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Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
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Re: EITF Issue No. 04-13, *Accounting for Purchases and Sales of Inventory with the Same Counterparty* (Issue 04-13)

Dear Mr. Smith:

The Accounting Committee of the American Petroleum Institute (API) appreciates the opportunity to comment on the proposed EITF Issue No. 04-13, *Accounting for Purchases and Sales of Inventory with the Same Counterparty* (Issue 04-13). As you know, buy/sell transactions are an important part of the oil and gas industry's supply chain activities. Conceptually, the API continues to believe that buy/sell transactions should be reported on a gross basis for the reasons outlined in its November 15, 2004 letter to you. We believe that buy/sell transactions are monetary transactions because each transaction results in physical delivery, separate title transfer, separate invoicing at gross value and separate settlement in cash. In addition, each transaction reflects the normal risk/reward characteristics of any other commercial buy or sale transaction and nonperformance by one party to deliver does not relieve the other party of their obligation to deliver.

If the EITF ultimately concludes that treatment as nonmonetary transactions is appropriate, we offer the following comments and observations for your consideration, which we believe, if adopted, would improve the clarity and effectiveness of the draft abstract. We also continue to support a prospective transition method, as we need time to make extensive programming changes to identify these buy/sell contracts within our accounting and marketing systems

Scope of the Proposed EITF

We are concerned that the use of the word *inventory* in the title and throughout the proposed abstract could be confusing to certain registrants. Certain products are not capable of being held in inventory such as electrical power (megawatts). In this case, companies do not recognize inventory on their balance sheets. For example, Company A owns a power generation plant in Northern California and has excess megawatt hours for sale to the Northern California grid, but needs electrical power in Southern California to power its refinery at that location. Company B has power for sale at the Southern California grid and needs electrical power for its operations in Northern California. Therefore, Company A enters into a contract to sell megawatts at the Northern California grid to Company B on a future date, and simultaneously agrees to buy from Company B megawatts at the Southern California grid. The characteristics of these contracts include gross cash settlement, and nonperformance by one party to deliver does not relieve the other party's obligation to perform except for events of force majeure. Both transactions require physical delivery of the megawatt. We believe these contracts meet the intent of paragraph 4 of the proposed EITF Issue No. 04-13, since the two transactions are entered into in contemplation of one another, except for the fact that the megawatt is never held in inventory nor can it be. However, the Derivatives Implementation Group (DIG) scoped power contracts out of the volumetric option accounting required by FAS 133, "*Accounting for Derivative Instruments and Hedging Activities*" as amended in Issue C15 'Scope Exceptions: Normal Purchases and Normal Sales Exception for Option-Type Contracts and Forward Contracts in Electricity' since power/electricity cannot be held in inventory among other reasons. Hence we believe the EITF's guidance can be strengthened by indicating that this EITF applies only to commodities that can be physically held in inventory.

Factors indicating that a purchase transaction and a sales transaction were entered into in contemplation of one another

In paragraph 4 of the proposed EITF, four factors are given that may indicate that a purchase transaction and a sale transaction were entered into in contemplation of one another. Of the four factors, we believe the third factor, *"Inventory purchase and sale transaction were at off-market terms"* needs to be further clarified or deleted, as we are concerned that this could require a major administrative effort to monitor. For example, Company A enters into a contract to sell 100 barrels of crude oil for each of the next six months, and simultaneously agrees to buy 100 barrels of crude oil for each of the next six months from Company B at a different location. The contract price is set at the then current strip price for each of the next six months. However, in month six, the price of the commodity has risen 20% and the strip price reference in the contract only reflected a 5% increase for month six. While the contract was entered into at a current market price, the market price in month six might be considered to be at off-market terms given the subsequent to inception price rise; however, one can not determine at inception whether the contract will be at off-market terms in the future months. To clarify what is meant by off-market terms when dealing with a contract period greater than one month, the bullet point could be rewritten as follows: "Inventory purchase and sale transactions were at off-market terms at inception." Alternatively, we would suggest dropping this factor, as it is unlikely that such a transaction by its nature would not meet at least one of the other three factors, particularly the fourth factor regarding "relative certainty that a reciprocal transaction would occur in the future."

Circumstances Under Which Exchanges Should be Recognized at Fair Value

The Task Force addressed fair value recognition of nonmonetary inventory exchanges in paragraphs 7 and 8. Our interpretation of paragraph 7 is that exchanges that require fair value recognition should continue to be reported on a gross basis. We suggest that paragraph 7 should include the following statement: "Transactions that require fair value recognition are not to be combined as described in paragraph 4."

In addition, we are unclear about the necessity of the disclosure required in paragraph 8. We believe the additional disclosure does not add value to the reader, as the amounts would be a subset of transactions that in substance are no different than any other transactions recorded in the revenue line. We recommend that the disclosure be removed or the intent and necessity of the disclosure be clarified.

Other Matters

Some API member companies will have to make significant modifications to their systems to accommodate this accounting change. Inasmuch as the net effect on income in any one period (due to possible differences in the amount and timing of related buy and sell transactions) will be immaterial, we request that the Task Force permit this netting to be within revenues or cost of sales, depending upon a company's most expeditious manner of implementing the standard.

Transition Guidance

While we are highly supportive of a prospective method, the practical aspects of complying with the current transition guidance provides for a difficult and time-consuming implementation process for certain contracts. For example, a company enters into the sell side of contract with a counterparty in November 2005 to deliver 50 barrels of crude oil in December 2005 and January thru May 2006. It is difficult to manage the accounting systems such that the barrels delivered December 2005 thru March 2006 would be reported gross, and the barrels delivered in April and May 2006 would be accounted for net since most of our members' systems manage transactions by contract and there is not a way to bifurcate between the pre- and post-implementation periods. Accordingly, we recommend that the transition guidance be "applied to *new contracts executed* in reporting periods beginning after March 15, 2006." We believe this change will greatly ease the implementation burden posed by the proposed consensus.

Summary

The API believes buy/sell transactions should continue to be reported on a gross basis. However if the consensus is adopted as proposed, we believe the above suggestions will improve implementation consistency and reporting comparability among companies. Additionally, we continue to be supportive of a prospective implementation.

The API appreciates the FASB Staff's attention to this issue and if you wish to discuss any of the comments, please contact me at 713-546-8440.

Very truly yours,

Lessie Sutherland (SB)

Lessie W. Sutherland
Chair, Accounting Committee
American Petroleum Institute

Cc: API Accounting Committee Members