



280 Park Avenue
New York, N.Y. 10017
8th Floor

Telephone 212-909-5600
Fax 212-909-5699

October 31, 2003

Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Dear Mr. Smith:

Proposed FASB Staff Position No. FIN 45-a

Our comments on proposed FASB Staff Position FIN 45-a, *Whether FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, Provides Support for Subsequently Accounting for a Guarantor's Liability at Fair Value* (Proposed FSP) are discussed below.

We are supportive of the FASB Staff's effort to provide additional guidance regarding the subsequent accounting for liabilities recorded pursuant to FASB Interpretation No. 45 (Interpretation). However, we believe that if guidance on this matter is issued, it should fully address the issue of subsequent accounting rather than providing the limited guidance contained in the Proposed FSP.

As stated in paragraph 12 of the Interpretation and as further explained in paragraph A49, the Board decided that subsequent measurement of the guarantor's liability was beyond the scope of the Interpretation. Nevertheless, the Interpretation states that the liability would typically be reduced as the guarantor is released from risk under the guarantee and also provides three methods that typically have been used to recognize the release from risk. The Interpretation does not provide guidance as to when certain methods would be inappropriate and does not limit the subsequent accounting to the methods mentioned. The only guidance provided for any method is a statement that guarantees accounted for as derivatives would be subsequently recorded at fair value.

The Proposed FSP's limitation on the use of one of the methods cited in the Interpretation appears contrary to the Board's stated intention of not addressing subsequent accounting. We believe that if subsequent accounting is to be addressed, it should be conducted as part of a fully integrated analysis by the Staff or the Board, if more appropriate. A



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limited approach, or an approach that only prohibits certain accounting, raises questions as to the applicability of the other methods mentioned in the Interpretation.

The Proposed FSP states that the Interpretation was not intended to imply that a guarantor is free to choose any of the three methods mentioned for subsequent accounting. Furthermore, it implies that the method chosen must be supported by other pronouncements or guidance under generally accepted accounting principles (GAAP). As GAAP did not previously address noncontingent, stand-ready obligations, questions remain as to what guidance should be looked to in selecting a method.

One source of guidance that we believe supports a fair value approach is the accounting for written options outside the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended, which are economically similar to guarantees that are within the scope of the Interpretation (in fact, certain written options are in the scope of the Interpretation). The SEC staff has expressed in various forums their longstanding position that written options initially should be reported at fair value and subsequently marked to fair value through earnings. This accounting is attributed to the asymmetrical risk inherent in a written option due to its limited upside opportunity and significant downside risk. Given the similarity in the economics, we believe that an argument can be made that guarantees accounted for pursuant to the Interpretation can be accounted for subsequent to issuance at fair value with changes in fair value recorded in earnings.

The Proposed FSP implies that whatever subsequent accounting method is chosen for the guarantee obligation, it must be specifically supported by GAAP. We are not aware of any specific GAAP that support the other two methods cited in the Interpretation. Debt obligations are only derecognized upon payment or legal release. Warranty obligations are amortized on a straight-line basis unless the costs of performing the services are on other than a straight-line basis. None of these principles seem to apply to the liabilities recorded pursuant to the Interpretation and do not seem to support the methods presented in the Interpretation. The Board stated in Concept Statement 7 that, when accounting for liabilities that are recorded based on present value and subject to changes in the original estimate of cash flows, as is the case with liabilities recorded pursuant to the Interpretation, they prefer a catch-up approach, in which the carrying amount of the liability is adjusted to the present value of the revised estimated cash flows, discounted at the original effective interest rate. This approach is not presented as an alternative in the Interpretation.



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As stated previously, we believe that full consideration should be given to the subsequent accounting for the liabilities recognized pursuant to the Interpretation and certain methods should not be eliminated until such consideration is given.

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If you have any questions about our comments or wish to discuss further any of the matters addressed herein, please contact John M. Guinan at 212-909-5449 or Michael Pierce at 212-909-5663.

Very truly yours,

KPMG LLP