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September 28, 2004

Mr. Lawrence W. Smith
Director, TA&I - FSP
Financial Accounting Standards Board
401 Merritt 7
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Letter of Comment No: 2/ File Reference: EITF03-1 Date Received: 9/28/04

File Reference No. EITF Issue 03-1-b

Re: Proposed FASB Staff Position EITF Issue 03-1-b

Dear Mr. Smith:

We are pleased to comment on the proposed FASB Staff Position EITF Issue 03-1-b, "Effective Date of Paragraph 16 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (the "proposed FSP").

We support the objective of the proposed FSP, which is to delay the effective date for the application of paragraph 16 of Issue No. 03-1, however, we believe its scope should be expanded to include more than debt securities impaired solely because of interest rate and/or sector spread increases. In addition, as explained in greater detail below, we believe the staff should expand the scope of the proposed FSP to also include a delay of the effective date for the application of paragraphs 10 through 15 of Issue No. 03-1. The basis for our views follows.

Deferral of Paragraph 16

We support a deferral and subsequent revision of the guidance in paragraph 16 of Issue No. 03-1, as we believe that paragraph 16, as it is currently written, will force entities to choose one of two alternatives, neither of which is consistent with the current principles in FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities (SFAS 115) with respect to available-for-sale securities. These two alternatives are summarized below.

Alternative A

Under the first alternative, entities would choose to continue to use the available-for-sale classification of securities under SFAS 115; however they would need to segregate their available-for-sale securities with unrealized losses into two categories.

The first category would apply to those securities in which the entity is unwilling or unable to assert the positive intent and ability to hold to recovery of fair value to at least cost (which may be maturity). Because all declines in fair value below cost for this category would be considered other-than-temporary, these securities would be effectively accounted for at the lower of cost or market (without the opportunity for recognizing subsequent unrealized recoveries in the income statement). Accounting for these securities at lower of cost or market is not consistent with the intent of the Board in issuing SFAS 115. Paragraphs 27(b) and 89 of SFAS 115 acknowledge that one of the objectives of and expected improvements in the model in SFAS 115 was to eliminate the lack of evenhandedness in the prior accounting practice of measuring securities at the lower of cost or

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market, which according to SFAS 115 "...recognizes the net diminution in value but not the net appreciation in value of those securities."

The second category under Alternative A would be for those securities that the entity is willing and able to assert that it will hold until recovery of cost, even if that is to maturity of the security. This category also does not appear consistent with the objective of the Board's providing for an available-for-sale category. Paragraphs 9 and 10 of SFAS 115 indicate that an entity may not classify a security as held-to-maturity if the security may be sold by the entity in response to various factors in managing its assets and liabilities. These securities will generally be classified as available-for-sale. In addition, paragraph 82 of SFAS 115 notes that securities in the available-for-sale category are those that the entity would consider selling to meet liquidity needs or as part of the entity's risk management program. Thus, Issue No. 03-1's additional requirement to effectively hold the security to maturity, if necessary, does not appear consistent with the objective of the available-for-sale classification. In fact, it blurs the distinction between the available-for-sale and the held-to-maturity categories.

Alternative B

The second alternative an entity could take is to prospectively eliminate its use of the available-for-sale category altogether and classify all securities as either held-to-maturity (to the extent they qualify) or trading (based on the response to Question 35 of the SFAS 115 Implementation Guide). This alternative is consistent with the view of those who question whether there should be an available-for-sale category. However, SFAS 115 was originally intended to be an interim solution to several problems with the existing accounting and reporting practices for securities, and the Board chose to provide for an available-for-sale classification after significant due process and deliberation.

1 We do not believe the ability to use this classification should be effectively precluded by impairment guidance issued by the EITF.

Additionally, the proposed deferral of the effective date of paragraph 16 only for securities experiencing a decline in value due to interest rate or sector spread increases does not appear to encompass all of the situations involving impairment of debt securities that FASB should consider in a final FASB Staff Position. For example, a security may experience impairment because it is downgraded from a rating of AAA to AA. However, all contractual cash flows continue to be expected to be collected. It appears that the example situation should also be addressed in any future implementation guidance.

Thus, for the reasons cited above we believe it is prudent to delay the effective date of paragraph 16 of Issue No. 03-1 in full until the FASB can address issues involving consistency with the objectives of SFAS 115. If the Board and staff choose not to delay the effective date of paragraph 16 in full, the final FASB staff position should explicitly address situations in which debt securities are impaired due to a credit downgrade but it is not probable that the investor will be unable to collect all amounts due according to the contractual terms (i.e., do not meet the example described in paragraph 16 of SFAS 115 of a security that is other than temporarily impaired).

Deferral of Paragraphs 10-15

In addition to supporting the proposed delay of the effective date of paragraph 16 of Issue No. 03-1,

¹ The financial reporting model of the available-for-sale category, as prescribed in SFAS 115, was intended to "alleviate the potential for volatility in reported earnings resulting from a requirement to value some assets at fair value without at least permitting fair-value-based accounting for related liabilities. It also would mitigate concerns about reporting the fluctuation in fair value of long-term investments in earnings." [SFAS 115, paragraph 94]

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the FASB should also consider delaying the effective date of paragraphs 10 through 15. In the process of soliciting comments on proposed FSP EITF 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments", it is possible that the Board and staff may learn that some of the proposed or suggested changes to paragraph 16 for certain debt securities would be equally applicable to the model for equity securities and other debt securities addressed in paragraphs 10 through 15. In addition, we have encountered a number of issues, and expect others have similar experiences, in implementing step 2 of Issue No. 03-1 (i.e., determining if an impairment is other-than-temporary). The FASB may determine that some of these implementation issues deserve additional clarification of the guidance in paragraphs 10 through 16. This presents a challenge for calendar year-end entities that will soon be reporting third quarter results, as they are implementing systems to adopt the new guidance in Issue No. 03-1 which may be modified by subsequent implementation guidance.

As indicated at a prior Board meeting, deferral of the guidance in Issue No. 03-1 is expected to be for a short period (maybe as short as one quarter). In addition, preparers and auditors would not be left without guidance during the deferral period as the guidance in paragraph 16 of SFAS 115, the SFAS 115 Implementation Guide, AICPA Statement of Auditing Standards No. 92, Auditing Derivative Instruments, Hedging Activities, and Investment in Securities, and SEC Staff Accounting Bulletin Topic 5M, Other Than Temporary Impairment Of Certain Investments In Debt and Equity Securities, would still be applicable. Thus, the overall benefit of implementing the guidance in paragraphs 10 through 15 of Issue No. 03-1 prior to the issuance of a final FASB staff position does not appear to outweigh the cost to preparers.

We appreciate the opportunity to comment on the proposed FSP. If you have any questions concerning our comments, please contact James Johnson at (203) 761-3709 or Robert Uhl at (203) 761-3705.

Yours truly,

Deloitte & Touche LLP