

July 30, 2004

Letter of Comment No: 24
File Reference: 1099-001

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

Reference No. 1099-001

Dear Mr. Smith,

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Financial Accounting Standards Board's (the FASB or Board) Exposure Draft, *Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143* (the "Proposed Interpretation").

We do not support the issuance of the Proposed Interpretation. We believe that companies should be allowed to continue to account for conditional asset retirement obligations under the policy they adopted upon implementing FASB Statement No. 143 (FAS 143), *Accounting for Asset Retirement Obligations*. In summary, we prefer this approach for two reasons:

- We find conceptual merit in both the Board's conclusion in the Proposed Interpretation and an alternate view. The alternative view is premised on the notion that an asset retirement activity under which an entity is not legally required to perform should be recognized when the conditional event occurs. Both views have merit and we find neither view to be superior.
- We question the Proposed Interpretation's usefulness from cost-benefit and operational perspectives. We believe the research, recordkeeping and reporting that would be required to comply with the Proposed Interpretation will not result in a significant, incremental benefit to financial-statement users and other capital market stakeholders, and will be costly to preparers.

The attached Appendix includes (1) our responses to the specific issues on which the Board requested comments, (2) further discussion of our views summarized above, and



(3) other matters we believe the Board should address and/or clarify if it decides to issue a final Interpretation. If you have any questions regarding our comments, please contact Dave Kaplan (973-236-7219) or Ray Beier (973-236-7440).

Sincerely,

PricewaterhouseCoopers LLP

APPENDIX

I. Responses to Issues on Which the Board Requested 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.

We believe the Board's conclusion is not entirely consistent with the conceptual definition and elements of a liability in FASB Concepts Statement No. 6 (CON 6), *Elements of Financial Statements*. The definition of a liability in paragraph 35 of CON 6 includes the notion of "**probable** future sacrifices of economic benefits" [emphasis added]. Footnote 21 to that paragraph states, "*probable* is used with its usual general meaning, rather than in a specific accounting or technical sense (such as that in Statement 5, par. 3), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved." Given that the CON 6 definition of a liability incorporates the notion of a probable future sacrifice, we believe that recognition of a liability must also inherently consider the uncertainty surrounding the timing and method of settlement.

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 are not aware of any instances in which a law or regulation would allow an entity to permanently avoid settling an obligation to perform retirement activities once the entity has triggered the legal requirement. However, we note that prior to the occurrence of the obligating event that triggers the legal obligation, the entity is not legally obligated to perform the retirement activities. See discussion below under the section II, "When Does the Obligating Event Occur?"

II. When Does the Obligating Event Occur?

Paragraphs B9–B11 of the Proposed Interpretation reiterate the three essential characteristics of a liability that are included in CON 6. Those characteristics are: “(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.”

In the Proposed Interpretation, the Board concludes that a legal obligation to perform an asset retirement activity that is conditional on a future event is within the scope of FAS 143. We agree that conditional asset retirement obligations are within the scope of FAS 143. However, we believe that the primary question with respect to recognition of a conditional asset retirement obligation runs to characteristic (c) in the CON 6 definition of a liability—i.e., whether the obligating event has occurred?

We refer the Board to our August 13, 2003 response letter regarding the proposed FASB Staff Position (FSP), *Applicability of FASB Statement No. 143, Accounting for Asset Retirement Obligations, to Legislative Requirements on Property Owners to Remove and Dispose of Asbestos or Asbestos-Containing Materials*. In that letter, we did not support the issuance of the proposed FSP. Our position at that time was based on our understanding of the applicable asbestos regulations; that is, the legal obligation to remove and dispose of asbestos or asbestos containing material (ACM) does not occur until the asbestos is disturbed or as a result of some future event disturbing the asbestos.

The underlying recognition principle the Board applied in developing FAS 143 was that an entity should recognize a liability for a legal obligation associated with the retirement of a tangible long-lived asset in the period in which that legal obligation is incurred (paragraph 3 of FAS 143). In the broader context of applying this principle to all conditional asset retirement obligations, we continue to believe that recording an asset retirement obligation (ARO) at the time the legal obligation is triggered has merit. However, where an existing law or regulation imposes certain legal requirements in conjunction with retiring or disposing of an asset, but does not require that an entity retire the asset, we believe that no legal obligation exists until retirement. That view is consistent with the guidance in the last sentence of paragraph B29 of FAS 143, which states:

...if an obligating event that leaves an entity little or no discretion to the future transfer or use of assets has not occurred, an asset retirement obligation does not meet the definition of a liability and, therefore, should not be recognized in the financial statements.

On the other hand, we respect the merits of the Board's conclusion in the Proposed Interpretation. The Board's underlying rationale appears to be based on the notion that, given their wasting nature, no tangible asset will last forever and, accordingly, asset retirement activities required by an existing law or regulation will eventually be performed by virtue of owning the wasting asset. From that perspective, an obligating event has occurred by the mere existence of a law or regulation that requires a specific asset retirement activity to be performed in combination with possession of an affected asset. Consequently, an entity's ability to indefinitely defer retiring a tangible asset does not eliminate that obligation. This position is also supportable by, for example, (1) a broad view that paragraphs A17-A18 of FAS 143 do not specifically scope out any particular type of conditional asset retirement obligation and (2) the fact that paragraph B25 of FAS 143 states, "an entity's promise may be unconditional or conditional on the occurrence of a specified future event that **is or is not with the entity's control ...**" [emphasis added].

