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* F S P A R B 4 3 A *

LETTER OF COMMENT NO. 25

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: Proposed FSP ARB 43-1, *Amendment of the Inventory Provisions of ARB No. 43*

Dear Mr. Golden:

Goldman Sachs appreciates the opportunity to comment on the above-referenced proposed FASB Staff Position (the "FSP"). We support the Board's decision to require fair value accounting for physical inventories included in an entity's trading activities. We believe that this decision ratifies the current accounting used by entities that apply the AICPA's Audit and Accounting Guide, *Brokers and Dealers in Securities*; reduces diversity in practice (since some trading entities are precluded from applying this Guide); reduces non-economic volatility in reported earnings (that results from mismatches between derivatives on commodities and the commodities themselves); and is another step towards convergence with IFRS.

Unfortunately, the Board's decision not to include traded emissions allowances in the scope of the FSP will result in continued non-economic volatility, and will not further the goal of convergence with IFRS.¹ We urge the Board to reconsider its decision and either

¹ IAS 38, *Intangible Assets*, specifies that its guidance does not apply to intangible assets held for sale in the ordinary course of business (paragraph 3(a)), and refers to IAS 2, *Inventories*. IAS 2, in turn, specifies that commodity broker-traders should measure inventories at fair value. We believe this guidance is applicable to traded emissions allowances.

require traded emission allowances to be accounted for at fair value or allow entities to make an irrevocable, entity-wide accounting policy election to account for all trading activities at fair value, as discussed in the FSP. By making either of these changes, the Board will level the playing field between U.S. and European firms and further contribute to the development of markets that are seen as crucial to combating climate change.

In support of our view, we offer the following observations:

Fair Value can be reliably measured

Unlike executory contracts (which may not be traded separately but, in many cases, are a necessary component of the trading strategy) emissions allowances are traded separately and markets do provide adequate depth and liquidity to enable entities to reliably measure fair value. For example, in May, 2008, monthly exchange traded volumes of EUA's (European Union Allowances) exceeded 130 million tons of carbon dioxide, CER's (Certificates of Emission Reduction) representing another 39 million tons of carbon dioxide, and many more trades were executed in the OTC market. These products are now traded across multiple exchanges in Europe, and trading volumes continue to increase rapidly. Likewise, markets and trading volumes in Asia and the Americas continue to increase as well.

While the FSP correctly notes that SFAS 157 does not require a minimum reliability standard, to the extent Board members are concerned about reliability, we hope these comments alleviate the concern.

Further market development is being hindered

Despite the liquidity cited above, we believe some market participants refrain from engaging in trading of emissions allowances because of the non-economic volatility that results from the mixed attribute model. As previously noted, IFRS permits use of fair value for traded emissions allowances. Consequently, entities that report under IFRS are at a competitive advantage over those that report under US GAAP, because the IFRS accounting model more faithfully represents the economics of trading activities.

Fair Value is the most appropriate model for trading activities

The SEC's Advisory Committee on Improvements to Financial Reporting has recommended, in the May, 2008, Subcommittee reports, that accounting principles be set by activity. Excluding traded emissions allowances from this FSP fails to further that goal. We have heard no conceptual dispute with the view that fair value is the right answer for trading activities. Given the near universal support for fair value accounting for traded emissions allowances, we do not believe minor implementation issues should be permitted to forestall a much-needed improvement in accounting principles.

The delay has been extensive

Accounting for traded emissions allowances has been before the Board for at least five years, since EITF Issue 03-14, *Participants' Accounting for Emission Allowances under a "Cap and Trade" program* was first raised. During this time, the issue of climate change has become more urgent, and policy makers are searching for market-based solutions. Given the urgency of the matter and the universal recognition that Fair Value is the most appropriate measure, we do not understand the measured pace of the Board in addressing this pressing issue. We believe it is time to remove the obstacle of cost-based accounting from the continued development of a much-needed market.

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We appreciate the opportunity to provide you with our views on the ED. Appendix A includes our responses to the specific Issues in the FSP. If you have any questions regarding our comments, please contact me at 212-357-8437.

Sincerely,

A handwritten signature in cursive script that reads "Matthew L. Schroeder". The signature is written in black ink and is positioned above the printed name.

Matthew L. Schroeder

Appendix A: Answers to specific issues in the FSP.

Issue 1: Commodities Inventories

This issue asks whether the scope of the FSP should be limited to commodity inventories that are not used in production, wholesale, retail or distribution activities. By contrast, the scope of the FSP as drafted applies to items of personal property held for trading.

We understand the practical impact of this difference is that the FSP as drafted applies to a broader scope of assets than would be the case with a limitation to commodities only. As for the nature of activities, we do not see a difference between “included in trading activities” and “not used in production, wholesale, retail or distribution activities.” If the Board intended to draw a distinction between the alternatives based on nature of the activities, we suggest a clarification as to what that distinction is.

With respect to the scope of items to which the FSP would apply, we support a very broad definition and scope, because we believe that accounting for trading activities at fair value provides the most decision-useful information, regardless of the underlying item being traded.

Issue 2: Readily Determinable Fair Value

This issue discusses an alternative to limit the scope of the FSP to inventories that have readily determinable fair values. We agree with the Board’s decision to reject this approach, because it would be inconsistent with the guidance under SFAS 157, which does not require a minimum reliability threshold.

We have seen in recent markets that a financial instrument classified at a given level within the SFAS 157 hierarchy can be hedged by an instrument of another level. In our experience, traded inventory other than financial instruments can often exhibit the same characteristic. Yet, the appropriate measurement attribute for each is fair value. To limit the scope to readily determinable fair values would result in inconsistency with financial instruments measured under SFAS 157.

Issue 3: Trading Items Other Than Physical Inventories

This issue asks whether the scope of the FSP should include trading items other than inventories, and notes that the Board rejected this approach because the current project has a limited-scope objective.

As noted in the main body of this letter and in Issue 2 above, we support fair value for all trading activities, and we support the notion of accounting based on the nature of the activity rather than the nature of the underlying. While including traded emissions allowances is of immediate concern and presents few if any practical issues, we believe the Board could improve financial reporting easily and markedly by requiring all trading

activities (including traded executory contracts) to be measured at fair value, both initially and subsequently. We do not believe this would require any significant delay in issuance of final guidance, particularly given the Board's commitment to moving towards a more principles-based approach, and converging with IFRS. Under an alternative approach, the Board could permit an entity-wide fair value accounting policy election for trading activities. Finally, we do not believe it would be necessary to provide any detailed guidance about how to determine what is included in trading activities.

Issue 4: Accounting Policy Election

This issue notes that the Board considered and rejected an approach that would permit an entity wide election to record all inventory, *whether included in trading activities or not*, at fair value. We agree with the Board's decision to reject such an approach. This alternative would not require accounting by activity. It could also reduce comparability, both within an entity (by permitting use of both fair value and other approaches within trading and within other activities) and across entities, where differing elections by different entities would result in divergence in practice.

In considering this issue, we noted the statement "However, the Board believes that fair value is always the appropriate measurement attribute for inventories included in trading activities." We agree, but cannot articulate a reason why this would not be equally true for traded items other than inventories.

Issue 5: Implementation Issues

This issue raises questions about implementation costs, appropriateness of transition provisions, and sufficiency of the time for implementation.

We expect to incur no significant implementation costs with respect to the FSP. We have no concerns about the appropriateness of the transition provisions. We also believe the time provided for implementation is adequate.