

Letter of Comment No: | File Reference: 1099-ARU

September 8, 2004

Mr. Robert H. Herz, Chairman Financial Accounting Standards Board 401 Merritt 7 P. O. Box 5116 Norwalk, CT 06856-5116

Dear Bob:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") is writing to formally submit a request that the Board reconsider FAS 143, Accounting for Asset Retirement Obligations. 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 those of FEI.

Under the Board's Rules of Procedure, any individual or organization may petition the Board to review or reexamine any effective standard or other pronouncement. Such requests are expected to state the reasons for the request, including "... how events and circumstances subsequent to the issuance of the pronouncement (including transitional and implementation issues) may be involved." It also suggests that such requests should provide specific proposals for solution with reasoning that supports its proposal. Our request relates to FAS 143 and the forthcoming Interpretation of that standard approved by the Board on August 25, 2004, which is expected to be effective on January 1, 2006.

We are requesting reconsideration of this standard because we are unable to determine the required measurement for certain types of asset retirement obligations, particularly obligations related to retirement activities that are conditional on an indeterminate future event occurring ("conditional obligations"). These obligations include but are not limited to, removal of asbestos encapsulated in the walls of buildings, environmental contamination on owned property for which there is no present requirement to begin remediation, removal of structures from leased property, and other similar retirement activities. It is simply not possible to measure the fair value of such conditional obligations with any degree of reliability. Moreover, if recognition were compelled by the issuance of the forthcoming Interpretation, it would not faithfully represent the true nature of the obligation. This is the case because there is no event or decision that makes the retirement of the asset probable in

<sup>&</sup>lt;sup>1</sup> FASB Rules of Procedure, Amended and Restated through May 1, 1991.

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the foreseeable future and thus would enable companies to reliably estimate the timing or amount of cash flows. Because conditional obligations can often be postponed indefinitely, we typically do not know when retirement activities would commence, when they would be completed, what methods would be used to effect settlement, and other important information that is necessary to measure the obligation accurately.

We note that even in the absence of further guidance, regulators have begun to compel recognition of liabilities in circumstances involving conditional asset retirement obligations. Paragraph A16 of FAS 143 provides that recognition and measurement is not required when insufficient information is available to estimate a range of potential settlement dates. Paragraph A23 of FAS 143 requires that if only two potential outcomes exist and there is no information about which outcome is more probable, each outcome should be assigned a probability of 50 percent. In the absence of significant historical evidence of required performance on an uncertain conditional obligation, regulators have cited lack of evidence as a reason to apply paragraph A23 and have specifically rejected the notion that this fact pattern provides sufficient basis to apply the guidance in paragraph A16. CCR believes that application of the guidance in paragraph A23 can only produce a fair value measurement result by chance. Accordingly, it is our view that compelling recognition on the basis of this requirement produces measurement results that are inconsistent with the requirements of the standard.

The Board's view is that recognition of such obligations is appropriate when the requirements of FAS 143 are met, even though the probability of settlement in the foreseeable future may be remote, and that the uncertainties described above should be factored into the measurement of the obligation. Implicit in those decisions is the Board's expectation that companies will develop cash flow scenarios for all plausible remediation strategies and time frames and assign probabilities to each scenario to deduce the expected value. In addition, companies will be expected to estimate the risk premium and profit margin that a market participant would require in order to assume the obligation if that information is available. In that vein, paragraph A20 specifically states: "It is expected that uncertainties about the amount and timing of future cash flows can be accommodated by using the expected cash flow technique and therefore will not prevent the determination of a reasonable estimate of fair value" (emphasis added). This effectively makes such measurements unavoidable in these circumstances. Our view is that because the timing of settlement is largely discretionary, application of this theory results in measurement based on speculative assumptions that are both highly judgmental and subject to substantial change. We note that this issue is not limited to circumstances in which the asset has an indeterminate useful life - all long-lived assets that have conditional aspects to their retirement, even those that may occur within a range of possible settlement dates - pose the same measurement conundrum. As financial officers of major public companies, we have significant concerns about our ability to certify in our securities act filings that these highly uncertain measurements fairly represent the value of retirement obligations. Nor do we believe that the basis for the measurement is verifiable and therefore question whether the financial statement result is auditable.

