March 6, 2006

Lawrence W. Smith
Director – Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 1235-001

Dear Larry:

The Committee on Corporate Reporting ("CCR") of Financial Executives International ("FEI") is writing to provide its views on the Financial Accounting Standard Board's ("FASB" or the "Board") Invitation to Comment, Selected Issues Related to Assets and Liabilities with Uncertainties (ITC). FEI is a leading international organization of 15,000 members, including Chief Financial Officers, Controllers, Treasurers, Tax Executives and other senior financial executives. CCR is the financial reporting technical committee of FEI, which reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. This document represents the views of CCR, and not necessarily the views of FEI or its members individually.

We support the Board’s decision to solicit early feedback on the fundamental changes to the accounting model outlined in the ITC. Further, we are encouraged that you have reached out to constituents early in the process and appreciate that you have not yet deliberated fully nor developed a basis for conclusions on the proposals. We believe that this is a prudent approach to follow because the changes proposed warrant candid, vigorous debate and should be supplemented with a robust field test (i.e., one that involves preparers, auditors and investors) before these changes are considered for inclusion in the financial reporting model.

We observe that the ITC is remarkably subtle in how the key IAS No. 37, Provisions, Contingent Liabilities, and Contingent Assets (IAS 37) principles are discussed. It seems
to us that the issues contained in the ITC are addressed at a high level and solely from a conceptual standpoint. In addition, there seems to be an air of inevitability underlying the proposals in the ITC. For example, the ITC states that these proposed principles are consistent with the conceptual framework, that they represent a natural evolution in the Boards’ thought process, and that they are supported by recently issued FASB standards that are in need of a convergent International Accounting Standards Board (“IASB”) counterpart. What is missing, in our view, is an analysis as to whether these proposals move financial reporting in a better direction. From a conceptual standpoint, we hold a different view on how these proposed principles have evolved and the issue of whether the principles are consistent with the conceptual framework as currently written.

As preparers, the members of CCR are required to implement these proposals at an operational and practical level. From that perspective, we find that the underlying principles at the heart of the ITC are complex and unworkable. We cannot envision preparers being able to develop mechanisms to sustain compliance and we expect that it would exacerbate issues with restatements that result from inadvertent non-compliance with GAAP. If that were to happen, we think that there would be significant negative consequences for investors. Given how we interpret the principles in the ITC and the potential impact of adoption, we are not convinced that the proposals outlined in the ITC would pass a realistic cost/benefit analysis. The remainder of this letter outlines our alternative view on those proposals and on the historical perspective outlined in the ITC. Responses to each of the questions posed in the document are provided in the attachment.

Conceptual Matters

Unlike the views expressed in the ITC, CCR believes that the proposed changes would be inconsistent with the FASB’s conceptual framework (CF). Events and transactions that are unlikely to produce future cash inflows or outflows appropriately do not meet the conceptual framework’s definitions of assets and liabilities. In paragraph 8 of the ITC, the inference is made that probability is not a factor in triggering the recognition of an asset or liability under the terms of the conceptual framework as it exists today: It suggests that the term probable in the definitions of assets and liabilities serves only to clarify that their existence is neither certain nor proved. However, the ITC omits relevant parts of the CF that contradict the view advanced in the paper. In the definition of assets and liabilities, footnote references indicate that the term probable is used in this context in a manner consistent with its general definition rather than its technical accounting sense and defines it as that which “can reasonably be expected or believed on the basis of available evidence but is neither certain or proved.” Those footnotes also refer to the definition in Webster’s, which defines probable as “supported by evidence strong enough to make it likely though not certain to be true” and “likely to happen or have happened.” We believe that the inclusion of Webster’s definition and other supporting references in the CF make it clear that the Board at that time intended for probability to be a significant factor to be considered in the recognition of assets and liabilities.

While we understand that the definitions in the Concept Statements imply a broader threshold for asset and liability recognition than what is imposed under SFAS 5, we believe that there is little doubt that the intended meaning is that an asset or liability must
meet the general definition of probable before it may be recognized. A contingent asset 
or liability, whose probability of occurrence is less than fifty percent cannot meet this 
recognition threshold. In addition, we believe any approach that factors probability only 
into measurement of an asset or liability is inconsistent with the current conceptual 
framework. We believe that further movement in this direction represents a fundamental 
change to the framework that must be conducted through a thorough consideration under 
the Board’s normal due process. We therefore believe that standards that are based on 
these concepts should be sequenced after they have been appropriately vetted through 
reconsideration of the conceptual framework.

