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FASB Accounting Standards Codification

LETTER OF COMMENT NO. 136

Dear Mr. Golden:

We appreciate the opportunity to comment on the FASB's Accounting Standards Codification (Codification). We support the FASB's primary goal of simplifying user access to all authoritative U.S. generally accepted accounting principles (GAAP) by providing all the authoritative literature related to a particular Topic in one place, and commend the FASB on this significant effort. We also agree that ultimately, the new structure and system will reduce the amount of time and effort required to research an accounting issue and improve the usability of the literature, thereby mitigating the risk of noncompliance with standards.

We do, however, have concerns with the Codification's readiness for the planned effective date of 1 July 2009. Our concerns relate to the current state of the Codification as we approach the end of the verification period. Although we have not performed a detailed review of the Codification during the verification period, and our use of the system during that period has not been robust, we have participated in detailed editorial reviews of some Topics in addition to occasional subsequent use of the Codification. Our experience has raised questions as to the readiness of the Codification to be the sole source for authoritative guidance and to supersede all accounting standards (other than SEC guidance). This concern arises not only from apparent errors and omissions we noted during our use during the verification period, but also as a result of the lack of follow-up from the FASB staff with regard to our many detailed editorial review comments. We would have expected the FASB staff to ask for clarifications or for follow-up, and are concerned that the lack thereof may indicate that reviewers' and users' feedback was not adequately considered. Moreover, we believe that if the FASB broadly considers the comments that it has received during the verification period, they will demonstrate user concern and some level of confusion.

Codification Structure

For the most part the original accounting standards that provide the source content for the Codification were not written in a format that lends itself to the Codification structure. In conforming the original standards to adapt to this structure, the guidance generally has not been changed, but at times, it has been split up or re-ordered. As a result, constituents who are familiar with the original standards may find the Codification guidance confusing or even misleading. Content that appears to be missing may have simply been relocated to another portion of the Codification. For instance, guidance related to a

specific industry that was embedded in the original standard may now be included under an Industry Topic, rather than being included in the relevant Presentation or Financial Statement Account Topic. While we appreciate the FASB's objective of achieving a consistent structure and organization within the codification, we are concerned that by splitting apart different sections, some of the context may be lost. For example,¹ paragraph E63 of FASB Statement No. 87, *Employers' Accounting for Pensions*, contains guidance on whether changes under existing laws should be anticipated in the determination of pension measurements. It also states that possible amendments of the law should not be considered. In the Codification, this guidance has been split into FASB ASC 715-30-35-31 and 715-30-55-21. As a result of that change, the discussion of assumptions in FASB ASC 715-30-55-21 is incomplete, as it does not clarify what should not be assumed.

The fact that the Codification is organized to allow all of the accounting literature related to a Topic to be located in one place may result in a change to users' assumptions. While accounting guidance related to a particular subject currently may be dispersed and voluminous, users understand that they have the responsibility to locate the appropriate guidance to apply. We believe, however, that user expectations when using the Codification will be different; there will be an assumption that all relevant guidance is included or cross-referenced within a Topic. This could cause a user to draw incorrect conclusions. For example, Topic 480 (Distinguishing Liabilities from Equity) does not include the discussion of EITF Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." This guidance is included in Topic 815-40 (Derivatives and Hedging – Contracts in Entity's Own Equity). A user who is not familiar with EITF 00-19 (or Topic 815-40) would not know that there is classification guidance for freestanding derivative financial instruments in Topic 815-40. The user, believing that all accounting guidance related to the subject has been consolidated into the Topic, may erroneously complete the analysis of that derivative by using only the guidance in Topic 480. In this instance, we would suggest that the guidance from EITF 00-19 is most appropriately incorporated into Topic 480. Alternatively, the guidance could be cross-referenced in the Overview section or in a Relationships section. FASB ASC 505-30-25-6 also demonstrates this issue. The guidance here reflects the literature in EITF 99-7 "Accounting for an Accelerated Share Repurchase Program." However, portions of this standard are affected by EITF 00-19, which is included in Topic 815-40. Users of the Codification in its current format who are less-informed on this subject would likely conclude that a forward contract should be classified as an equity instrument, while, in reality, the instrument must be evaluated under other accounting literature before such a conclusion can be reached. It becomes imperative that the related guidance be appropriately cross-referenced in a prominent manner.

