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Mr. David R. Bean
Director of Research and Technical Activities
Project No. 3-27E
Governmental Accounting Standards Board
401 Merritt 7
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Dear Mr. Bean:

The American Institute of Certified Public Accountants (AICPA) has reviewed the Governmental Accounting Standards Board (GASB) Exposure Draft (ED), *Certain Asset Retirement Obligations,* and is pleased to offer its comments. Overall, we are supportive of the Board undertaking a project to provide accounting and financial reporting guidance for certain asset retirement obligations. The remainder of this letter provides our observations and recommendations on certain aspects of the ED for the Board's consideration.

Simplify Recognition Criteria for Liability. We agree with the Board that an asset retirement obligation (ARO) meets the definition of a liability, and therefore, meets the criteria for potential recognition as a liability based on whether a legal obligation has been incurred based on law, regulation, or a contract. However, the ED goes on to require consideration of the occurrence of both an *external obligating event* and an *internal obligating event* to determine when a liability for an ARO is incurred. We believe there will be confusion regarding the interplay between an *external obligating event* and an *internal obligation event.* For further simplification, we also believe the notion of "obligating events" can be eliminated altogether, while still achieving the same result. Therefore, we recommend the Board consider revising the recognition criteria to eliminate the notion of "obligating events." An example of how paragraphs 8 -10 of the ED might be revised to remove the obligating event concept follows:

> 8. A government should recognize a liability for an asset retirement obligation when the liability is incurred and reasonably estimable. A liability is incurred when a government has a legal obligation associated with the retirement of a tangible capital asset. A legal obligation arises based on federal, state, or local laws or regulations; a legally binding contract; or issuance of a court judgment that imposes a legally enforceable liability on a government to retire a tangible capital asset.
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> 9. For contamination related asset retirements for which there is a legal obligation, the liability is incurred when the contamination is physically manifested. For purposes of this Statement, contamination only refers to contamination that (1) is a result of the normal operation of a tangible capital asset, such as nuclear contamination of a nuclear reactor vessel as a result of the normal operation of a nuclear power plant and (2) is not in the scope of Statement 49.

> 10. For non-contamination-related asset retirements for which there is a legal obligation:
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> > (1) If the pattern of incurrence of the liability is based on the use of the tangible capital asset, the liability is incurred when the capital asset is placed into operation and consuming a portion of the usable capacity by the normal operations of that capital asset. For example, the liability for the retirement of a coal strip mine is recognized over time based on the excavation of the coal strip mine (using a portion of the capacity of the coal strip mine).
> >
> > (2) If the pattern of incurrence of the liability is not based on the use of the tangible capital asset, the liability is incurred when the capital asset is placed into operation. For example, the liability for the retirement of a wind turbine is recognized when wind turbine is placed into operation.
> >
> > (3) If the tangible capital asset is permanently abandoned before it is ready for use, the event is the permanent abandonment itself. For example, the liability for the retirement of a sewage treatment plant that is permanently abandoned during construction is recognized when a formal decision has been made to abandon the plant.
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> 11. For acquired asset retirement for which there is a legal obligation, the liability is incurred when the tangible capital asset is acquired. For example, the liability for an acquired power plant with an existing asset retirement obligation is recognized when the power plant is acquired.

Inconsistent Measurement Criteria with Similar Standards. Paragraph 15 of the ED requires the measurement of the liability for an ARO to be based on the best estimate of the current value of outlays expected to be incurred (that is, a hybrid approach). We are concerned that the hybrid approach introduces inconsistencies with the measurement approaches used in other similar standards such as GASB Statement No. 18, *Accounting for Municipal Waste Landfill Closure and Postclosure Care Costs,* and GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. The inconsistencies between the standards may have the effect of confusing preparers and unduly complicating the financial reporting framework through the use of different terminology and measurement approaches for financial statement elements that are arguably very similar in nature.

For example, GASB Statement No. 49 requires pollution remediation obligations (PROs) to be measured using an expected-cash flow approach based on weighted amounts as follows:

> **Measurement of the Expected Cash Flow**
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> 16. Pollution remediation liabilities should be measured using the expected cash flow technique, which measures the liability as the sum of probability-weighted amounts in a range of possible estimated amounts – the estimated mean or average. This technique uses all expectations about cash flows.

The Basis for Conclusions of GASB Statement No. 49 provide several reasons for the use of the expected cash flow technique as follows:

> 72. The ASTM International Standard Guide for Estimating Monetary Costs and Liabilities for Environmental Matters calls for measurement of environmental

> liabilities using an expected value technique when an environmental professional has access to sufficient information to use that technique. It states that outcomes' probabilities should be based, "to the extent practicable, on statistical data drawn from comparable events." Similarly, once obligating events occur, this Statement requires pollution remediation liabilities to be estimated using the expected cash flow technique. . .

In addition, paragraph 73 of GASB Statement No. 49 states that "because pollution remediation is a well-known process, the Board believes that governments often will have access to considerable data about ranges of potential outcomes."

The above excerpts from GASB Statement No. 49 suggest that the Board believes the prevalence of pollution remediation and the existence of comparable events provides governments with enough data to use a probability-weighted approach. Given the similarity of AROs to PROs, we believe this same logic could equally apply to AROs, but this is not addressed in the ED's Basis for Conclusions.

