10 Paragon Drive Montvale, NJ 07645-1760 Tel: 800-638-4427, 201-573-9000

Fax: 201-573-8185



Certified Management Accountant Program
Certified in Financial Management Program

July 27, 2004

Larry W. Smith
Director, Technical Application and
Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
Norwalk, Connecticut 06856-5116

RE: File Reference 1099-001

Letter of Comment No: 6
File Reference: 1099-001
Date Received: 7/28/04

Dear Larry:

The Financial Reporting Committee of the Institute of Management Accountants is pleased to provide comments on the Exposure Draft of a Proposed Interpretation, "Accounting for Conditional Asset Retirement Obligations, an interpretation of FASB Statement No. 143" (the Proposed Interpretation). Although we favor clarification in the areas the Proposed Interpretation addresses, the FRC does not support the conclusions reached by the Board. Our major objections are as follows:

- (1) We continue to disagree with the fundamental recognition and measurement guidance in FAS 143 and believe that it would be inappropriate to recognize obligations related to retirement activities that are conditional on an indeterminate future event ("conditional obligations").
- (2) We disagree with the Board's conclusion that these principles produce relevant financial reporting information when applied to conditional obligations. In these circumstances, we do not believe that such obligations are reliably measurable nor is the resulting liability representationally faithful.
- (3) We do not believe that the document provides the necessary guidance for determining whether a conditional obligation should be recognized. The examples do not provide enough information to help the reader understand why the useful lives of some assets are indeterminate and others are not.

- (4) If a liability is to be recorded for conditional obligations, neither FAS 143 nor the Proposed Interpretation provide implementation guidance on what are likely to be very difficult measurement exercises. In that regard, we do not believe the guidance in paragraph A23 of FAS 143 is either helpful or appropriate in achieving a representationally faithful fair value measurement.
- (5) We are concerned that the Proposed Interpretation broadly expands the application of FAS 143 but only highlights a small number of affected areas. Constituents need a more comprehensive and representative list of potential asset retirement obligations that are likely to result from this Proposed Interpretation.
- (6) We do not understand the rationale underlying the Board's conclusions on transition. We strongly prefer a required effective date and transition guidance that avoids the need to restate previous interim periods.

We suggest that before the Board decides on a course of action in finalizing the document, it consider field tests involving the specific fact patterns identified. We also believe that other fact patterns should be developed that more clearly address the issues we see in practice. We will be pleased to make our members available to assist the Board in that effort.

Our more detailed comments follow:

Definition of a Liability

We believe that the need for the Proposed Interpretation underscores fundamental problems with the principles in FAS 143, which we raised during the Board's earlier deliberations leading to issuance of that standard. As a Committee, we continue to have significant concerns with the Board's position concerning the role of uncertainty in the recognition and measurement of a liability. Both the standard and this Proposed Interpretation base recognition on incurrence of a legal liability without regard to an assessment of likelihood that any "future sacrifice of economic benefit" will result from it. In the document's Summary, it states, "The requirement to consider uncertainty in the fair value measurement of the liability rather than the recognition of the liability provides information about the uncertainty surrounding future cash outflows." We disagree that uncertainty about the occurrence, timing and amount future payments is always a measurement question. We believe it pertains first and foremost to recognition.

Concepts Statement 6 defines liabilities as "... probable future sacrifices of economic benefits arising from present obligations..." and states that "probable" is used with its usual general meaning, rather than a specific meaning associated with FAS 5. Further, paragraph 36(b) of CON 6 states that one of the essential characteristics of a liability is that an entity has "little or no discretion to avoid the future sacrifice...." We do not believe the conditional retirement obligations that are the subject of the proposed Interpretation qualify as liabilities under the current conceptual framework for the following reasons:

• "Probable" is defined by Webster's dictionary as: "1. supported by evidence strong enough to make it likely to occur or be, though not certain to be; 2. that which can be reasonably,

but not certainly, expected; 3. likely to happen or have happened." All of these definitions indicate an explicit assessment of the degree of uncertainty and a presumption that the likelihood is fairly high.

The future sacrifice is not supported by evidence strong enough to make it likely to occur
because the entity has the ability in many circumstances, particularly in the case of
conditional obligations under the entity's own control, to delay the retirement obligation
indefinitely.

We therefore believe that the most supportable conclusion on the application of these terms in the context of the CON 6 definition is that recognition is required when it is fairly likely that the obligation has been incurred.

