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LETTER OF COMMENT NO. 51

Mr. Russell G. Golden  
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**Proposed amendments to the disclosure requirements in FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments**  
**File Reference: FSP FAS 107-a**

Dear Mr. Golden:

We appreciate the opportunity to comment on the above referenced proposed FASB Staff Position No. FAS 107-a, *Disclosures about Certain Financial Assets: An Amendment of FASB Statement No. 107* (the proposed FSP). We understand the proposed FSP was developed jointly with the International Accounting Standards Board (IASB) as an interim step to help users of financial statements better understand and compare the effects of different accounting methods used for various financial assets, both for International Financial Reporting Standards (IFRS) and US generally acceptable accounting principles (US GAAP). Given the current conditions in the financial markets, many enterprises have experienced impairments in financial assets. We support the efforts of the Financial Accounting Standards Board (FASB or the Board) and the IASB (acting jointly, as appropriate) to increase the comparability of information about certain financial assets that have related economic characteristics but have different reporting measurement attributes, especially for financial assets affected by the recent market events and credit crisis. In that regard, the global organization of Ernst & Young also will comment on the IASB's recently released exposure draft that would require similar disclosures for financial statements prepared in accordance with IFRS by amending IFRS 7, *Financial Instruments: Disclosures* (IASB ED). We also support the FASB's previously announced longer-term comprehensive project to address the complexity in existing accounting standards for financial instruments that would be undertaken jointly with the IASB. In short, we unequivocally support greater transparency and enhanced comparability of financial statements for use by investors and others around the world.

Our support notwithstanding, we have several concerns about the proposed FSP. We are concerned with (a) the short timeframe associated with the exposure and implementation of the proposed FSP, (b) whether the proposed disclosures provide meaningful information to users of financial statements and (c) the intended scope of the proposed FSP. These concerns are further discussed below. Additionally, we have included our response to the FASB's specific questions in the proposed FSP.

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## General comments

### Timeframe associated with the proposed FSP

We believe the comment period (i.e., 22 calendar days that began in late December, concludes in mid-January and includes approximately 14 business days) associated with the proposed FSP does not provide sufficient time for constituents, the FASB staff, and the Board to adequately consider, deliberate and evaluate the consequences of the proposed changes in order to make certain that a meaningful and well-designed disclosure standard is developed. In addition, we believe that issuing a final standard well after the completion of the year in which the standard must be applied is an unacceptable burden to place on financial statement preparers, who are in the midst of their busiest time of the year and are facing unprecedented challenges in completing their year-end financial statements and regulatory filings. Preparers are already burdened with applying existing accounting and financial reporting requirements, including implementing several recently issued accounting standards that are effective for periods ending after 15 December 2008 – for example, FSP FAS 140-4 and FIN 46 (R)-8 and FSP 99-20-1. Introducing a new disclosure requirement approximately 30 days before large-accelerated filers are required to file their Form 10-Ks (or, for certain registrants, 10 days before they are required to file their Form 10-Qs) with the U.S. Securities and Exchange Commission (SEC) will be extremely burdensome for preparers to accurately (subject to appropriately designed and implemented internal controls) accumulate the information necessary to provide the newly required disclosures, especially the pro forma income statements on the incurred loss impairment basis. Although the FASB has discussed several accounting and disclosure issues related to financial assets over the past several weeks in various forums, including recent joint IASB and FASB roundtables on reporting issues arising from the global financial crisis, as well as a series of roundtable discussions sponsored by the SEC on fair value accounting, the nature of the proposed disclosures was not known until several weeks ago and will not be finalized until 21 January 2009 at the earliest. As a result, we believe the effective date should be deferred to at least the first quarter of 2009 or, preferably, addressed in the longer-term comprehensive project the FASB has jointly undertaken with the IASB.

