

April 30, 2004

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**Proposed Statement of Financial Accounting Standards,
Accounting Changes and Error Corrections,
a replacement of APB Opinion No. 20
and FASB Statement No. 3
File Reference No. 1200-400**

Dear Ms. Bielstein:

Ernst & Young appreciates the opportunity to respond to the Financial Accounting Standards Board's Proposed Statement of Financial Accounting Standards, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3* (the "Proposed Statement"). While we are supportive of the efforts of the Board and the International Accounting Standards Board to harmonize their accounting standards, we are concerned that the retroactive application will not improve financial reporting. We believe that, given the direction of financial reporting and recently issued standards and proposals, many future standards will fall under the practicability exception (particularly paragraphs 11(b) and 11(c)), and therefore the retrospective approach will be applied to new accounting standards less often than not. Further, when applied, the retrospective approach will at best result in a pro forma adjustment of the effect of the new standard, since any judgments will be heavily influenced by hindsight. Thus, given the cost of restating historical financial statements, and the limitations of applying judgments in hindsight, we believe that pro forma disclosures, consistent with those required in Opinion 20, continue to be the most practical approach to dealing with comparability concerns related to accounting changes.

The following paragraphs summarize our key observations related to the Proposed Statement.

Change in Accounting Principle in Response to a New Pronouncement

As the minutes to the March 7, 2004 Board meeting indicate, Board members noted the Proposed Statement would function as a framework for future transition decisions. Thus, even if the Board issues the Proposed Statement, it may see fit to continue to mandate the adoption of new accounting standards as it has in the past (normally using the cumulative-effect approach or a prospective approach). However, for purposes of providing comments, we have assumed that

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the Board would generally require the retrospective application approach for newly issued accounting standards unless the practicability exception in the Proposed Statement is applicable.

Factors Considered with Original Issuance of APB Opinion No. 20

In its first exposure draft on accounting changes, the Accounting Principles Board proposed a “retroactive restatement” approach consistent with that in the Proposed Statement. However, the Accounting Principles Board determined the practical issues outweighed the benefits of this approach. We believe many of those concerns continue to warrant consideration, particularly for new accounting standards.

- There are significant costs associated with restating financial statements, and we question whether in most cases the benefits of restating would outweigh those costs, especially given the pro forma disclosures requirements of Opinion 20. Further, given the volume of new accounting change effected by the FASB, as well as EITF consensuses, FASB Staff Positions, and SEC Staff Accounting Bulletins, a broad application of the retroactive application would result in companies continuously restating previously issued financial statements. We question whether users will find this information beneficial.
- Although retrospective application infers what the historical financial statements would have looked like if the new accounting principles had been applied at the time, those restated historical financial statements do not provide a basis for management’s prior decisions. In many cases, management may have not reached the same conclusions utilizing restated results, which would thus have impacted both the historical and current financial statements.
- Restating prior financial statements may have an impact on contractual or other arrangements. In situations where the contractual provisions were negotiated in good faith based on financial reporting standards that existed at the time, we question the benefit of restating prior year financial statements, to the benefit or detriment of individual users. While a thorough review of each individual contract would ultimately be required to determine the legal ramifications, these secondary restatement effects only increase the cost of applying the retrospective application method.
- Although the Proposed Standard provides practicability exceptions, we have concerns that revising prior year financial statements related to amounts involving judgments (for example, related to marketplace assumptions) will inherently be different than if those judgments had been made at the earlier date. That is, while a company may determine that certain information would have been available, the consideration or weighting given to that information will inherently be different with hindsight than it might have been at the prior date.

Given the direction of financial reporting, and as indicated by recently issued standards, we expect that many future standards will likely fall under the practicability exception. Further, we expect that other newly issued guidance, such as EITF consensuses, will often be applied under

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either the cumulative effect or prospective approach. As a result, the prior year financial statements will not reflect an accounting basis that is consistent with the current year, and also will not reflect the historical basis of accounting, but will instead become "pro forma" financial statements whose basis of accounting only partially reflects current GAAP. We believe that pro forma disclosures continue to be a more appropriate method of conveying, to the users of financial statements, the effect of current accounting changes on prior year financial statements.

Further, the retroactive application approach could significantly increase the cost of financial reporting for companies who have changed auditors. In those situations, if the prior auditor is unable (for example, due to independence considerations) or unwilling to reaudit the prior years, the company would (1) incur the cost (and possible timing delays) of having the prior year(s) re-audited by the current auditor, or (2) in extreme situations, be unable to have the prior year audited if all possible service providers were not independent for that prior period.

Voluntary Accounting Changes

We also do not support requiring a retroactive application when an entity makes an elective change to an alternative accounting policy. This is based on the reasons described above, as well as concern that it would tend to discourage companies from making voluntary changes to a preferable accounting policy.

Paragraph 5 of the Proposed Statement

Although we do not believe it was the Board's intent, we question whether paragraph 5 of the Proposed Statement would result in mandating that a company assess each of its accounting standards (when GAAP allows alternative methods) for preferability, and in those cases where the company's policies were not deemed preferable, changing to the preferable method. If it was not the Board's intent to mandate this change, then we suggest revising the language in the Proposed Statement. If it was the Board's intent to mandate such a change, we believe further deliberation of the ramifications of such a change is clearly warranted, as there did not appear to be a discussion of this issue at the Board meetings discussing the Proposed Statement.

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