In raising this issue, we recognize that the underlying principle was debated at length by the Board in the deliberations leading up to issuance of FAS 143. That said, we do not believe that we are in a better position to apply the requirements of the Proposed Interpretation to conditional obligations than we were under FAS 143. Rather, the Proposed Interpretation has the potential to expand application of the principle to a much broader population and in areas where it is clearly not feasible to develop reliable and verifiable measures of fair value. In that regard, the recent comments of Douglas Carmichael, Chief Auditor of the PCAOB, about the use of fair value measures in such instances are particularly relevant.

Relevance to Financial Statement Users

Our strong preference would be for the Board to reconsider its decisions in FAS 143. However, we recognize that the Board is unlikely to act on that request even if it were properly documented and presented under the Board's Rules of Procedure. Accordingly, our only alternative in the context of this proposed Interpretation is to ask the Board to reassess the relevance of the financial reporting result that follows from application of the principle to the specific conditional obligations identified in the Proposed Interpretation. It is the Board's assessment that using the uncertainty of timing and method of payment in assessing the fair value of the liability will bring consistency and comparability to financial reporting in these circumstances. The premise underlying that assertion is that a reader of financial statements is provided with more information about future cash outflows through this reporting of asset retirement obligations. In other words, a probability-weighted discounted cash-flow model estimate is alleged to be more predictive of the future cash flows of an enterprise than information derived using a FAS 5 approach.

We believe that in most instances the use of a probability-weighted measure is much less predictive of the ultimate disposition of a conditional asset retirement obligation. These analytical techniques provide reliable estimates only when applied to transactions or events that are highly likely to occur within a fixed period or when applied to large volumes of transactions or events, such as those associated with estimating insurance loss reserves or pension liabilities. The relationship between the reliability of a statistical estimate and the volume of data used to make the estimate is well understood and accepted. Statistical estimation techniques employ explicit finite population correction factors that have the effect of reducing the reliability or

precision that would otherwise be attributed to estimates drawn from sample information when sample sizes used to estimate the value of a population are small.

We are not aware of any evidence that supports the Board's hypothesis that fair value estimates developed for a single or small number of events using subjective probability factors have sufficient relevance or reliability to support a pricing decision. Likewise, application of these techniques to valuation of non-financial assets and liabilities is fraught with difficulties that do not exist in capital market applications. We believe that non-financial liabilities recorded using these measures are frequently overstated compared to the ultimate disposition of the obligation, and occasionally are significantly understated. It also is highly unlikely that companies with otherwise identical conditional asset retirement obligations will derive similar probabilities and make similar judgments about settlement methods.

We do not believe that recording liabilities based on this methodology enhances the ability of financial statement users to make informed predictions about the entity's future cash flow prospects, nor does it assess Management's current performance. The Board appears to believe that financial statement users have an inherent understanding of the limitations of the probability-weighted assessment amounts recorded. We disagree. Average users of financial statements do not understand what these recorded liabilities represent and are unaware of the fact that settlement may occur decades into the future using remediation techniques that do not exist today. In addition, there is evidence that industry analysts are either ignoring the information altogether or making explicit adjustments to differentiate liabilities whose incurrence is probable from those that are speculative or will be settled far in the future.

We also wish to make the Board aware that in the absence of significant historical evidence of required performance on an uncertain liability, regulators are not permitting low probabilities to be used in measuring an asset retirement obligation. Rather, they are pointing to the language of paragraph A23 of the standard and requiring that a 50 percent probability be applied to the discounted cash flow scenario in which full remediation is required. We note that in example 4, part of the reasoning for concluding that there was an indeterminate useful life was that very few refineries have been dismantled. In certain cases, regulators have cited lack of evidence as a reason to apply paragraph A23 and have specifically rejected the notion that it provides sufficient basis to apply the guidance in paragraph A16. However, anecdotal evidence suggests that this view is not being consistently applied across all registrants. This demonstrates that even regulators, who are fairly sophisticated users of financial statements, may not have a common understanding of how this model works and how to distinguish between circumstances when application of paragraphs A16 is more appropriate than paragraph A23. Equally disturbing is the fact that application of the guidance in paragraph A23 can only produce a fair value measurement result by chance.

Before the Board requires that probability-weighted fair value measures be applied in these very difficult and subjective circumstances, we would strongly recommend objective research be done to determine the usefulness of this information to typical financial statement users and potential investors.

