



Deloitte & Touche LLP
Ten Westport Road
PO Box 820
Wilton, CT 06897-0820

Tel: +1 203 781 3000
Fax: +1 203 834 2200
www.deloitte.com

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Ms. Suzanne Bielstein
Director of Major Projects and Technical Activities
Financial Accounting Standards Board
401 Merrit 7
Norwalk, Ct 06856-5116

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

Dear Ms. Bielstein:

We are pleased to comment on the FASB's exposure draft of a Proposed Statement of Financial Accounting Standards, *Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No.3*, dated December 15, 2003 (the "Exposure Draft").

This Exposure Draft was issued in connection with the FASB's short-term international convergence project. The stated intent of this Exposure Draft is to amend U. S. GAAP by converging with the provisions of International Accounting Standard No. 8, *Accounting Policies, Changes Estimates and Errors* ("IAS 8"). Overall, we support international convergence and the goal of removing certain individual differences between U.S. GAAP and International Financial Reporting Standards ("IFRS"). We encourage the Board to continue to work closely with the International Accounting Standards Board (IASB) and other national standard setters to develop high-quality standards that will be applied globally.

Notwithstanding our support for the short-term international convergence project, we do not believe that the changes to U.S. GAAP proposed in the Exposure Draft should be adopted at this time. We believe that application of the proposed approach will result in multiple revisions to previously issued financial statements which has the potential to dilute investor confidence in those financial statements. In addition, we do not believe the enhancement in interperiod comparability afforded by the proposal outweighs the complexities and additional costs that may be involved in a retrospective application for an accounting change. We discuss these issues and other practical concerns regarding the Exposure Draft in the remainder of this letter.

Dilution of Investor Confidence – Multiple Revisions to Previously Issued Statements

The Exposure Draft requires retrospective application for changes in accounting principles unless it is “impracticable” to determine either the cumulative effect or period-specific effects of the change. It would apply to voluntary changes in an accounting principle as well as changes in accounting principle required by issuance of new pronouncements, unless a new pronouncement contains specific alternative transition guidance. Under current U.S. GAAP, with some exceptions (e.g., certain voluntary changes in accounting principle, EITF consensuses, certain FASB Statements), accounting changes are accounted for by computing the retrospective cumulative effect of the change and recognizing this amount, in the period of change in net income and retained earnings. This treatment was adopted in Accounting Principles Board Opinion No. 20, *Accounting Changes* (APB 20). In paragraph 18 of APB 20, the Accounting Principles Board states the basis for this treatment at follows:

The Board believes that, although they conflict, both (a) the potential dilution of public confidence in financial statements resulting from restating financial statements of prior periods and (b) consistent application of accounting principles in comparative statements are important factors in reporting a change in accounting principles.

In reaching its conclusion on the method to be used to account for the impact of changes in accounting principles, the APB appears to have focused on the “the potential dilution of public confidence . . . resulting from restating financial statements of prior periods.” On the other hand, the Exposure Draft focuses solely on the benefit of consistent application of accounting principles in comparative statements. The conflicting objectives that existed in 1971, when APB 20 was issued, are still present today.

We are also in an unprecedented period in which all participants in the standard setting, regulatory and financial statement preparation process are working diligently to restore investor confidence in the financial reporting process. Accordingly, we believe that the retrospective method of accounting for accounting changes proposed in the Exposure Draft should not be adopted at this time. We believe that the adoption of the method proposed in the Exposure Draft may result in the diminution of public confidence in financial statements.

Paragraph 10 of the Exposure Draft indicates, absent specific transition guidance for a new accounting pronouncement, the adoption of such pronouncement should be accounted for via retrospective application. We believe there are potential issues encountered by requiring retrospective accounting for changes in accounting principle and are concerned such a bias related to new accounting pronouncements will detract from the perceived quality of financial reporting and the value of financial statements to investors and other users. Given the significant volume of new U. S. GAAP accounting pronouncements issued in a given year, including FASB Staff Positions and EITF consensuses, such a bias for retrospective application to adopt new standards could lead

to multiple revisions to previously issued financial statements (and the Management's Discussion and Analysis for public companies) for an entity in a given year due to the retrospective application of subsequent changes in accounting principles, which we do not believe would increase investor confidence. For example, if all new accounting pronouncements adopted in 2003 required retrospective application, a calendar year end SEC registrant may have been required to retrospectively adjust their 2002 and prior financial statements 4 times during 2003 (at the end of each quarter). The Company would revise its 2002 and prior financial statements (1) in the first quarter for the adoption of certain provisions of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees Including Indirect Guarantees of Indebtedness of Others*, (2) in the second quarter for the adoption of FASB Staff Position 140-1, *Accounting for Accrued Interest Receivable Related to Securitized and Sold Receivables under FASB Statement No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, (3) in the third quarter for the adoption of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and (4) at the end of the fourth quarter for the adoption of certain provisions of FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*. We believe that a situation such as this, where the 2002 financial statements are retrospectively adjusted every time they are reissued in 2003 will result in a dilution of investor confidence.