We point out, however, that it appears the Board's view with respect to the obligating event for a conditional ARO is inconsistent with a prior view held by the Board regarding the obligating event associated with planned major maintenance activities that are required by law. Specifically, while the Board ultimately objected to the issuance of the proposed Statement of Position (SoP), *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*, we understand that the Board had nonetheless supported the conclusion contained in the proposed SOP that planned major maintenance activities that are required by law should be expensed when incurred and should not be accrued in advance. A planned major maintenance activity may occur, for example, in the airline industry, where an airline company may be required by law to overhaul its airplane engines at defined intervals. Although such legally-required overhaul represents a probable future sacrifice of the company's assets that, on a going concern basis, the company will have little or no discretion to avoid, we understood that the Board did not believe that an obligating event for such overhaul had occurred until the expense was incurred. It could be argued that given the similarities between a conditional ARO and planned major maintenance –i.e, both are a result of legal obligations--that a similar conceptual model should exist for the recognition of those obligations. Further, some may argue that accrual of the overhaul expenses over the legally-defined interval is more relevant and the amount is more reliably determinable than the cost of retirement activities that may or may not be incurred by the entity in a distant future period.

In our opinion, neither view of the obligating event is superior to the other. Based on FAS 143's underlying recognition principle, one can reasonably conclude that the accounting under either approach may reflect the economic substance of the conditional asset retirement obligation. Therefore, we question whether specific guidance for conditional asset retirement obligations is necessary.

III. Operationality and Cost-Benefit Considerations

We believe the research, recordkeeping and reporting that would be required to comply with the Proposed Interpretation will not result in a significant, incremental benefit to financial-statement users and other capital market stakeholders. Further, considering factors such as extended settlement dates and ability to reasonably estimate the liability, we believe that in many situations accounting results would not differ significantly under either the FASB's view or the alternative view that a liability should not be recognized until the conditional event occurs. Nevertheless, the Proposed Interpretation would require entities to undertake considerable efforts to research laws and regulations and develop complex assumptions and estimates in order to demonstrate that accounting results do not differ significantly.

Discussed below are a number of issues that highlight our cost-benefit and operational concerns associated with the Proposed Interpretation.

The extent to which the Board expects practice to research legal requirements and implement FAS 143's recognition principle to conditional asset retirement obligations is unclear. For example, in legal jurisdictions that require demolition of a building at the end of its useful life for public safety concerns, is it the Board's intent that an asset retirement obligation be recognized for the future demolition costs? If a jurisdiction does not require demolition, but would require the owner to incur costs for public safety purposes to mothball the facility, would those costs qualify for recognition under the Proposed Interpretation?

The unit of accounting for conditional asset retirement obligations is yet another issue that requires clarification. It appears that an entity's capitalization policies may significantly impact the application of FAS 143 and the Proposed Interpretation and thwart objective comparability. Although this issue exists for asset retirement obligations in general, requiring recognition of all conditional asset retirement obligations exacerbates the problem.

Consider, for example, a situation in which an entity acquired a significant asset that consists of numerous parts and one of the parts must be replaced periodically (e.g., every five years) in order for the asset to continue to function properly. No legal obligation to replace the part exists. However, assume that when the entity replaces the part and disposes of the old one, a special method of disposal is required under current legislation. Based on Example 3 in Appendix A of the Proposed Interpretation, the obligation associated with disposing of the component part in a certain manner would appear to represent a conditional retirement obligation subject to the provisions of the Proposed Interpretation. However, that conclusion implies that the Board intends to require recognition of an obligation at what could be a very detailed level. In many such situations, an entity may not record the component part as a separate asset and instead charges the periodic replacement of the part as incurred to expense. In those situations,

the entity treats the replacement as maintenance expense, which is explicitly excluded from the scope of FAS 143, and therefore, the retirement costs of the component may be interpreted as being excluded from the scope of the Proposed Interpretation.

Contrast that approach to one where an entity accounts for the component part as a separate asset (and does not account for the replacement as maintenance). The second entity would appear to be subject to the requirements of the Proposed Interpretation. Because the unit of account question for property, plant and equipment remains unresolved, the application of the Proposed Interpretation to the same obligation at two entities may result in inconsistent accounting treatments.

