January 13, 2006

Technical Director
File Reference 1235-001
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

RE: Invitation to Comment: Selected Issues Relating to Assets and Liabilities with Uncertainties (File Reference 1235-001)

Dear Technical Director:

We appreciate the opportunity to respond to the Financial Accounting Standards Board's Invitation to Comment on assets and liabilities with uncertainties.

We support the Board's efforts to improve the Conceptual Framework and believe that a complete and internally consistent Conceptual Framework is essential for developing high quality accounting standards that are principles-based. We also support the Board's objective of achieving international convergence between US and international accounting standards and believe that a common Conceptual Framework that is shared by both the FASB and the International Accounting Standards Board is critical to achieving that objective. The improvements to the Conceptual Framework should be made in a manner that is consistent with the Board's objective of simplifying the accounting literature and, therefore, the concepts should be clear, intuitive and easily applied.

We believe that an entity should recognize a liability when an obligation exists and the obligation can be reasonably measured. If a reasonable measurement cannot be made, an entity should disclose the existence of the obligation and that the obligation has not been recognized because a reasonable estimate cannot be made. Subsequently, the liability should be recognized in the period in which a reasonable estimate can be made.

Additionally, if there is uncertainty about whether an obligation exists, probability may continue to have a role in the recognition of a liability. Accordingly, the Conceptual Framework should allow standard-setters to consider the use of probability when developing standards that establish recognition criteria and it should provide guidance as to when probability should be used as a recognition criterion.
We discuss recognition and measurement in more detail in the following sections. We have included our responses to the specific questions that were raised in the Invitation to Comment in the appendix to this letter.

Recognition

We believe that the IASB’s proposed amendment to IAS 37, Provisions, Contingent Liabilities and Contingent Assets, lacks a framework for determining when a liability exists and, as a result, it likely would result in the inconsistent recognition of liabilities when there is uncertainty about the existence of an obligation. For example, the IASB concluded that an unconditional obligation exists when an entity is named as a defendant in a lawsuit because it has a stand-ready obligation to defend itself. We would not necessarily reach that same conclusion. Arguably, the entity has a stand-ready obligation to defend itself even before the litigation is initiated and we are unclear how the initiation of the litigation changes the stand-ready obligation. We believe that litigation uncertainty often relates to the question of whether an obligation exists, rather than about the measurement of the obligation. We agree with the concerns that are stated in the alternative view of the Exposure Draft, which states that the Exposure Draft fails “to distinguish element uncertainty from measurement uncertainty” and fails “to provide guidance on...what level of element uncertainty would preclude recognition.” Accordingly, we believe that the Board should articulate when an obligation exists and it should provide a framework that preparers can use for determining whether an obligation exists. For example, the Board may conclude that an obligation exists only when there is a legal obligation. Conversely, the Board may conclude that an obligation also exists when there is a constructive obligation.

Measurement

As stated previously, an entity should recognize a liability when an obligation exists and the liability can be reasonably measured. In situations where it is clear that an obligation exists and the measurement objective is fair value, probability should be considered in the
measurement of the obligation rather than in recognition. However, as noted above, probability assessments for recognition purposes may be appropriate in situations where there is uncertainty as to whether an obligation exists. In those cases, it may be appropriate to consider probability in both recognition and measurement. Estimates of fair value or other measures may be particularly difficult when there are uncertainties about the existence of a right or an obligation. The Board should continue to work with the Valuation Resource Group and others to consider potential guidance about measuring fair value in such situations that could limit diversity in valuation practices and ensure that the resulting information is sufficiently reliable.

After the completion of the Conceptual Framework project, we would expect the Board to reconsider the guidance in FASB Statement No. 5, Accounting for Contingencies. We believe that any reconsideration of Statement 5 should be a joint effort with the IASB’s reconsideration of IAS 37, and, therefore, the FASB should encourage the IASB to postpone its current project to amend IAS 37 until the projects can be conducted as a joint effort.

In addition to the items discussed in the Invitation to Comment, we believe that the Board will need to consider related issues of aggregation and disaggregation of arrangements and losses on executory contracts in the Conceptual Framework project.

If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Mark Bielstein at (212) 909-5419, Paul Munter at (212) 909-5567, or Landon Westerlund at (212) 909-5553.

Sincerely,

KPMG LLP
Appendix: Responses to the Questions in the Invitation to Comment

Contingent Assets

Question 1: Do you agree with eliminating the notion of contingent asset? If not, why not?

Question 2: Do you agree with the IASB’s analysis of unconditional and conditional rights in contractual settings, as summarized in paragraphs 30 and 31 of this Invitation to Comment and paragraphs BC10-BC13 of the IASB Exposure Draft? If not, why not?

Question 3: If you answer yes to Question 2, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of Examples 1-3 in paragraphs 33-35 of this Invitation to Comment? If not, why not?

Question 4: Do you agree with the IASB’s proposal to classify as intangible assets those unconditional rights that are associated with conditional rights that satisfy the definition of an asset, without shifting the consideration of the uncertainty surrounding the conditional rights from recognition to measurement?

We are concerned that splitting all rights into unconditional and conditional rights will add complexity to financial reporting with little potential benefit to the users of the financial statements. Such an outcome would be inconsistent with the Board’s objective of simplification of the accounting literature. In situations where any party may have the right to be heard by a court or apply for a license, such a right should not be included within the definition of an asset. Accordingly, we disagree with the conclusions in examples 1 and 2 from paragraphs 33 and 34 of the Invitation to Comment. Specifically, we would not identify (1) the right to be heard by the court as a plaintiff or (2) the right to participate in the application process for an operating license as unconditional rights that are assets of an entity as such rights are not unique to the entity and do not give rise to economic benefits that are controlled by the entity.