### Meaningful information for financial statement users

We agree that certain additional disclosures about financial assets would improve the transparency and quality of information about the differences in the recognition, measurement, and impairment models for financial assets. In that regard, the proposed disclosures specified in paragraph 10 of the proposed FSP regarding financial assets measured pursuant to an incurred loss model at the balance sheet date provide a user of the financial statements with useful information about management's estimates of realizable cash flows. For example, the balance sheet carrying value for held-to-maturity securities is amortized cost, which would be net of any other-than-temporary impairment (OTTI) write downs that were previously recognized. Because the write downs for OTTI are to fair value, which includes considerations other than credit losses (e.g., a discount for liquidity risk), the amount disclosed for held-to-maturity securities measured pursuant to an incurred loss model informs the user of the financial statements of the amount that management actually expects to recover (i.e., only adjusts for the true credit impairment). The same is true for debt securities classified as available-for-sale. Although the carrying value of available-for-sale securities is fair value, the amortized cost of available-for-sale securities is the basis on which investment income is reported and

is a required disclosure under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. We do observe, however, that the requirement in paragraph 10 of the proposed FSP to include fair value information in the disclosure is redundant, as the same information is already required by FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments* or Statement 115.

With respect to the proposed disclosures in paragraph 14 of the proposed FSP regarding pro forma income from continuing operations (before taxes) (1) as if the financial assets were carried at fair value with changes in fair value recognized in earnings and (2) as if the financial assets were carried at the incurred loss amount with changes recognized in earnings, we question whether those disclosures provide meaningful information for financial statement users, particularly the pro forma measure of income from continuing operations as if the financial assets were carried at fair value with changes in fair value recognized in earnings. Although we have not surveyed users of financial statements, we understand that many users do not find a measure of operating results that reports all changes in fair value through earnings useful in predicting future operating results.<sup>1</sup> Further, we believe such amounts could be misleading as they include remeasurement only of financial assets at fair value and not financial liabilities, which further exacerbates the problems of the mixed attribute model. While we can see some benefit in a measure that reports pro forma earnings with impairment charges that only reflect incurred losses, as a general matter we believe the inclusion of two *additional measures of income from continuing operations (before taxes) could be confusing to users and undermine the amounts reported on the face of the income statement*. In other words, we do not believe that disclosure is a substitute for appropriate recognition and measurement, which will be addressed in the longer-term joint project with the IASB.

#### Financial assets within the scope of the proposed FSP

Paragraph 8 of the proposed FSP states, among other items, that “long-term receivables except those measured at fair value with changes in fair value recognized through earnings” are included in its scope. Additionally, Example 4 in the Appendix to the proposed FSP includes “lease receivables” in the illustrative disclosure. Currently, paragraph 8(d) of Statement 107 excludes leases from the Statement’s fair value disclosure provisions, as specified in paragraphs 10 through 14 of Statement 107. However, the proposed FSP is only amending paragraph 15 (i.e., Disclosure about Concentrations of Credit Risk of All Financial Instruments). Accordingly, lease receivables (e.g., finance/sales type leases and operating lease receivables), which meet the definition of a financial instrument and would be subject to the current provisions in paragraph 15 of Statement 107, appear to be included in the scope of the proposed FSP and now would require disclosure of the fair value of those lease receivables. As mentioned above, this would be in direct conflict with paragraph 8(d) of Statement 107, which excludes lease contracts from the fair value disclosures of paragraphs 10-14. Accordingly, we recommend the Board revise the scope of the proposed FSP to exclude lease receivables and better define which long-term receivables are within its scope. If lease receivables are not excluded from the scope of the final FSP, we believe that additional guidance on the

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<sup>1</sup> See, for example, Center for Excellence in Accounting & Security Analysis, *Principles for the Application of Fair Value Accounting* (July 2008)

measurement of these receivables will be required (e.g., whether contingent rents and renewal options would be considered in the measurement of the fair value of the receivable).

