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Certified Management Accountant Program Certified in Financial Management Program

April 13, 2004

Ms. Suzanne Bielstein Director of Major Projects and Technical Activities Financial Accounting Standards Board 401 Merritt 7 P.O. Box 5116 Norwalk, CT 06856-5116

Letter of Comment No: 56
File Reference: 1200-400
Date Received: 4//3/04

Dear Ms. Bielstein,

The Financial Reporting Committee (FRC) of the Institute of Management Accountants appreciates the opportunity to provide its views on the four Exposure Drafts related to the Board's short-term convergence project. For the convenience of staff, we have separated our responses to each of the ED's as individual attachments to this letter. The FRC supports the Board's efforts towards convergence with international accounting standards, including circumstances in which US GAAP must change in order to achieve this objective. That said, we also believe that convergence efforts must not simply accomplish conformity – they also must produce high-quality accounting standards. In studying the ED's, the FRC has identified aspects of the proposed statements that we believe the Board needs to address before proceeding further. Some may interpret our objections, which in certain areas are quite strong, as a lack of support for convergence. That is not the case. It is our hope that you will consider the issues raised in each of the responses on their merits and without prejudice as to our support on the broader issue of convergence. A brief summary of our views on each is provided below:

Inventory Costs (File Reference 1200-100)

We interpret the proposed modification to ARB 43 as doing more than conforming wording. In contrast to the Board's expectations, the way that the concept of normal capacity is employed will affect inventory accounting in more circumstances than those in which production is abnormally low. We are therefore concerned that the proposed standard will introduce changes in US practices that have not yet been researched by the Board. Moreover, we believe that in certain cases the accounting result is inappropriate. In the attachment we have provided further information about what we believe are unintended consequences of the change. If the Board decides to proceed with the change, we believe that the project time horizon needs to be extended to examine the effect on inventory accounting in greater depth. However, we also observe that this issue is not a priority in the near term and would therefore recommend that the Board simply suspend work on the ED.

Earnings Per Share (File Reference 1200-200)

We agree with the basic principles of the ED related to determining incremental shares. However, we oppose the requirement that shares to be issued upon conversion of a mandatorily convertible security be included in the computation of basic EPS from the date that conversion becomes mandatory. We believe there are instances where that presentation is not representationally faithful to the underlying economic substance during the period that the mandatorily convertible security is outstanding and not yet converted. In the attachment we have provided an example that illustrates our concern.

Exchanges of Productive Assets (File Reference 1200-300)

The FRC was unable to adopt a unified view on whether gain recognition was appropriate in all circumstances where the commercial substance test was satisfied. The two views could loosely be described as the "realization and culmination of the earnings process" view on the one hand, and the "accounting for a transaction with economic consequences" view, on the other. Even those who support the latter view, which is relatively consistent with the ED's concept of economic substance, could not reconcile the answers the ED produced across different fact patterns. In the attachment we have provided these examples for your consideration.

Accounting Changes and Error Corrections (File Reference 1200-400)

While we agree that retrospective application of changes in accounting principles enhance the interperiod comparability of financial information, we also believe that restating financial statements of prior periods on a regular basis will dilute public confidence in financial reporting and confuse the users of financial statements. Only time will tell whether the benefits of increased comparability outweigh these consequential effects. We also are concerned about the implications this may have on transition methods in other areas of the standard setting process (e.g., EITF Consensuses and FASB Staff Positions). If the Board proceeds with this proposed ED, we believe that it needs to carefully consider how to define the practicability exception as it relates to cost. Cost benefit judgments made in ordinary course of developing new standards are difficult by their very nature. The cost benefit implications to individual companies of retroactively applying a new standard for all prior periods presented will be highly dependent on the company's circumstances and capabilities and the Board is likely to have difficulty factoring this into its overall assessment. Therefore, the Board needs to include a mechanism, much like materiality, to ensure that the costs of retrospective application incurred by each company are not excessive.

If you have questions regarding this letter or the attached responses, please feel free to contact me at (203) 373-3563.

Sincerely,

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Chair, Financial Reporting Committee Institute of Management Accountants

File Reference 1200-400 "Accounting Changes and Error Corrections"

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As indicated in the ED, the proposed Statement would require retrospective application of a newly adopted accounting policy for *most* changes in accounting principle, including changes in accounting principles required by issuance of new pronouncements. While the Board may require different transition provisions for changes in accounting principle required by issuance of new pronouncements, it must deem the departure from retrospective application to be appropriate in those circumstances. While not specifically discussed in the ED, taking this concept to its logical conclusion, it would seem most EITF consensuses and FASB Staff Positions would also require retrospective application. Clearly, this would precipitate a significant increase in the frequency of restatement and cost associated with new standards and would make it more difficult to reach consensus on interpretive accounting matters.

Practicability Exception

The FRC supports a practicability exception to retrospective application, but we believe that a more principles-based approach should be taken in regards to this exception. We note that the concept of a practicability exception is included in a number of current standards, including Statement 107, Statement 109, Statement 113, and Statement 131. Each of these standards contains a more principles-based approach in describing practicability versus the ED's approach that lists specific conditions that must exist for retrospective application to be deemed impracticable.

At the very least, the FRC believes the notion of excessive cost should be included as an impracticability condition. This would be consistent with the guidance in standards referenced above. Absent an excessive cost provision as part of a practicability exception, we can envision situations where companies would not change to a preferable accounting method due to cost concerns.

Disclosures

The FRC also objects to the expanded disclosure requirements in the ED. While the Basis for Conclusions indicates that, in general, disclosures were carried forward from Opinion 20, the requirement to disclose the effect of the change on each financial statement line item expands on the current requirements in Opinion 20. We believe disclosing the effect on operating income, net income, and earnings per share is sufficient for users of financial statements.