The Benefits of the Proposed Standard Do Not Outweigh the Complexities and Costs

As previously stated, we are supportive of the Board continuing to work closely with the IASB to develop high-quality standards that will be applied globally. Where both Boards have previously addressed an accounting issue but have issued differing guidance, one or both Boards may need to reconsider their Standards. We generally agree that one standard would be considered of higher quality than another standard addressing the same subject if, for example, it is more consistent with the conceptual framework, provides fewer exceptions, and provides investors with more useful information. In the case where one standard setter's guidance is considered to be of significantly higher quality than another standard setter's, the standard setter with the lower quality guidance should consider revising its guidance towards convergence with the higher quality standard. Where neither standard is clearly superior, we do not believe that converging to the latest issued standard is the best solution for convergence. We believe that the Boards should consider simplicity and the costs of application of each approach.

We do not believe that IAS 8, while considered more recently than APB 20, provides a clearly superior approach than APB 20. In addition, we believe that APB 20 generally provides an approach that is simpler and less costly to apply than IAS 8. Thus, we currently advocate retaining the approach in APB 20. In addition, we believe that the approach in APB 20 avoids certain potentially costly and disruptive issues associated with a retrospective application. These are discussed next.

Access to Capital Markets and Predecessor Auditor Concerns - In applying a change in accounting retrospectively, SEC registrants may be required to amend previously filed periodic reports if such changes are made during an interim period and previously filed periodic reports are incorporated in a registration statement. This substantially increases the cost and burden of changing an accounting principle or implementing a new standard via retrospective application and may delay access to capital markets. We do not believe this is the desired outcome of adoption of this proposed standard.

Entities may also be faced with situations where auditors are unable to reissue an audit opinion on statements changed as a result of retrospective application, due to independence matters or other predecessor auditor issues. It does not appear the Exposure Draft contemplates such a situation and how the notion of impracticability would apply. In such a situation an entity may be required to hire their current auditor to perform a re-audit of prior years which could cause the entity to incur excessive cost and may delay their access to the capital markets. We believe this issue would be addressed by expanding the definition of impracticability to include excessive cost as discussed below.

Disincentive for Voluntary Changes - The increased cost and burden of reporting changes in accounting pursuant to the Exposure Draft may be a disincentive for entities to adopt better accounting principles. Consequently entities may forgo a change to a preferable accounting principle in light of the excessive burden and cost. Additionally, paragraph 22 of the Exposure Drafts states that "an entity shall not assert that retrospective application of pre-change interim periods of the fiscal year in which the change was made is impracticable." This requirement may cause an entity to wait until the beginning of a new fiscal year to make an accounting change and may discourage entities from early adopting a new accounting standard that requires retrospective application in a period other than the first quarter.

We also have the following practical concerns and observations about the provisions in the Exposure Draft.

Impracticability

Impracticability – General Observations - The definition of *impracticable* in paragraph 11 of the Exposure Draft is not consistent with the definition used in other FASB standards. Previously issued FASB standards use the term *practicable* and *impracticable* in conjunction with the notion of excessive cost, as illustrated in the following citations:

- Paragraph 15 of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* (SFAS 107), states "practicable means that an estimate of fair value can be made without incurring excessive costs".... "Practicability, that is, cost considerations..."

- Paragraph 55 of FASB Statement No. 109, *Accounting for Income Taxes* (SFAS 109), states “impracticable, either because the necessary information is no longer available or because the cost to develop that information is excessive”
- Paragraph 25 of FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts* (SFAS 113), carries forward the definition of *practicable* from SFAS 107.
- Paragraph 23 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information* (SFAS 131), states “For purposes of this Statement, information is impracticable to present if the necessary information is not available and the cost to develop it would be excessive.”

The definition of impracticable in the Exposure Draft should be modified to be consistent with the definition used throughout other FASB standards (which may be inconsistent with the guidance in IAS 8). If the Board decides not to expand the exception and keep the guidance consistent with IAS 8, then the term “impracticable” should be removed from the final standard leaving simply the circumstances indicating when retrospective application should not be applied.