We also disagree with the proposal that all assets with uncertainties should be accounted for as intangible assets. Although some assets with uncertainties may meet the definition of intangible assets, we do not believe that either the IASB or FASB’s standards on intangible assets were developed with an objective to capture all assets with uncertainties. Accordingly, we believe that the accounting for assets with uncertainties should be considered in a separate project and that the respective standards on intangible assets should not be used as a “catch-all” for assets with uncertainties.
Contingent Liabilities

Question 5: Do you agree with eliminating the notion of contingent liability? If not, why not?

Question 6: Do you agree with the IASB’s analysis of unconditional and conditional obligations in contractual settings, as summarized in paragraphs 39 and 40 of this Invitation to Comment and paragraphs BC24-BC28 of the IASB Exposure Draft? If not, why not?

Question 7: If you answer yes to Question 5, do you agree that the IASB has appropriately applied the notion and supporting reasoning referred to therein in the analysis of example in paragraph 41 of this Invitation to Comment? If not, why not?

As with assets with uncertainties, we also are concerned that splitting all obligations into unconditional and conditional obligations will add complexity to financial reporting with little potential benefit to the users of the financial statements. Such an outcome would be inconsistent with the Board’s objective of simplification of the accounting literature. While we agree with the IASB’s analysis of unconditional obligations in situations in which there is no uncertainty as to the existence of an obligation (for example, financial guarantees) and the conclusion that probability should be included only in the measurement of the liability in that situation, we disagree with the IASB’s proposal to extend that conclusion to circumstances in which there is uncertainty as to the existence of an obligation.

The notion of an obligation to stand-ready to perform for noncontractual arrangements (for example, litigation and constructive obligations) is different from the concept that the Board used to identify obligations in a contractual guarantee. In a contractual guarantee, there is no uncertainty as to whether the obligation exists. The only uncertainty relates to the amount of payment that will be required under the guarantee. In contrast, other arrangements may involve uncertainty as to the existence of the obligation. For example, litigation typically involves a dispute regarding whether a legal obligation exists. Accordingly, it may be appropriate to consider probability for purposes of recognition of a liability when there is uncertainty as to the existence of an obligation.

We also are concerned with the IASB’s broad application of unconditional, stand-ready obligations. Based on the definition and the illustrative examples, the potential population of noncontractual obligations could be extremely broad and may include many activities that are part of ongoing operations. If the Board adopted a similar approach in its Conceptual Framework project, we believe that it would need to clearly explain its concept of stand-ready obligations to allow the concept to be understood and consistently applied in practice. We also believe that the Board would need to articulate the boundary between stand-ready obligations and general business risk.
Probability Recognition Criterion

Question 8: Do you agree with omitting the probability criterion for recognition of nonfinancial liabilities? If not, why not?

Probability may continue to have a role in the recognition of certain liabilities with uncertainties. Specifically, probability may continue to have a role in the recognition of a liability when there is uncertainty about whether an obligation exists. Accordingly, the Conceptual Framework should allow standard-setters to consider the use of probability as a recognition criterion and it should provide guidance as to when probability should be used in recognition as well as measurement decisions.

The Board should consider the unique economic attributes of major types of liabilities to determine the extent to which an entity should use probability in recognition and measurement when there is uncertainty as to the existence of an obligation. For example, the Board identified the existence of a stand-ready obligation as the recognition criterion for guarantees and concluded that the probability of payment under the guarantee should be considered in the measurement of the liability, not in the recognition. Likewise, based on the premise that no tangible asset lasts forever, the Board concluded that asset retirement obligations should be recognized and that the uncertainty in the amount and timing of the cash flows should be reflected in the measurement of the liability. In both of these instances, there is no uncertainty about the existence of the liability and the Board concluded that probability should be reflected in the measurement of the liability. However, we believe that the use of probability may be necessary as a recognition criterion when there is uncertainty about the existence of an obligation.

Measurement

Question 9: Do you agree with the proposed measurement requirements for non-financial liabilities? If not, why not?

We believe that the objective of the proposed measurement requirement is unclear. The IASB’s proposal would require an entity to measure a non-financial liability at the amount that it would rationally pay to settle the obligation or to transfer it to a third-party on the balance sheet date. It is unclear whether an entity should consider entity-specific assumptions or marketplace participant assumptions (including risk and profit assumptions) in the measurement of that liability. The basis for conclusions in the proposed amendment to IAS 37 states that the measurement objective is similar to fair value. If it is the intent to require a fair value measure including marketplace participant assumptions, that should be clear.
As stated previously, probability assessments for recognition purposes may be appropriate in situations where there is uncertainty as to whether an obligation exists. In those cases, it may be appropriate to consider probability in both recognition and measurement. Estimates of fair value or other measures may be particularly difficult when there are uncertainties about the existence of a right or an obligation. The Board should continue to work with the Valuation Resource Group and others to consider potential guidance about measuring fair value in such situations that could limit diversity in valuation practices and ensure that the resulting information is sufficiently reliable.

We agree with the IASB’s proposal that entities should not recognize non-financial liabilities that are not reliably measurable. This reliable measure exception is consistent with the guidance in Statement 143. In the comment letters and at the roundtable for FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations, many constituents asked for guidance as to when a liability can be reliably measured. The Board provided some guidance in FIN 47 to respond to those requests. Addressing those issues in the Conceptual Framework project also would be appropriate.