Recording Liabilities When Retirement is Under Entity's Own Control

We disagree with the statement in paragraph B14 of the Proposed Interpretation, which states "...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 the examples included in the interpretation, we believe that the conditional future event is the obligating event, not the act of contamination nor 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 a reasonable number of discounted cash flow scenarios with probabilities that are derived based on known facts rather than on speculation. Given that the actual date of retirement may be no more than a guess because the decision to do so often can be postponed indefinitely, we believe that the underlying assumptions are not verifiable and the resulting measurement is not representationally faithful.

The basis for the Board position appears to be 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 today because of the existence of legal or constructive obligations. Even if we were to accept the Board's premise, the Proposed Interpretation deems some long-lived assets to have indeterminate useful lives and concludes that others do not for reasons that are not articulated clearly. This guidance is critical to the consistent application of the Proposed Interpretation and has been the principal source of the implementation issues we see in practice. We do not believe that the guidance in this document will be operational unless and until more robust guidance is provided on this issue.

Comments on Examples Provided in the Proposed Interpretation

Example 1

We question the appropriateness of some of the facts used in this example. While many commercial facilities built within the last 50 years contain asbestos, it is acknowledged that if the asbestos is encapsulated, the building's environment is considered safe under present law. State and local regulations require the removal of asbestos only when it is disturbed. Therefore, it would appear that the obligating event would be the planned actions that would result in the release of the material (e.g., capital improvements, repairs, etc.) not the acquisition of the building itself.

We also do not understand the Board's statement that the fair value of the liability can be estimated using the present value embodied in the acquisition price. One might assume that this means the buyer performed a "with and without" analysis at the purchase date, which carries with it no more credibility than a similar analysis performed after the fact and in the absence of a transaction. Real estate experts tell us that there is no specific market evidence of the amount of value loss associated with this condition that can be derived from actual purchase and sale transactions. Therefore we need more facts to understand under what circumstances we should be able to obtain such information and what the likely sources might be.

In addition, this example states that an obligation must be recognized, since no building will last forever. The same statement could be made of the refinery in example 4, which is identified as an example of an asset with an indeterminate useful life. Would a liability be required to be recognized for the refinery when ownership changes in a purchase transaction? The information provided in the examples does not help the reader understand why the refinery has an indeterminate useful life and this building does not.

Example 2

This example contains a number of presumptions regarding the industry's operational activities that are not accurate. In the telecommunications industry, a pole is replaced when it is damaged due to exogenous events (e.g., weather or natural disasters, vehicular damage, road-widening projects, infestation by organisms, etc). The retirement of poles is not age-related and they are not periodically replaced as a maintenance activity. In some cases, there are poles standing that are more than 100 years old. Telephone poles are placed in service as a group to support a route or area of service. The wireline telecommunications business has existed for more than a century. Once built, routes are not abandoned – they are maintained. Individual poles may be replaced for the above referenced causes, but the routes are sustained indefinitely. We therefore believe that this example is ineffective because it does not reflect the actual fact patterns that are prevalent in this industry.

In addition, we note that before the enactment of SFAS No. 143, pole removal costs were estimated and accrued for in the accumulated depreciation calculations in order to more ratably account for on-going costs of service. Application of the standard required removal of those accruals upon adoption, which generated billions of dollars in credits to earnings in the form of an accounting change. While the industry and the major accounting firms were in agreement that this was the required treatment, and we know that the issue was discussed with the SEC Staff prior to the effective date of FAS 143 (presumably the FASB Staff also was consulted). Given these facts, we are concerned about the prospect of changing the conclusion on this specific issue in a document that interprets FAS 143. We believe that it is imperative that the Board examine the underlying rationale for the accounting conclusions provided to this industry in adopting FAS 143. If the Board ultimately determines that the original assessment was not appropriate, it will be important to constituents to understand the basis for the revised conclusion.

Example 3

The aluminum smelter example discusses kilns lined with bricks that must be periodically replaced. This industry is not one where we have expertise but there is a close analogy between this example and similar fact patterns in the Oil and Gas industry, where furnaces are operated as part of the refining process. Like the kilns, these furnaces also are lined. The lining must be replaced every four to five years in order to continue the refinery's operations. The industry has reflected this activity in one of several ways; (1) furnaces were given five year lives, and each "rebuild" was capitalized at 100% of cost, including environmental remediation costs; (2) the initial furnace was given the life of the refinery and each "rebuild" was expensed when it occurs; or (3) the initial furnace was given the life of the refinery and the cost of a "rebuild" was accrued for in the five-year period preceding its occurrence.