In addition, we believe there is a significant difference between the Exposure Draft and IAS 8. While the intent of the Standard is convergence between U.S. GAAP and IFRS, we believe the Exposure Draft may not result in actual convergence in all situations. Both the Exposure Draft and IAS 8 require retrospective application for changes in accounting principles unless it is *impracticable* to do so. Paragraph 5 of IAS 8 defines impracticable, in part, by stating “applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.” The definition in paragraph 5 of IAS 8 goes on to provide circumstances under headings (a), (b) and (c) to illustrate conditions which indicate retrospective application is impracticable. We believe the notion of determining retrospective application of an accounting change impracticable after an entity has made “every reasonable effort” to retrospectively apply such a change to be the overriding principle. Conversely, the Exposure Draft defines impracticability in paragraph 11 as the existence of one of the conditions in (a), (b) or (c). While these definitions are close, the guidance in IAS 8 is not as absolute as the proposed guidance in the Exposure Draft. We believe that if the Board decides to issue the approach in the Exposure Draft as a final standard to converge with IAS 8, that the overriding principle that an entity is exempt from retrospectively applying a change in accounting principle if retrospective application cannot be applied *after making every reasonable effort to do so* (admittedly a very high, but important, threshold).

Impracticability – Indirect Effects of Accounting Changes - The Exposure Draft is not clear as to whether the notion of impracticability extends to indirect effects of

retrospective application of a change in accounting principle. That is, whether retrospective application is practicable when the direct effects of a change are determinable (i.e., are not deemed impracticable under paragraph 11 of the Exposure Draft), but the indirect effects of a change would be considered impracticable under paragraph 11 of the Exposure Draft (e.g., the indirect effects are not determinable, require significant estimates or judgment as to management's intent). For example, assume an entity changes its method of recognizing actuarial gains and losses related to their benefit plans, say from a deferral method to one in which actuarial gains and losses are immediately recognized, and the retrospective application results in an additional temporary difference under SFAS 109 for which a deferred tax asset would be recorded. In certain circumstances it may be impracticable for the entity to determine whether they would have recorded a valuation allowance against the newly established deferred tax asset because the determination requires significant estimates as to the recoverability of the deferred tax asset and/or assumptions regarding management's intent related to tax planning strategies. Under this scenario, an entity may conclude that while it is not impracticable to determine the *direct* retrospective effect of the change in method of accounting for actuarial gains and losses, it is impracticable to determine the *indirect* effect of retrospective application related to the recording of a deferred tax asset.

To assist in the implementation of this standard, it would be helpful to include examples of the application of impracticability and consider in the examples how entities would address a change in accounting when it is practicable to determine the direct effect of an accounting change, but impracticable to determine the indirect effects.

Impact on New Standards Setting Initiatives

When new standards are to be adopted retrospectively, standard setters will need to provide increased time from the issuance of the standard to the effective date to allow for the increased implementation efforts, everything else equal. We trust that standard setters will be sensitive to this additional burden when specifying effective dates. However, longer transition periods that may be required to allow preparers adequate time to retrospectively adjust previously issued financial statements may not be in the best interest of users of financial statements who would be best served by having current financial statements reflect new accounting principles as quickly as possible, which can often be achieved through prospective application.

We also recommend consideration of, and explicit guidance for, how the Exposure Draft impacts future EITF consensuses. The Exposure Draft indicates that FASB Interpretation No. 20, *Reporting Accounting Changes under AICPA Statements of Position* (FIN 20), will be superseded. However, the Exposure Draft does not indicate that FASB Statement No. 111, *Rescission of FASB Statement No. 32 and Technical Corrections* (SFAS 111), will be amended. SFAS 111 amended FIN 20 (paragraph 5) to indicate that EITF consensuses may be applied prospectively to future transactions unless otherwise stated. In addition, the Exposure Draft does not indicate whether it nullifies EITF Topic D-1 "Implications and Implementation of an EITF Consensus". Topic D-1 provides general

transition guidance for EITF issues for which no specific transition is provided, and indicates that transition should be prospective in these instances. The Exposure Draft should clarify if the intent is to require retroactive application for all accounting changes required by EITF and whether EITF Topic D-1 will be amended.

Retrospective Application vs. Restatement

Recording voluntary changes in accounting principles under the method prescribed by the Exposure Draft may also provide entities an opportunity to obscure a negative financial trend or to obscure the correction of an error with a simultaneous change in accounting principle. Entities may also be able to manage the timing of a voluntary change in accounting principle such that the change is recorded when retrospective application of such a change offsets a negative financial trend. Although we would be hopeful preparers of financial statements would not use retrospective application of changes in accounting to divert attention from negative trends or corrections of errors, under the Exposure Draft the possibility of such misuse exists. We do not believe such possibility results in accounting standards that best serve users of financial statements.

Further, we are concerned that users of financial statements will have difficulty discerning whether a revision of prior period financial statements relates to a restatement for correction of an error or the retrospective application of a change in accounting principle. Given the pace of accounting change, frequent retrospective applications might dilute the consequences of a restatement caused by an error. Some constituents may confuse the two; or worse, they may become blasé about “another new set of financial statements.”

