FINANCIAL EXECUTIVES INSTITUTE

May 17, 2000

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference No. 206-B
Accounting for Obligations Associated with the Retirement of Long-Lived Assets

Dear Mr. Lucas:

The Committee on Corporate Reporting ("CCR") of the Financial Executives Institute ("FEI") appreciates the opportunity to comment on the February 17, 2000 Proposed Statement of Financial Accounting Standards, *Accounting for Obligations Associated with the Retirement of Long-Lived Assets*.

Our summary comments capture our consensus views in the areas of the scope of the proposed Statement, use of fair value in measuring the liability for an asset retirement obligation, use of the present value technique in measuring the asset retirement obligation, classification of related expenses, disclosures, the recording of a cumulative effect upon adoption and the treatment of obligation trust funds. We believe that this proposed Statement has significant problems and inconsistencies with other generally accepted accounting principles that are rooted in the flaws of Statement of Financial Accounting Concepts No. 7, "*Using Cash Flow Information and Present Value in Accounting Measurements*." Because of its adherence to Concepts No. 7, we believe that the proposed Statement has significant implications that may surprise many companies. This proposed Statement does not make a logical case for the use of the fair value measurement method in determining asset retirement obligations. Instead, the proposed Statement blindly follows Concepts No. 7 for use of fair value without providing a compelling reason why the entity specific or cost accumulation methods should not be used.

Our summary comments are as follows:

- CCR does not believe that fair value is the most appropriate method of measuring the liability for an asset retirement obligation. CCR believes that asset retirement obligations are accrued

expenses and not financial instruments and, accordingly, fair value measurement is not appropriate. The proposed Statement is inconsistent with the Preliminary Views on major issues related to "*Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value"*, which is inconsistent with Concepts No. 7. CCR believes that the current accounting model for expense accruals under Statement No. 5, *"Accounting for Contingencies,"* is appropriate for accrual of asset retirement obligations. Additionally, CCR believes that an expected present value technique can be used in conjunction with a cost-accumulation objective to capture an amount that represents the most likely present value of a future transfer of assets to settle an asset retirement obligation.

- CCR also notes that the fair value measurement method is inconsistent with current generally accepted accounting principles; the most notable inconsistency being Staff Accounting Bulletin No. 100, *"Restructuring and Impairment Charges,"* and SOP 96-1, "*Environmental Remediation Liabilities*."

- CCR does not believe the scope of the proposed Statement is clear. It is unclear whether the scope is meant to cover all long-lived tangible assets, including office buildings, plants or mills that could require retirement costs if retired or abandoned. CCR does not believe such assets should be included within the scope of the Statement.

- CCR does not believe that the credit-adjusted risk-free rate is the only appropriate rate to use in all cases. In our opinion, the Statement should take the same approach as prescribed in FASB Statement No. 121, *"Accounting for Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,"* of "using a discount rate commensurate with the risks involved."

- CCR does not agree with the requirement to characterize and classify subsequent changes to asset retirement obligations as interest expense. Companies should be allowed to determine an income statement expense classification consistent with the nature of the asset to be retired.

- CCR does not believe that many of the disclosure requirements are meaningful, and the administrative cost of accounting for and tracking components of the disclosure outweighs any potential benefits.

- CCR notes that in many instances, the liability for asset retirement will have already been recorded on an entity's balance sheet through a charge to operating earnings under current accounting principles. We believe that in doing so, companies have essentially deemed the useful life of the corresponding capitalized asset retirement cost to be zero (consistent with paragraph 11 and footnote 11 of the proposed Statement). CCR recommends that the new Statement be applied prospectively when a liability for asset retirement already has been recorded. In other words, the accounting change should be from a zero useful life of capitalized asset retirement costs for transition purposes, with that life modified prospectively for purposes of any adjustment to the recorded liability.

- CCR believes that trust funds established specifically for satisfying asset retirement obligations should be offset against related liabilities in the same manner as the accounting for trust funds established for pension or other postretirement obligations under Statements 87, *"Employers' Accounting for Pensions,"* and 106, *"Employers' Accounting for Postretirement Benefits Other Than Pensions*."