While, we believe the hybrid approach introduced in the ED will provide a reasonable estimate of the liability and agree with the Board's view in paragraph B39 of the ED that the current value approach is justified based on the cost-benefit and simplicity of measurement, there does not appear to be a conceptual basis for the difference in measurement methods for similar liabilities. If the Board moves forward with the hybrid approach for AROs, we recommend the Board add a project to its agenda to reexamine the required measurement methods for similar liabilities (e.g., landfills and PROs). If the Board does not accept this recommendation, the Board should clearly explain the conceptual support for the divergence in measurement methods from existing similar standards in the Basis for Conclusions of the final Statement.

Clarification of Initial Measurement of Liability. Paragraph 15 of the ED states that current value is the amount that would be paid if all equipment, facilities, and services included in the estimate were acquired during the current reporting period. However, we are unclear whether current value is intended to capture *costs that are unavoidable as of the measurement date* or *all projected costs when the asset is ultimately retired*, similar to the approach taken in GASB Statement No. 18. We assume the intent is to recognize costs that are unavoidable (based on the notion of legal obligation) as of the measurement date. However, we believe the guidance in paragraph 15 of the ED may be difficult for preparers to interpret and consistently apply based on the various ways in which liabilities are incurred for different types of AROs. For example, an ARO that occurs on day 1 as a result of placing a capital asset in use as opposed to an ARO that increases over time based on usage of a strip mine. To ensure consistency in practice, we recommend the Board provide clarification as to what costs should be included in "current value" as of the measurement date. We also recommend the final Statement include examples to illustrate the notion of current value.

Clarification of Subsequent Measurement of Liability. We recommend the Board simplify the final Statement to require remeasurement on an annual basis. Given that the current value measurement approach provides significant relief in the effort to measure the liability for an ARO (as opposed to alternative measurement methods in similar standards), we believe this change will not result in a significant increase in effort by preparers in the years subsequent to initial measurement. We also believe requiring annual remeasurement would address our concerns related to paragraphs 18 and 19 of the ED described in the following paragraphs.

Paragraph 18 of the ED requires annual remeasurement of the current value of the asset retirement liability for the effects of inflation or deflation. We are unclear as to whether the concept of inflation or deflation is a general concept based on the broad economy (e.g. Consumer Price Index) or specific to the costs included in the measurement of the liability. If the Board's intent of this paragraph is to be based on the broad economy concept of inflation, it creates a two-step process. Preparers would apply a broad concept of inflation and then, using the guidance in paragraph 19, address specific changes in the estimated outlay to determine if they are significant. If the Board does not elect to require annual remeasurement, we recommend the final Statement be more specific about which concept of inflation or deflation needs to be considered (i.e., broad or specific).

Paragraph 19 requires remeasurement of the liability for an ARO only when the results of the evaluation indicate there is a *significant* change in the estimated outlays. We have three concerns with this requirement. First, it is difficult to know whether a change is significant without remeasurement. Second, paragraph 19 is not clear whether the consideration of significant change is for an individual year or the cumulative change since the last remeasurement. Preparers may overlook cumulative changes if focused solely on the changes in an individual year. Third, we have concerns in that the term *significant* is not defined in the ED. The term is used in various other circumstances throughout the GASB financial reporting framework which adds to the difficulty of interpreting its meaning. Some, in fact, believe *significant* is equivalent to *material*. If the Board does accept our recommendation to require annual remeasurement, we recommend that the Board more clearly explain its intent for the meaning of *significant* as used in the ED and clarify that a significant change should consider all cumulative changes since the last remeasurement of the liability.

Separate Measurement of Layers from Subsequent Recognition of Incremental Liability. A liability for an ARO may be incurred over more than one reporting period if the events that create the obligation occur over more than one period. Based on the subsequent remeasurement provisions in paragraph 19 of the ED, it appears the remeasured amount (current value) would be accounted for as a single amount, as opposed to a requirement to account for the liability based on the year incurred (i.e., in layers). In contrast, FASB Topic 410-20, *Asset Retirement Obligations* (formerly FASB Statement No. 143, *Accounting for Asset Retirement Obligations*), requires that incremental liabilities be considered to be an additional layer of original liability. Although we understand that FASB requires separate layers based on the recognition of each liability at fair value, we believe the layers serve a meaningful role in determining how costs should be attributed to future periods. Specifically, paragraph 21 of the ED requires that a portion of the corresponding deferred outflows of resources be recognized (amortized) in a systematic and rational manner over the estimated useful life of the tangible capital asset. We believe that layers may play an important role in determining how these costs should be recognized, especially in circumstances where recognition is a function of time or use of the capital asset. Accordingly, we recommend the GASB include a similar layering requirement (from FASB Topic 410-20) to account for the liability based on the year the obligating event occurs.

Provide Citations for Appropriate Guidance. Paragraph 6 of the ED addresses what this Statement will not apply to. We suggest the paragraph be modified to make reference to where the appropriate guidance is located in the GASB's literature for the various items. This would be similar to the approach taken in paragraph 4 of GASB Statement No. 49.

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The AICPA appreciates the opportunity to comment on the ED. This comment letter was prepared by members of the AICPA's State and Local Government Expert Panel and was reviewed by representatives of the Financial Reporting Executive Committee who did not object to its issuance. Representatives of the AICPA would be pleased to discuss these comments with you at your convenience.

Sincerely,

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Chair
AICPA State and Local Government
Expert Panel

Mary M. Foelster
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cc: State and Local Government Expert Panel
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