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### Specific comments

1. *Do you believe that requiring disclosure of different reporting measurement attributes (that is, as reported in the statement of financial position, at fair value, and at the incurred loss amount) for certain financial assets within the scope of this proposed FSP would (a) improve the quality of information provided to users of financial statements and (b) increase the comparability of financial statements under US generally accepted accounting principles (GAAP) and IFRS? Why or why not?*

As stated above in the section entitled "Meaningful information for financial statement users," we believe the information regarding financial assets measured pursuant to an incurred loss model at the balance sheet date provides a user of the financial statements with useful information about management's estimates of realizable cash flows. In this regard, the quality of information provided to users would be improved. On the other hand, the proposed disclosure in the proposed FSP of fair value information for the financial assets within the scope of the FSP would be redundant to information already required to be disclosed by other standards. Further, if the Board's primary objective is to convey information about incurred losses, it would be simpler to report the amount that the entity expects to recover on impaired assets as companies must estimate this amount in order to report future investment income on their impaired securities.

With respect to whether requiring disclosure of different measurement attributes would increase the comparability of financial statements under US GAAP and IFRS, we believe the IASB ED does not include the same three categories prescribed by the proposed FSP. Rather than the "at the incurred loss amount" included in the proposed FSP, the IASB ED requires an enterprise to disclose the amortized cost amount. For a debt security designated as available-for-sale under IFRS, the amortized cost amount would be net of any impairment write downs that were previously recognized. Consistent with US GAAP, write downs for impairment of available-for-sale securities under IFRS are to fair value, which includes considerations other than credit losses (e.g., a discount for liquidity risk). Conversely under the incurred loss method of valuation that would be required to be disclosed by the proposed FSP, a financial asset is measured based on the present value of expected future cash flows discounted at the financial asset's effective interest rate (consistent with FASB Statement No. 114, *Accounting for Creditors for Impairment of a Loan*, and as described in paragraph 11 of the proposed FSP). Because the incurred loss amount only includes credit losses and not other elements of a write down to fair value, the use of the amortized cost method and the incurred loss method will result in different amounts being disclosed. Therefore, if the FASB and IASB adopt the proposed disclosure amendments to Statement 107 and IFRS 7, respectively, financial statement disclosures under US GAAP and IFRS would not be entirely comparable.

2. *Do you agree that the proposed disclosures should not include financial assets measured at fair value in the statement of financial position with changes in fair value recognized through earnings? If not, would you propose including such financial assets within the scope of this proposed FSP? Should financial assets measured at the lower of cost or fair value (such as mortgage loans) be included within the scope of this proposed FSP? Why or why not?*

If the Board decides to adopt the proposed FSP and amend the disclosure requirements of Statement 107, then we agree that securities classified as trading pursuant to Statement 115 should not be included in the scope of the proposed disclosures. For securities classified as trading, the carrying value and fair value are the same, while the incurred loss amount is irrelevant, because an entity that classifies a security as trading has indicated the financial assets were bought and held principally for the purpose of selling them in the near term (i.e., the entity does not expect to recover the incurred loss amount). Likewise, we agree that financial assets that have been designated under the fair value option pursuant to FASB Statement 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, (as well as those securities classified as trading pursuant to Q&A #35 of Q&A 115, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*) should also be excluded from the scope of the proposed disclosures. In these cases, the carrying amount and fair value are the same and the incurred loss amount is not relevant as management, by electing to measure the financial assets at fair value, has essentially asserted that fair value is the best measurement attribute for these financial assets (in some cases in the context of related financial instruments).

With respect to financial assets measured at the lower of cost or fair value (such as mortgage loans), we believe that such assets should not be included within the scope of this proposed FSP, because they have been designated as held for sale. Consistent with our comment on trading securities in the preceding paragraph, the incurred loss amount is irrelevant as the entity does not expect to recover that amount. Information about the fair value of loans is already required by Statement 107.

