



Letter of Comment No: 2  
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**Proposed FASB Staff Position (FSP EITF 85-24-a), “Application of EITF Issue No. 85-24, “Distribution Fees by Distributors of Mutual Funds That Do Not Have a Front-End Sales Charge,” When Cash for the Right to Future Distribution Fees for Shares Previously Sold Is Received from Third Parties”**

We appreciate the opportunity to comment on the referenced document. We commend the Staff for its reconsideration of this FSP based on comment letters received from constituents and now support its issuance. However, we suggest that the Staff reconsider the proposed transition guidance of the Exposure Draft and further clarify the application of certain provisions of the FSP by more clearly addressing the types of indemnities typically provided to purchasers that could represent the type of continuing involvement that would preclude revenue recognition. In addition, we suggest that the Staff separately provide guidance about the subsequent accounting for the liability that arises when a transaction does not meet the criteria of the FSP for revenue recognition.

We believe that the FSP should permit early application and application by restating previously issued financial statements. Many distributors prepare their financial statements on a calendar year end basis. Reporting sales of Rights in these distributors' calendar year 2004 financial statements differently than contemplated by the FSP only to adjust the amounts by a cumulative effect adjustment the next time the financial statements are issued (perhaps only one quarter later) could be confusing for users of the financial statements. This would particularly be the case with respect to companies that previously issued financial statements that were in compliance with the guidance of the FSP but have already restated their historical financial statements to report certain transactions as financings. They should be permitted to restate their financial statements back to the way they were, provided such treatment is in conformity with the guidance of the FSP. To do so at the time of issuing their 2004 financial statements would be less confusing to users of the financial statements than to treat the transfer of Rights as debt and then evaluate a cumulative effect adjustment to reflect the transfer as the completion of the revenue recognition process in the next quarter. We also observe that permitting early application and application by restatement would be consistent with the conclusions reached by the Board with respect to its separate project on Accounting Changes and Error Corrections

The principles articulated in paragraphs 8 and 9 of the FSP are appropriate to distinguish transfers of Rights that represent the completion of the earnings process from those that do not. However, they would be more consistently applied if the FSP contained additional guidance to assist with the evaluation of the impact of various types of indemnities that exist in transfer arrangements on the accounting.

Our experience with the types of transactions addressed by the FSP indicates that the most sensitive criteria to be evaluated will be that provided in paragraph 9(b) of the FSP – that neither the distributor nor any member of its consolidated group guarantees or assures in any way the purchaser’s rate of return or return on investment relative to the rights that are sold. Paragraphs 23 through 25 in the Basis for Conclusions section of the FSP elaborate on that criterion. We believe these paragraphs would be enhanced by emphasizing that indemnities that seek to provide relief to the purchaser for external risks such as unfavorable market fluctuations and shareholder behavior, credit losses, Fund Board actions such as termination of 12b-1 plans, and regulatory modifications of 12b-1 plan authority, violate the principles of paragraph 9 and preclude revenue recognition. However, indemnifications which provide relief to the purchaser only in circumstances in which the seller or its affiliates initiate actions that would harm the purchaser or fail to take action thereby undermining the Rights owned by the purchaser should not preclude revenue recognition. Examples of these types of indemnities would be ones that require the seller to reimburse the purchaser if it voluntarily waives the collection of the Rights owned by the purchaser as an accommodation to the investor or where the seller does not provide required information to the Fund Board to ensure continuation of the 12b-1 plan.

We also offer the following editorial observations:

The use of the term “recourse” in the FSP (primarily paragraphs 8 and 24) is confusing. “Recourse” is defined in Statement 140 as the right to receive a payment as a result of the failure of debtors to pay an amount when due or adjustments resulting from defects in the eligibility of transferred receivables. However, in the FSP it seems to be referring to an obligation to perform certain actions, rather than to pay an amount when due.

We have noted some confusion among readers regarding paragraph 9(a). Many readers of the FSP may read the criteria to preclude the retention of a risk position in the transferred Rights. We agree that the retention of either a risk or reward position in the transferred Rights would be inconsistent with a transfer that represents the completion of the revenue recognition process. As a result, we suggest that the concept be emphasized in the first sentence of paragraph 18 by inserting “either the” between “in” and “future” and changing the conjunctive “and” to “or”. In addition, the second sentence of the paragraph

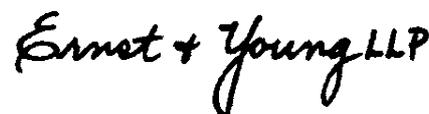
should be reconsidered in that it seems to be out of place in a paragraph that is addressing the retention of a disproportionate interest.

In paragraph 8, consider explicitly referring to EITF 85-24 as providing guidance regarding the treatment of costs related to sales of shares so as to more appropriately address sales of less than all of the Rights related to specific shares. Also, paragraph 21 could be clarified and made more consistent with paragraph 24 by more clearly describing the future services discussed in the fourth sentence as those required "in order to receive the Rights."

Finally, some companies will still determine that their transfers of Rights do not qualify for revenue recognition under the criteria of the FSP. We suggest that the Staff undertake a separate project to provide guidance to those companies as to the subsequent accounting for the resulting liability. The guidance in EITF 86-28, "Accounting Implications of Indexed Debt Instruments," may provide a workable starting point for an accounting model. However, such model would have to address the possibility that under these arrangements, there is no "guaranteed" portion of the debt, since the original amount deemed to be "borrowed" is not necessarily repaid before the obligation expires. The model also should address the period over which changes in the amount of the eventual liability (both increases and decreases) should be recorded as expense, presumably by the application of a level yield method.

We would be pleased to discuss our views further with the staff at your convenience.

Sincerely,

 Ernst & Young LLP