We observe that since FAS 143 was issued and made effective, the Public Company

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Accounting Oversight Board was formed with the mission of examining the performance of accounting firms that conduct audits of public companies. The responsibilities of the PCAOB place it a unique position to directly observe the application of accounting standards through oversight of auditing. As a result, emerging problems with newly issued accounting standards will often be detected first through the work of the PCAOB. Verifiability of certain types of fair value measurements required by FASB standards is one such issue. This topic was addressed in a recent speech made by Douglas R. Carmichael, the Chief Auditor of the PCAOB<sup>2</sup>. While we recognize that Mr. Carmichael's comments reflect his personal opinions and not necessarily those of the PCAOB, his views relate directly to the issues we face in applying FAS 143. Mr. Carmichael's remarks on this topic included the following:

"... to the extent accounting measures incorporate management's thoughts about the future—such as management's intent or forecasts—those thoughts cannot be verified because they also are not observable. Consider the implications of this situation, and I mean by that, the lack of verifiability, for the increasing instances in which the FASB specifies the use of fair value in accounting measurements...When fair value cannot be measured by reference to matters that are directly observable, and if the measure represents little more than the measurer's state of mind, neither the measurement nor the measurement method are verifiable. In those circumstances, the independent auditor has a scope limitation and should not express an unqualified opinion on financial statements that are materially affected by such a measurement. However, there is nothing specific or definitive in accounting or auditing standards to direct this result...Resolving this verifiability issue will require the attention and cooperative efforts of accounting and auditing standard-setters and regulators. In the meantime, the independent auditor should exercise due care, including the use of heightened professional skepticism, to ensure that measurer bias has not materially affected a fair value measurement based on valuation techniques."

We believe that Mr. Carmichael's observations raise important and significant issues with respect to the measurement of conditional obligations, where the timing and/or method of settlement may be partially or entirely at the discretion of the company. As we indicated in our July 30<sup>th</sup> letter, we continue to believe that recognition of conditional obligations is inconsistent with the definition of a liability articulated in FASB Concepts Statement No. 6, Elements of Financial Statements. To our knowledge, the Board has never conducted research to support its view that requiring recognition of conditional obligations in financial statements and incorporating uncertainties into the measurement provides useful information to users of financial statements. Nor has the Board provided specific implementation guidance to companies and their auditors to assist them in determining how to address the difficult measurement issues inherent in the application of FAS 143 to conditional obligations. For reference, we have attached our July 30, 2004, comment letter.

<sup>&</sup>lt;sup>2</sup> "The Accounting and Auditing Connection", Third Annual Financial Reporting Conference, Baruch College, April 29, 2004

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For all of the reasons discussed above, CCR believes that the required application of the principles in Statement 143 in these circumstances is inappropriate and potentially misleading to users of financial statements. CCR believes that the most appropriate way to resolve these issues is for the Board to reconsider this aspect of FAS 143 and we therefore request that a limited scope project be undertaken to amend the standard in a manner that would place conditional obligations outside its scope. We also ask the Board to address this matter in expeditious manner to ensure completion prior to the effective date of the Interpretation. If the Board believes that it will not be able to complete the project by then, we ask that the effective date of the Interpretation be postponed. We note that once effective, the Interpretation will broaden the application of FAS 143 and the consequential effects we discuss above could result in recognition of liabilities for conditional asset retirement obligations that are material to the financial statements of many companies.

We appreciate your careful consideration of this important request. CCR would be pleased to provide subject matter experts to assist the Board in better understanding the issues, should it decide to undertake this project. We welcome the opportunity to discuss our concerns with you further at your convenience. Please contact me at 989-636-1541 with any questions.

Sincerely,

Frank H. Brod

Chair, Committee on Corporate Reporting

Financial Executives International

Fred HBrok

cc: Robert E. Denham, President FAF

Donald T. Nicolaisen, SEC Chief Accountant