We believe that this proposed Statement needs significant work. We also believe that it will affect many companies and that unchanged, this Statement could lead to several implementation interpretations and issues. We hope that these comments have been helpful. The chair of the CCR Environmental Subcommittee that developed this response is James E. Terrell of Georgia-Pacific Corporation. Should you have any questions, please contact him at (404) 652-4366.

Sincerely,

Philip D. Ameen

Philip D. Ameen
Chairman, Committee on Corporate Reporting
Financial Executives Institute

We have addressed the issues included in the proposed Statement and other matters as follows:

Recognition of a Liability for an Asset Retirement Obligation

Issue 1: This proposed Statement would require that an entity recognize a liability for an asset retirement obligation when (a) that obligation meets the definition of a liability, (b) a future transfer of assets is probable, and (c) the amount of the liability can be reasonably estimated. Is guidance in the proposed Statement sufficient for making judgements to determine when or if a liability should be recorded? If not, what additional guidance would be useful in making those judgements?

CCR agrees with the Board that entities will have to use considerable judgement in applying the guidance in this Statement, especially when assessing whether a constructive obligation meets the definition of a liability. However, CCR does not believe that the scope of the Statement is clear. For instance, if companies have the intent and ability to maintain and operate an asset indefinitely, or owns long-lived assets such as generating or manufacturing plants where there is no constructive obligation or plan to remove the facilities upon retirement, then CCR does not believe that such assets should be included within the scope of this pronouncement.

Conversely, the proposed Statement does not appear to address assets utilized under operating leases by lessees. There are instances where retirement of assets leased under operating leases would obligate the lessee to incur costs for retirement. CCR believes that these assets should be included within the scope of this pronouncement.

In addition, CCR believes that the guidance on constructive obligation provided in Appendix A as background information (specifically paragraphs 71 and 72, and in particular footnote 27 to paragraph 71) should be moved forward to the Standard of Financial Accounting and Reporting.

Finally, CCR recommends that the Board satisfy itself that the benefits of compliance with the proposed Statement will outweigh the costs of creating a new accounting model.

Expected Present Value Technique

Issue 2: This proposed Statement would require an entity to initially measure the liability for an asset retirement obligation at fair value. Most entities will estimate fair value using the expected present value technique that is described in paragraphs 16-20 and that is illustrated in the examples included in Appendix B. Does this proposed Statement provide enough guidance for implementing an expected present value technique in the measurement of a liability for an asset retirement obligation? If not, what additional guidance would be helpful?

CCR does not believe that fair value is the most appropriate method of measuring the liability for an asset retirement obligation. We believe that asset retirement obligations are accrued expenses and not financial instruments and, accordingly, fair value measurement is not appropriate. Paragraph 152 and Table 1 of Preliminary Views on major issues related to "*Reporting Financial*

Instruments and Certain Related Assets and Liabilities at Fair Value" clearly exclude environmental accruals from being financial liabilities and provide guidance that such liabilities should be accounted for under Statement of Financial Accounting Standards No. 5. Therefore, it seems that the proposed Statement is inconsistent with the above mentioned Preliminary Views, which is inconsistent with Concepts No. 7. We find this all very confusing. CCR believes that the current accounting model for expense accruals under Statement No. 5 is appropriate for the accrual of asset retirement obligations.

This proposed Statement does not make a logical case for the use of fair value in determining asset retirement obligations. Instead, the proposed statement blindly follows Concepts No. 7 for use of fair value without providing a compelling reason why the entity specific or cost accumulation methods should not be used**.** In paragraph 88, the Board writes: "In Concepts Statement 7, the Board concluded that neither an entity-specific measurement nor a cost-accumulation measurement results in a relevant amount for initial and fresh-start accounting measurements". In other words, the Board decided that only the fair value approach could ever be relevant based on Concepts No. 7 and automatically discarded the cost-accumulation measurement without providing compelling evidence that the Board considered whether the answer makes sense in this context. CCR believes the Board should be compelled to make a case for relevance of the fair value measurement objective in each situation.