Finally, the FASB should carefully consider disclosure requirements and presentation that makes the distinction between a restatement and a retroactive application clear, especially if an error is being corrected at the same time a new accounting principle is being retroactively applied.

Preferable Methods of Accounting

In the initial discussion regarding accounting changes, paragraph 5 of the Exposure Draft states, in part, “When more than one accounting treatment is allowed, management shall consider the principles behind each treatment and, on that basis, chose the *most* relevant information about the transactions and events of the reporting entity.” This could be interpreted to mean that when initially adopting an accounting principle entities are required to always use the *best* accounting principle. This paragraph suggests when changing an accounting principle if there is a *good*, *better* and *best* alternative, entities could not change from *good* to *better*, but would be required to change from *good* to *best*.

The impact of the language in paragraph 5 on accounting standards that have more than one acceptable method of accounting is unclear. For example, FASB Statement No. 87, *Employers' Accounting for Pensions* (SFAS 87), allows measurements of plan assets and

obligations as of the date of the financial statements or as of a date not more than three months prior to that date. Would a company that for the first time creates a defined benefit pension plan subject to the requirements of SFAS 87 be required to establish a measurement date at the date of the financial statements because that would give users the most relevant information and be the most preferable accounting principle? Or would it be able to pick a measurement date within 90 days of the date of the financial statements as would be permitted under SFAS 87?

Paragraph 6 retains the requirement from APB 20 for an entity to justify the use of an alternative accounting principle is preferable, however it does not require an entity to justify an alternative accounting principle is the *most* preferable. As such, there appears to be conflicting language in paragraph 5 and paragraph 6. Such inconsistencies and the questions raised in the preceding paragraphs may be addressed by modifying the language in paragraph 5 to parallel the language in IAS 8.

The language in the Exposure Draft also differs from IAS 8 which refers to a change in accounting as acceptable if it "results in the financial statements providing reliable and *more* relevant information".

Interim Periods

Paragraph 22 of the Exposure Draft states an entity shall not assert that retrospective application of pre-change interim periods of the fiscal year in which the change was made is impracticable. While we understand it may not be reasonable for retrospective application of pre-change interim periods to be deemed impracticable as a result of the criteria in paragraph 11(a), there might be circumstances where retrospective application is not practicable under the criteria specified in paragraphs 11(b) and 11(c). We recommend this paragraph be amended to address the applicability of the impracticability criteria in paragraphs 11(b) and 11(c) in interim periods.

Depreciation

Paragraph 2 on page iii of the introduction of the Exposure Draft addresses the proposed requirement for treating changes in depreciation method as changes in estimates versus changes in accounting principles. This paragraph states, in part, the following:

The proposed statement would better reflect the fact that an entity should adopt changes in its depreciation, amortization or depletion method only in recognition of changes in estimated future benefits of an asset, *in the pattern of consumption of those benefits*, or in information available to the entity about those benefits. (emphasis added).

This statement is consistent with the principles for depreciation under IFRS. Specifically, International Accounting Standard No. 16, *Property Plant and Equipment*, paragraph 60 states "The depreciation method used *shall reflect the pattern in which the asset's future*

economic benefits are expected to be consumed by the entity" (emphasis added). On the other hand, U.S. GAAP does not require that the method of depreciation be based on the expected pattern of "consumption" of an asset. Accounting Research Bulletin No. 43, Restatement and *Revision of Accounting Research Bulletins* (ARB 43), Chapter 9, Section C, paragraph 5 states that depreciation is "a system of accounting which aims to distribute the cost or other basic value of tangible capital assets, less salvage (if any), over the estimated useful life of the unit (which may be a group of assets) ***in a systematic and rational manner***" (emphasis added). It is unclear whether the intent of the Exposure Draft was to amend current U.S. GAAP regarding depreciation from a "systematic and rational" method to one that requires the method that most closely reflects the expected *pattern of consumption* of the future economic benefits embodied in an asset. We suggest that the Board consider this issue and clarify the impact of this issue on ARB 43.

In addition, the treatment proposed in the Exposure Draft of treating depreciation methods as estimates, seems to imply that entities would be obligated to assess depreciation methods and patterns of consumption on a regular basis as they would other accounting estimates. We believe most entities do not currently have systems or policies to regularly review of patterns of consumption and assess depreciation methods on a periodic and consistent basis. We are uncertain as to whether the intent of the standard is to require such a change, which may be significant, in an entity's accounting processes and policies.

* * *

We appreciate the opportunity to comment on the Exposure Draft. If you have any questions concerning our comments, please contact William Platt at (203) 761-3755 or Robert Uhl at (203)761-3705.

Yours truly,

Deloitte & Touche LLP