Financial Accounting

Oil, Gas Industry's Accounting 'Loophole' Frustrates Investors

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- Oil and gas companies are using a gap in US financial reporting rules to omit hefty obligations to clean up retired refineries and pipelines from their balance sheets, according to climate and investor advocates.
- The groups are pushing the Financial Accounting Standards Board to close this "loophole," which they say limits investor insight into a company's financial position, with the board set to meet on Oct. 8 to discuss its next priorities.
- Research group Carbon Tracker has estimated that US oil and gas decommissioning costs could exceed $1.2 trillion, with companies like Phillips 66 Co. only recognizing asset retirement obligations when they announce plans to cease operations, such as the closure of a Los Angeles-area refinery.

Oil and gas companies are using a gap in US financial reporting rules to omit from their balance sheets hefty obligations to clean up retired refineries and pipelines, climate and investor advocates say.

Under existing guidance, companies leave off these liabilities by citing uncertainty over when the assets will be shuttered, according to groups like the Climate Accounting and Audit Project.

The groups are pushing the Financial Accounting Standards Board to close this "loophole," which they say limits investor insight into a company's financial position. The board will meet on Oct. 8 to discuss its next priorities.

Asset retirement obligations, or AROs, span different industries where companies are ultimately responsible for removing physical equipment or hazardous materials. Common examples include landfill closures and oil well plugging.

Research group Carbon Tracker has estimated that US oil and gas decommissioning costs—including for pipelines and refineries—could exceed $1.2 trillion.

While the topic would be met with debate at FASB, it's "one of the 'last hurrah' areas for off-balance-sheet accounting," said Sue Harding, consultant at the Climate Accounting and Audit Project. CAAP is among the groups that submitted comment letters earlier this year asking the standard-setter to address the issue.

Phillips 66 Co. is an example that illustrates the impact of "belated" recognition of retirement obligations, CAAP, nonprofit advocacy group Ceres, and Carbon Tracker told FASB in a joint letter.

The energy company announced last year it would cease operations of a Los Angeles-area refinery during 2025, citing significant market pressure.

Phillips 66 increased its ARO balance—primarily due to $205 million in obligations associated with closing the refinery, according to its 2024 annual financial report. It hadn't previously disclosed the estimated remaining lives of these assets, the groups noted.

The company has said it is committed to transparency in its reporting.

The accounting "loophole" raises concerns given that refineries won't operate in perpetuity amid a shift toward cleaner energy sources, according to consumer advocacy group Public Citizen.

"What's particularly compelling about these issues is they are not theoretical and they are not in the future," said Andrew Logan, senior director at Ceres. "They're very much in the here and now—and they are expensive for investors."

'High Bar'

The question remains whether investors who aren't as plugged into these environment-related issues similarly view ARO rules as an important topic, according to Greg Rogers, founder of environmental financial consulting firm Eratosthenes.

US accounting rules initially written more than 20 years ago require companies to recognize the fair value of a liability for an ARO in the period it's incurred if a "reasonable estimate" of that measure can be made. Fair value is a metric of current market value.

Still, a "minor exception" exists, said Scott Ehrlich, founder and managing director of educational organization Mind the GAAP LLC. If companies don't have sufficient information to estimate fair value when the ARO is incurred, the liability should be recognized when that estimate can be made.

For example, if an asset has an "indeterminate useful life," it may not be possible to estimate when the obligation might be settled, the rules say.

The rules indicate the board at the time of the 2001 guidance felt a "high bar" needed to be met for firms to claim they couldn't put a liability on the books, Ehrlich said.

Measurement might not be possible "if literally no information exists" about settlement timing, the board said in the reasoning for its guidance.

Companies show on investor calls and in press releases that they have some awareness that refineries will be imminently shutting down, Mekedas Belayneh, policy advocate at Public Citizen, said.

Identifying zero costs is the "least accurate" value that companies could give investors, Dwayne Purvis, founder and principal adviser at Purvis Energy Advisors, told FASB.

FASB didn't comment on the push to revisit ARO guidance or the intention behind its rules.

Financial Effects

Phillips 66 said in its 2023 10-K annual report it generally believes its refining and other processing assets "have no expected retirement dates" for purposes of estimating AROs "since the dates or ranges of dates upon which we retire these assets cannot be reasonably estimated at this time."

Still, the company told investors in October 2024 it plans to cease operations of its L.A.-area refinery during the fourth quarter of 2025. The company said it was working with real estate development firms in evaluating the future use of the sites in Wilmington and Carson, Calif.

Phillips 66 Chairman and CEO Mark Lashier told investors in an earnings call for 2024's third quarter that "the continued outlook in California in the face of declining diesel and gasoline demand was a pretty tough one," according to a transcript.

The company said in an emailed statement it's working with local governments and others to propose redevelopment that reduces emissions and maximizes value for shareholders and the community.

"Phillips 66 remains committed to transparency in its financial reporting in accordance with applicable accounting standards and regulations," the company said.

FASB's Role

Institutional asset manager KBI Global Investors recommended FASB clarify that the "indeterminate asset lives" designation "should be limited to rare, well-supported cases" that are accompanied with more disclosure.

Other groups also pushed for further disclosure.

FASB could also retool its measurement approach. Despite being measured at fair value, AROs are "seldom settled through market transactions," researcher and consultant Nick Gibbons said in a letter.

Adopting a "best estimate framework" allowing for a broader range of measurement techniques, like internal engineering estimates, would scrap reliance on "hypothetical third-party pricing" and thus address a barrier to initial recognition, Gibbons wrote.

"Where FASB probably will have a little pause is the idea of introducing any volatility to the financial statements," Gibbons, who is also an adjunct assistant professor at New York University, told Bloomberg Tax.

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