We also believe that applying the Proposed Interpretation will prove to be onerous. For simplicity, the above example assumes that only one part of the larger asset has special disposal requirements and that the cost of the special disposal requirements can be distinguished from other costs associated with replacing and retiring the component part. In reality, conditional asset retirement obligations are likely to exist for a variety of an entity's tangible assets with a variety of component parts having a variety of potential legal requirements. For example, consider an entity that owns a fleet of delivery vehicles. In our experience, many entities capitalize vehicles as a single asset. However, under environmental regulations, many of the components of a vehicle, such as its tires, battery, oil, antifreeze, air conditioning refrigerant, and transmission fluid, may require special disposal methods. While we suspect that in practice entities will not attempt to identify and recognize an asset retirement obligation for the components of a vehicle, this example demonstrates the large number of conditional asset retirement obligations that may potentially exist for an entity at a component-part level.

Concerns over the proposed requirements also exist in many other situations. For example, it is not clear to us how one would apply the provisions of the Proposed Interpretation when the mass-asset method of accounting is used (e.g., railroad ties or utility poles that are accounted for as a group and not tracked on an individual basis). Similar concerns exist with respect to regulated entities subject to FASB Statement No. 71, "Accounting for the Effects of Certain Types of Regulation," and whether they are required to break down amounts collected from customers for future removal and disposal costs of utility poles (currently recorded as a regulatory liability) into the amount related to pole removal, which is not legally required, and the amount related to legally-required disposal costs. Although paragraph A22 of FAS 143 permits the use of aggregation techniques, estimates, and computational shortcuts when computing an aggregate asset retirement obligation for assets that are components of a larger group of assets, we still question the benefit and operationality of identifying, recognizing, and tracking conditional asset retirement obligations associated with many component parts.

Another operational issue with accounting for conditional asset retirement obligations relates to measuring the fair value of the obligation prior the point the legal obligation has been triggered. When an asset's retirement is at the discretion of management and a

retirement activity is legally required only if and when management retires the asset, we question how recording a liability prior to triggering the actual legal requirement will provide financial statement users with more relevant and reliable information with respect to the fair value of the obligation, the entity's future cash outflows, or the comparability of the entity with its peers. Another likely question would be how one would estimate the "fair value" of such obligations that may be triggered at management's discretion. Until the point that an entity is legally required to perform the asset retirement activity, it is likely the fair value of the future obligation is not determinable. That is, it is difficult to see why a third-party would be compelled economically to assume an obligation from a counterparty for which the counterparty retains almost complete discretion over the timing of when that obligation will be settled. Accordingly, it is not clear that a "fair value", which is based on the concept of a willing buyer and seller, for the obligation would exist.

IV. Costs to be Included in a Conditional Asset Retirement Liability

Example 3 in Appendix A of the Proposed Interpretation addresses a situation in which contaminated bricks within a kiln must be replaced periodically. When the bricks are removed, a state law requires that they be disposed of at a special hazardous waste site. The example concludes that because the kiln will not last forever, the contaminated bricks will eventually need to be removed and disposed of at a special hazardous waste site. Further, footnote 6 of the example states:

The fair value of a liability for an asset retirement obligation would include only the activities required to satisfy the legal obligation. 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.

Given the Board's underlying recognition premise that no tangible asset will last forever, we question the appropriateness of limiting the liability for the asset retirement obligation to only the activities required to satisfy the actual legal obligation, which in the above example would include only the disposal costs and would exclude the removal costs. Removal of the bricks is a precondition to the legal requirement to dispose of them at a special hazardous waste site. Because the basis for liability recognition is that no tangible asset will last forever, the substance of the obligation contemplates both removal and disposal of the bricks (i.e., removal of the bricks is an unavoidable cost of satisfying the obligation).

In other scenarios, discerning which costs qualify for liability recognition may be difficult. For example, we understand that asbestos regulations require specific preparation and disposal procedures to be followed with respect to the removal of certain asbestos applications. However, the regulations do not require the actual removal of the

asbestos. In the asbestos situation, it is not clear to us based on the concept outlined in the Proposed Interpretation whether only those incremental costs that are specifically required under the law—the costs to prepare the asbestos for removal and the costs pertaining to the actual disposal of the removed asbestos—are to be included in liability estimate, with the actual removal costs being excluded from the liability estimate.

If the Board decides to issue a final interpretation, the Board should address and further clarify the principle underlying the type of costs that would be included in the liability.

V. Effective Date and Transition

Paragraph 5 of the Proposed Interpretation states that an entity is not permitted to restate prior interim financial information if the Proposed Interpretation is adopted during the interim period including its required effective date or during the first interim period of the fiscal year. On the other hand, if an entity adopts the Proposed Interpretation during any other interim period of that fiscal year, restatement of prior interim financial information would be required. The Basis for Conclusions section of the Proposed Interpretation does not elaborate on why the Board chose to prohibit or require restatement of interim financial information depending on the interim period in which the Proposed Interpretation is adopted. Absent a compelling reason for different treatment among interim periods, we recommend that if the Board decides to issue a final interpretation, restatement of interim financial information should be required in accordance with the guidance in FASB Statement No. 3 (FAS 3), *Reporting Accounting Changes in Interim Financial Statements*. If the Board believes that restatement of interim financial information would be onerous or impracticable, then restatement should not be required and the reasons for the Board's conclusion should be articulated in the final Interpretation.

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