We note that in example 3, the Board is explicit on the point that the determining factor for existence of an ARO is that the kiln will not last forever. By analogy to the refining industry, furnaces are the same as new once they have been rebuilt, so there is no reason to separately account for this rebuild activity apart from the purchase and maintenance of the furnace. We suspect the kilns are similarly incapable of being distinguished from new once the re-lining activity discussed in the example is performed.

In our view, this example appears to be focused on an operations maintenance issue, rather than an asset retirement issue. We believe that existing practices in accounting for planned major maintenance provide more relevant financial reporting results in these circumstances than would the Proposed Interpretation.

Example 4

In this example, the Board concludes that the refinery has an indeterminate useful life, ostensibly because of the lack of objective evidence regarding its retirement date. The only other fact provided to aid in determining the basis for that assessment is that the company and its competitors have historically upgraded and maintained their refineries such that very few have been dismantled. This stands in marked contrast to the conclusion in example 1, where an imputed value is derived in some way from the purchase price and a liability is recorded. As discussed on page 4 of this response, this determination has been the source of numerous practice issues

We believe a conclusion that the assets have an indeterminate useful life could be reached in three out of the four examples. We do not see how the Proposed Interpretation will improve existing practice, as it is difficult to discern the conclusion reached from the facts presented. We also are concerned that this guidance will put enormous pressure on companies during filing reviews and will result in most asset retirement obligations with these characteristics being accounted for under paragraph A23 rather than paragraph A16. We cannot envision a basis to assert that application of the guidance in paragraph A23 produces a fair value result, except by chance, and we do not understand how the Board concluded that this guidance is appropriate in such circumstances. Moreover, we do not believe that broader application of such guidance, which seems likely under the Proposed Interpretation, will improve financial reporting.

Another Example

We would like to propose a fifth hypothetical example for the Board's consideration, which posits issues related to contractual obligations which are typical of the types of situations being faced by preparers and auditors as they apply FAS 143.

An entity is an operator of national convenience /gasoline retail stores. All of the retail locations are situated on leased ground. The standard lease has a five-year original term with three renewal options; each renewal is for an additional five-years, resulting in a total lease term of 20 years. Assume that any ARO obligations are outside the scope of SOP 96-1.

The entity has a 25-year operating history and currently operates 10,000 locations across the nation. In its 25 year history, the lease term in 2,000 of the locations expired. In just 50 of these 2,000 cases, the entity decided not to renew the lease. In these non-renewal situations, only 3 lessors have required site restoration actions to be taken and none of these required that the site be brought back to its original condition.

In the other 47 non-renewal situations, the lessor of the land allowed the site to remain in its current state because a competitor to the national convenience/gasoline retail store had agreed to lease the space. The entity was not required to perform site restoration actions even though the contract language in the lease agreement required performance.

We believe that a better understanding of the methods of applying the standard would be facilitated by examples that have this level of detail. Guidance could then clarify the manner used to determine if a liability is incurred and when to apply paragraph A16 of FAS 143.

Other Potential Asset Retirement Obligations

The FRC also is concerned that the issuance of this document in its present form will cause practice issues to increase significantly, as the number of cases for which difficult valuation procedures is required expands to a much broader population. We believe the number of areas affected extends well beyond those identified in the Proposed Interpretation. For example, the document does not address the EU Directive on Waste Electrical and Electronic Equipment. At least some members of our Committee believe that it may trigger asset retirement obligations that are within the scope of FAS 143, as many of the affected products are long-lived assets. We note that the International Financial Reporting Interpretations Committee is actively considering this issue at its July 29th meeting. There also are a host of environmental issues that do not fall within the scope of SOP 96-1, *Environmental Remediation Liabilities*, which are potentially affected by this document. It would be quite helpful to constituents and would improve consistency in application of the Interpretation if these areas were specifically addressed in the document.

Please feel free to contact me at (203) 373-3563 if you have any questions regarding the issues discussed in this letter.

Sincerely,

mitch Dansher

Mitchell A. Danaher Chair, Financial Reporting Committee Institute of Management Accountants