion-dollar proposition."

Even a smaller-scale refinery could cost at least \$1 billion to build, said James Nelson, a division manager at Marathon Ashland Petroleum LLC's Detroit refinery, the only refinery left in Michigan. And due to changing clean-air rules for refineries, it costs millions to maintain the operations, experts say.

In the last 10 years, U.S. refiners have invested about \$47 billion in environmental improvements for their facilities, much of that to make cleaner fuels. Recently, refiners have invested millions to make cleaner, low-sulfur fuels for the environment.

But even before the idea of building a new refinery leaves the gate, it's faced with opposition from consumers and environmentalists. They're considered eyesores, so no one wants one in the neighborhood. It's difficult for oil companies to get the environmental permits to build. Smaller refineries have a tough time thriving because they just don't produce enough fuel to offset their operating costs, and experts say that's why so many refineries have shut down over the years.

"Most of them, if not all, were inefficient, and the owners of those refineries were unable to make a reasonable profit," Marathon's Nelson said. "That's typically the reason people would shut down a refinery."

Ashland Inc., which has a 32 percent interest in Marathon Ashland Petroleum, closed several refineries in the last 25 years. Marathon Ashland operates seven refineries.

Marathon's Garyville, La., refinery, which makes 245,000 barrels of gasoline a day, was the last major refinery to be built in the United States. Since then, oil companies have acquired or expanded refineries to boost production.

For instance, production at Garyville went from 232,000 to 245,000 barrels this year, Nelson said. And its Detroit refinery is going from 74,000 barrels of gas to 100,000 barrels by 2005. A barrel is 42 gallons.

Experts also say fewer refineries give the oil companies a huge advantage: They stand to make a lot more money when supplies are limited, so, even if people wanted more refineries, companies don't have a lot of incentive to build more.

In the first quarter, industry giant ExxonMobil saw its profits from refining operations jump 38.8 percent. Refining profits at ConocoPhillips grew 19.2 percent in the first quarter. Marathon Ashland, which isn't publicly traded, wouldn't release information on profits.

A spate of mergers in the oil industry has also limited the number of companies that operate refineries, so they're able to control the market, said Tyson Slocum, research director for Public Citizen's energy program.

"Let the record show that they're not very unhappy financially with the current state of affairs," Slocum said. "They're making profits on the tight capacity."

Limited capacity also presents another huge problem: When a breakdown occurs in the refinery system, it can create supply disruptions. And when that happens, consumers are likely to see the impact at the pump.

Though opposition for refineries is abundant, some lawmakers are pushing for construction of new refineries to help ease tight gasoline supplies and lower prices. House Republicans recently pushed through legislation that could speed up the regulatory and approval processes for new refineries in certain regions of the country. The bill encourages construction of new refineries in areas that have an unemployment rate 20 percent higher than the national average, have experienced massive layoffs in manufacturing segment or have a closed refinery in the area. The bill still has to be approved by the Senate.

Marathon Ashland's Nelson also said advanced-technology vehicles such as fuel cells and gaselectric hybrid vehicles could ease demand for gasoline over the years.

Experts also say the nation can expect more imports of gasoline to make up for what the domestic refineries can't produce.

Expansions of existing refineries are expected to continue.

But, as Sabino puts it, oil companies can only "increase capacity so much."

"Eventually we will have to build more refineries," Sabino said.

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