CCR notes that no other liabilities for similar obligations (i.e., environmental cleanup and remediation activities recorded under SFAS No. 5) where internal workforce is used, are measured using the fair value method. Instead, these liabilities are measured using the cost-accumulation method (see Statement of Financial Accounting Concepts No. 7, par. 24 d). In many instances, companies will use their own workforce to retire long-lived assets. In these cases, inclusion of assumed third-party overhead, profit mark-up and risk premium in the initial valuation will result in a credit to operating earnings in the period in which the asset retirement is completed through the reversal of excess reserves. This treatment results in misleading information to users of the financial statements. CCR believes that obligations associated with the retirement of long-lived assets should be measured on a basis consistent with similar liabilities (e.g., environmental cleanup liabilities measured using the cost-accumulation method). CCR also believes that an expected present value technique can be used in conjunction with a cost-accumulation objective to capture an amount that is more relevant than fair value. A cost-accumulation objective would capture an amount that represents the most-likely present value of a future transfer of assets to settle an asset retirement obligation. With a cost-accumulation objective, a company would adjust its cash flow estimates and probability assessments of those estimates as the company gets closer to settlement of the obligation to reflect the decrease in uncertainty resulting from the passage of time. Thus, the carrying amount of the asset retirement liability would be equal to the cash outflow upon settlement of the obligation.

The proposed Statement assumes that the expected present value technique will be used to estimate fair value in most cases. CCR notes that discounting is permitted when expected cash flows are fixed and determinable (see APB Opinion No. 21, *"Interest on receivables and Payables"*). Since the cash flows for many retirement costs are not determinable, CCR does not believe that discounting is appropriate in all cases. For example, many assets (e.g., office

buildings) have been in existence for a long period of time and, assuming adequate maintenance, such assets are not expected to be retired in the foreseeable future. In addition, the proposed fair value measure of the asset and obligation is inconsistent with the historical cost accounting model currently used. We also request that the Board provide guidance on how the expected present value technique can be applied.

CCR notes that the fair value measurement method is inconsistent with current generally accepted accounting principles; the most notable inconsistency being Staff Accounting Bulletin No. 100. CCR believes that many asset retirement obligations are exit costs and that by following the guidance in the proposed Statement, companies will violate SAB 100. The result of following the proposed Statement will be over accruing exit costs in one period and then reversing the excess in another period – exactly the outcome the SEC Staff was trying to avoid in SAB 100. CCR also notes that the proposed Statement is inconsistent with SOP 96-1, which follows the guidance in Statement No. 5.

Subsequent Measurement of a Liability for an Asset Retirement Obligation

Issue 3: In periods subsequent to initial measurement, this proposed Statement would require that an entity use an allocation approach to recognize and measure changes in the liability for an asset retirement obligation related to the passage of time (interest expense) and revisions in cash flow estimates. Those changes would be measured using the credit-adjusted risk-free rate in effect when the liability or portions thereof were initially measured. The Board rejected subsequent measurement using a fresh-start approach. Under that approach, an entity would have been required to remeasure the entire liability at fair value in periods subsequent to initial measurement thereby recognizing changes in the liability resulting from fluctuations in market rates. Do you agree with the Board's decision to require an allocation approach rather than a fresh start approach for subsequent measurement of the liability? Is sufficient guidance provided for applying the subsequent measurement provisions of this proposed Statement? If not, what additional guidance is needed?

CCR agrees with the Board's decision to require an allocation approach rather than a fresh-start approach for subsequent measurement of the liability for asset retirement. However, CCR is troubled by the characterization and classification of environmental remediation costs as depreciation and interest expense. Many manufacturing companies already accrue for asset retirement obligations as a production cost under current accounting principles. The proposal to classify a portion of the asset retirement costs as interest expense would seem to inconsistently state production expense and inventory costs. In addition, such treatment would inconsistently skew interest coverage ratios such as contained in debt covenants and in Exhibit 12 to certain SEC filings – "Calculation of Ratio of Earnings to Fixed Charges". CCR notes that the interest component of pension and postretirement benefit expense is not classified as interest expense under Statements 87 and 106. Accordingly, CCR does not believe that the Standard should require interest expense classification for changes in the liability associated with the passage of time. Instead, companies should be allowed to determine an income statement expense classification consistent with the nature of the asset to be retired.

Disclosure

Issue 4. Do you agree with the disclosure requirements of the proposed Statement? Are there any disclosures that you would omit from or add to this proposed Statement?