In structuring the Codification, it appears that the FASB consciously decided that the benefits of a consistent format were significant enough to outweigh these concerns. However, we do believe that there are standards that do not lend themselves to this format and, as a result, those codified standards may be difficult for constituents to use. For example, much of the guidance in FASB Statement No. 123(R), *Share-Based Payment*, relates to both awards classified as equity and those classified as liabilities. However, much of that guidance has been included in the section dealing with equity instruments and not in the liabilities or overall sections. While Statement 123(R) had similar organizational issues, the greater distinction between the sections on equity awards and liability awards in the Codification could exacerbate confusion on whether specific guidance applies to liability awards.

¹ Note that the examples included in this letter have been separately submitted to the FASB via the Codification's online feedback system.

We are not recommending that the Codification structure be revisited at this time. We understand that a tremendous amount of thought and effort has been invested by the FASB and many others. Moreover, we acknowledge that, to some extent, this is a transitional issue that will become less of a problem as new standards are set and written in a way that better accommodates the Codification structure, and users become accustomed to the new format. However, we are recommending that careful thought be given to potential approaches to alleviate this confusion when the Codification becomes effective. One solution has already been instituted by the FASB in the form of the cross-reference tool. As discussed further below, it is therefore critical that this tool be in excellent form prior to the launch of the Codification. In addition, the users of the Codification should be given to *understand that there will be time and effort involved in learning and becoming familiar with the Codification*, requiring them to read Topics in their entirety, even if they were very familiar with the underlying original standards.

Missing Guidance and Errors

As noted above, our use of the Codification has been limited. Yet we have noted instances in which GAAP has inadvertently been changed by the FASB during the process of combining standards into the Codification. The FASB understood that this might occur, and established the verification period for the purpose of testing and assessing the Codification. However, as this period draws to an end, we are still noticing errors. For example, Topic 820-10-20 (the Glossary for Fair Value) includes a definition of nonperformance risk that is currently defined in paragraph 15 of FASB Statement No. 157, *Fair Value Measurements* as follows: "Nonperformance risk refers to the risk that the obligation will not be fulfilled and affects the value at which the liability is transferred.... Nonperformance risk includes but may not be limited to the reporting entity's own credit risk." However the definition in the Codification excludes the words "but may not be limited to", which we believe are important to the definition. Another example demonstrates a standard that is missing completely from the Codification. FSP FAS 123(R)-3, *Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards*, is currently not included in the Codification, although its guidance on measuring the APIC pool after initial adoption is still relevant if a company uses the "short-cut method."

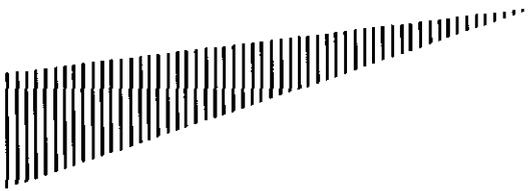
While these types of issues may not be widespread, they appear to be common enough to cause concern with the completeness and accuracy of the Codification. For example, within Topic 715, we have identified several paragraphs or portions of paragraphs, mostly from implementation guidance, that were not included in the Codification. Some of the omitted text relates to illustrations or background material that we believe provides context for the illustrations. For example, paragraph 429 of FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions*, includes a sentence preceding the illustration that is not included in FASB ASC 715-60-55-68 and 69. In addition, a footnote to that illustration, which provides an important reminder about the *amortization of gains/losses that arise during the period, has been omitted. Likewise, the last paragraph of E61 in Statement 87 has been omitted. This paragraph provides important context for the Board's decisions regarding discount rates. In particular, its reference to zero-coupon treasury securities is often cited in response to questions of which bonds should be considered when high-quality corporate bonds are not available for determining the discount rate.*

We understand that the process of cleaning up the Codification is best accomplished through its extensive use by constituents and that the verification period was designed to meet this objective. Unfortunately, users are inclined to continue to use existing GAAP (which currently is authoritative and familiar) until they have no choice but to begin to use the Codification (when it becomes authoritative). Few constituents have the time or the patience to research accounting issues under existing GAAP and the Codification. As a result, we believe the Codification was not as widely used during the verification period as the FASB had hoped. Additionally, certain existing GAAP standards, which have not yet been incorporated into the Codification, will not be available for verification prior to the date that the Codification becomes authoritative. Despite these concerns, extending the verification period, or running the Codification in parallel with the original standards for a transition period, likely will not resolve this issue. And yet, the issues are real ones, and a process must be put into place so that errors noted after the Codification becomes effective can be addressed in a systematic manner. We therefore encourage the FASB to consider both the need for 1) an ongoing comprehensive review of the Codification after the verification period, as well as, 2) an established and timely process to resolve (and notify users of) errors or missing guidance and provide any necessary transition.