3. *Do you believe that requiring disclosures of the pro forma income from continuing operations (before taxes) for financial assets within the scope of this proposed FSP as if those financial assets were carried (a) at fair value with changes in fair value recognized through earnings and (b) at the incurred loss amount with changes recognized through earnings would improve financial reporting? Why or why not? Should the disclosure requirements described in the preceding sentence also be required for net income and shareholders' equity? Why or why not?*

We question whether requiring disclosures of the pro forma income from continuing operations (before taxes) for financial assets within the scope of the proposed FSP as described would improve financial reporting. Please refer to our comments above in the section entitled 'Meaningful information for financial statement users.' Consistent with this view, we do not believe these disclosures should be required for net income and shareholders' equity.

4. *Would including separate reconciliations of reported income from continuing operations (before taxes) to the proposed pro forma adjusted income from continuing operations (before taxes) under both a fair value basis and an incurred loss basis for financial assets within the scope of this proposed FSP be useful? Why or why not?*

If the FASB decides that the disclosures related to pro forma income from continuing operations (before taxes) will be required in any final FSP, we do not believe that the above-described reconciliations should be required. Although the reconciliations may provide information that some users find useful, the objective of the proposed pro forma disclosures appears to be to provide an alternative measure of income from continuing operations. Accordingly, the information that may be provided in the above-described reconciliation would be peripheral to this objective.

5. *Do you believe that the provisions of this proposed FSP should be effective for interim and annual reporting periods ending after December 15, 2008? Why or why not? Do you believe that the disclosures in this proposed FSP should be provided on a comparative basis for subsequent periods after initial application of the proposed FSP? Why or why not?*

No, we do not believe the proposed FSP should be effective for interim and annual reporting periods ending after 15 December 2008. Please refer to our comments above in the section entitled "Timeframe associated with the proposed FSP."

Although we do not believe the proposed disclosures will accomplish the intended objective of the proposed FSP, if the Board adopts the FSP then presumably the Board believes the disclosures are meaningful and, consistent with other financial statement disclosures about financial condition or results of operations, generally should be provided for the same periods for which statement of financial position or operating results, respectively, are provided. We see no reason why the disclosures should not be provided on a comparative basis for subsequent periods after initial application of the proposed FSP. We observe that, although the disclosures are not required for comparative periods in the period of initial adoption, preparers will still need to determine the balance sheet disclosure amounts as of the beginning of the period in order to calculate pro forma income from continuing operations disclosures. Therefore, disclosure of the incurred loss amounts of financial assets (but not the pro forma disclosures) could be provided without undue incremental cost and effort.

6. *Are all of the disclosures in this proposed FSP operational based on the proposed effective date? Why or why not? Please be specific in your response.*

As we noted above in the section "Timeframe associated with the proposed FSP" and discussed further below, we believe this project should be deferred at least until the first quarter of 2009. If the Board so desires, early application can be permitted.

In addition to the need to determine the incurred loss amortized cost basis for impaired securities at both the beginning and end of the year, additional information will need to be derived in order to compute the pro forma income from continuing operations. For example, when OTTI is recognized on a debt security (and the debt security is written down to its fair value), a new

effective yield is determined for the security, based on the amount and timing of estimated cash flows. This new effective yield is used for future income recognition. This creates another difference between the amount reported as income from continuing operations in the income statement and the amount reported as pro forma income from continuing operations as if financial assets were carried at incurred loss amounts. Also, as a result of differences in the cost basis of debt securities between existing Statement 115 accounting and an incurred loss model (e.g., due to different measures of impairment), any realized gains or losses on sales of financial assets during the period will differ. These two amounts (i.e., differences in discount accretion and realized gains and losses) will need to be determined and considered (there may be others) in the pro forma income from continuing operations. We believe that the level of effort needed to determine the amounts required to be disclosed is significant and makes the proposed disclosures non-operational given the proposed effective date.

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We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

*Ernst & Young LLP*