The proposed Statement requires, among other disclosures, that companies provide a reconciliation of the beginning and ending aggregate carrying amount of the liability showing separately the changes attributable to (1) the liability incurred in the current period, (2) the liability settled in the current period, (3) interest expense, and (4) revisions in expected cash flows. CCR does not believe that such disclosure is meaningful and the administrative cost of accounting for and tracking each component of this disclosure far outweighs any potential benefit. Accordingly, CCR recommends that this disclosure requirement be omitted from the final pronouncement. CCR agrees with all other disclosure requirements outlined in paragraph 31 of the proposed Statement.

Other Matters

Cumulative Effect of Initial Adoption – The proposed Statement requires that an entity recognize (a) a liability for any existing asset retirement obligations (adjusted for cumulative interest through the date of adoption), (b) an asset retirement cost capitalized as an increase to the carrying amount of the associated asset, and (c) accumulated depreciation on that capitalized cost. The net difference between the historical values and the values recorded under this pronouncement would be recorded as a cumulative effect of a change in accounting principle under APB Opinion No. 20, "*Accounting Changes"*. CCR notes that in many instances, the liability for asset retirement will have already been recorded on an entity's balance sheet through a charge to operating earnings under current accounting principles. We believe that in doing so, companies have essentially deemed the useful life of the corresponding capitalized asset retirement cost to be zero (consistent with paragraph 11 and footnote 11 of the proposed Statement). CCR recommends that the new pronouncement be applied prospectively when a liability for asset retirement has already been recorded (similar to the transition of SFAS No. 34, *"Capitalization of Interest Costs"*). In other words, the accounting change should be from a zero useful life of capitalized asset retirement costs for transition purposes, with that life modified prospectively for purposes of any adjustment to the recorded liability.

Additionally, by requiring the asset retirement cost to be capitalized through the recording of a cumulative effect credit to earnings (which is typically discounted by analysts and ignored for debt covenant purposes), CCR believes that many companies will be unfairly penalized for taking depreciation expense on this capitalized retirement cost through a charge to operating earnings in future periods. This "double charge" to operating earnings results from the initial recording of the liability prior to adoption of this Statement and the depreciation expense on the capitalized retirement cost after adoption.

Computation and Disclosure of Pro Forma Effect on Balance Sheet – The proposed Statement requires that companies compute, on a pro forma basis, and disclose, on the face of the

balance sheet for the beginning of the earliest year presented and the end of all years presented, the amount of liability for asset retirement obligations as if the standard had been applied during all periods affected. CCR does not believe that such disclosure is meaningful. Nonetheless, if this disclosure is required, CCR believes that any pro forma balance sheet disclosure should be made in the notes to the financial statements and not on the face of the balance sheet.

Effects of Funding and Assurance Provisions – The proposed Statement does not allow the amount of the liability for an asset retirement to be reduced because of trust funds or other similar assets dedicated to satisfy the asset retirement obligation. CCR disagrees with the Board's decision as outlined in paragraph 108 that trust funds established for satisfying asset retirement obligations should be treated different from trust funds established to meet obligations for pensions and other postretirement benefits. CCR believes that trust funds established specifically for satisfying asset retirement obligations should be offset against related liabilities in the same manner as the accounting for trust funds established for pension or other postretirement obligations under Statements 87 and 106.

Credit Adjusted Risk Free Rate – While we do not believe that the proposed Statement has made a strong case in support of a credit-adjusted risk-free rate, we do not believe that a risk free rate in all cases is the best approach either. In our opinion, the Statement should take the same approach as prescribed in FASB Statement No. 121 of "using a discount rate commensurate with the risks involved." For example, in some large investment projects such as offshore oil platforms, the estimated future expenditures for dismantlement and restoration are included in the economic analyses of cash flows for making the investment decision. These cash outflows are normally discounted at the same rate as the cash inflows, which is the rate needed to achieve the minimum return for considering the project for investment. Because these costs are viewed as part of the investment decision and not the financing decision, the investment hurdle rate, which is used in the underlying economic analyses, is the most appropriate rate for recording the liability. There are likely to be other examples where neither the risk free rate nor the rate risked only for credit would be appropriate.