Other Concerns

In compiling the Codification, the FASB distinguished between essential and nonessential guidance in the original standards. In doing so, judgments were made as to the nature of guidance in some of the Appendices, including the Basis for Conclusions. As we use the Codification, we have noted instances in which we question why certain guidance was not deemed essential. For example, in paragraph B103 of the Basis for Conclusions of Statement 123(R), the Board notes that it expects that few instruments presently awarded to employees by public entities will fall into the category of *instruments for which it is not possible to reasonably estimate fair value (or calculated value, for a nonpublic entity that qualifies to use that measure) at the grant date*. However, this intent was not included in the guidance provided in Topic 718-20-35-1. Based on our experience, we would suggest that this information should be included in the authoritative guidance. These types of issues will likely be identified after the Codification is in use. We recommend that the FASB establish a process so they can be addressed systematically as they arise.

The Cross Reference tool provides a critical mapping of the original standards to the Codification. For those who are new to accounting, the Codification may actually be a more intuitive and easier system to navigate than the current plethora of accounting guidance. However, there are a great number of users who are accustomed to the original standards and who will be looking for a bridge. The Cross Reference tool serves this function well. It is therefore imperative that the tool be complete, correct, and at a level of detail that facilitates this process. Our experience indicates that there are instances where the tool falls short of these criteria. For example, the cross reference list for FASB Statement No. 52, *Foreign Currency Translation*, does not include paragraph 6 of that standard. However, the guidance in that paragraph appears to be encompassed in Topic 830-10-45-4 (we noted other instances in which guidance was included in the Codification but not in the Cross Reference tool). In fact, the cross reference provided for Topic 830-10-45-4 is to the Basis-for-Conclusions paragraphs, which elaborate on the paragraphs discussing functional currency, including paragraph 6. We encourage the FASB to carefully review the Cross Reference tool in preparation for its extensive use when the Codification becomes effective.



Specific Requests for Feedback

During the Codification process, the Codification team identified various technical accounting issues that required resolution and the FASB has requested feedback on these issues. We generally agreed with the changes proposed by the FASB, except as follows.

Disclosure of Long-Term Obligations

FASB Statement No. 47, *Disclosure of Long-Term Obligations*, is included in the Commitments/Overall Subtopic of the Codification. Its Appendix C, Examples 2 and 3: "Illustrations of the Application of this Statement to Common Arrangements" are deemed no longer technically necessary and have the potential to contradict the requirements of EITF Issue No. 01-8, *Determining Whether an Arrangement Contains a Lease*. Therefore, the FASB decided to exclude these examples from the Codification. EITF 01-8 is currently included in the Leases/Overall Subtopic of the Codification. Although we do not necessarily expect the proposed deletion to be controversial, we question whether an alternative course of action is preferable.

Currently, the facts presented in Examples 2 and 3 do not provide sufficient information to conclude whether or not the arrangements are leases pursuant to the guidance in EITF 01-8 and FASB Statement No. 13, *Accounting for Leases*. However, if the arrangements are deemed not to be leases, we believe the examples would be helpful. Therefore, rather than eliminating the examples, we would suggest adding a statement that there is an assumption the arrangements are not leases under Statement 13. Similarly, it may be appropriate to add an assumption to Example 3 that the "take-or-pay" arrangement is not considered a derivative under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

We believe Examples 2 and 3 are helpful illustrations for the contracts described, assuming they are not found to be leases or derivatives. Therefore, we suggest that the Board consider retaining them in the Codification after adding the appropriate assumptions.

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The Codification encompasses a tremendous amount of authoritative guidance in a structure that we agree ultimately will mitigate the risk of noncompliance with standards. We appreciate the FASB's efforts in this regard and are supportive of the move to a single source of content. However, we believe that there are steps that the FASB must take at this time to ensure that the transition to the Codification is relatively smooth and that ongoing issues can be appropriately and timely addressed.

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

Very truly yours,

Ernst + Young LLP