Relevance

A fundamental question that must be carefully considered is whether the proposed 
approach to recognition of assets and liabilities will produce meaningful and useful 
financial statements for investors. It is clear that the Board understands that the proposed 
model will require assets and liabilities to be recognized even though they may produce 
no future cash inflows or outflows. However, we were unable to find any rationale or 
analysis in the basis for conclusions that describes how this improves an investor’s ability 
to predict future cash flows.

It is troubling to us that an IASB document that is one step away from a final standard 
would support such a fundamental change in financial reporting solely with conceptual 
arguments, many of which we find hard to understand. The principal arguments for 
making these changes are that contingent assets and liabilities don’t meet the CF 
definitions of assets and liabilities (ITC paragraph 29) and that they are in line with the 
Boards’ current thinking (ITC paragraph 30). These are inward-looking reasons that have 
meaning only within the domain of standards setters. Additionally, in paragraph BC17 of 
the IASB ED it states that the term contingent asset should be eliminated because “The 
Board concluded that the term was troublesome and confusing.” The issue is not whether 
those terms are confusing to Board members. Rather, it is whether they vex preparers, 
auditors and investors. Since they have been in use for more than half a century and are 
well understood in practice, we think it is clear that practitioners and users do not share 
that concern. And in practice, we have a very high threshold for recognizing in earnings 
a gain from an asset that is contingent. We doubt whether users of financial statements 
will understand how all of those contingencies can be recognized, even if they are remote 
of occurring. We suspect that application of these new principles will be the real source 
of confusion – and that it could have adverse consequences for investors.

CCR also does not believe that eliminating probability as a recognition trigger for assets 
and liabilities will produce accurate, reliable and useful financial statements. In many 
cases, the IASB proposal will require recognition of assets and liabilities related to 
transient phenomena that have remote probabilities. Except in rare circumstances, these 
temporary assets and liabilities will never produce a future cash inflow or outflow. It does 
not help investors or other users of financial statements to require assets or liabilities to 
be recorded for what might happen or that most likely will not happen. We expect that if 
investors were aware of this new class of highly uncertain assets and liabilities and 
understood them as we do, they would try to isolate and eliminate their effects from their 
analyses. In addition, investors would need to be vigilant in tracking such items until the
period(s) in which those contingencies are reversed (when the underlying uncertainty is resolved as expected), so that they can isolate and eliminate them once again.

Complexity and Operationality

We do not understand the IASB's objective in making a distinction between components of a contingency; since neither part exists in real life without the other. We observe that the three examples provided in paragraphs 33-35 of the ITC seem artificial and unrealistic. The notion that these unconditional rights represent separate assets is difficult to understand and implement. If this approach were adopted, unconditional assets and obligations have the potential to arise in many different forms, including executory contracts, lawsuits, and commitments based on promissory estoppel, which could render the scope of the revised IAS 37 extraordinarily broad.

We believe that capturing and measuring unconditional assets and liabilities will pose significant challenges for preparers and auditors. Determining the fair value of stand-ready unconditional assets and liabilities will be extremely challenging as developing probability-weighted expected cash flows requires judgment to estimate the various cash flow scenarios and to conclude as to the associated probabilities to assign those various scenarios. Frequently, those judgments will have to be made under the most difficult of circumstances. For example, at each interim reporting date, preparers and auditors will need to conclude as to whether they have identified the complete inventory of such rights and obligations and that they have correctly valued the unconditional aspect of the right.

From a valuation standpoint, this will be a challenge in circumstances where there is little available information upon which to base an estimate, which is not at all unusual in the early stages (when one first learns about the existence of the right or obligation). For example, in the early stages of a lawsuit, there may be little, if any, information regarding the plaintiff's claim and the available evidence that is relevant to reaching an informed conclusion about the potential outcomes and associated probabilities. Under existing GAAP, the difficult measurement issues would only be considered if it was deemed probable that the plaintiff would prevail. Under the proposed model, if the lawsuit has any probability of success whatsoever, it is within scope of the proposed standard.

In a model that blurs the distinction between traditional notions of recognition and measurement, it also is very unclear as to how one can differentiate between changes in fair value and correction of errors. With the irregular pattern and intervals associated with gathering the information relevant to the required valuations, it would seem logical to assume that the receipt of new information would always be of the former type. However, in the present environment it would be optimistic to assume that regulators will not find a case to be made for the latter in many situations.

CCR also has significant concerns that when applied broadly throughout an organization the proposed model will provide more powerful yet subtle levers for those who desire to manage earnings through financial engineering. We cannot envision how compliance professionals within the organization can ensure that earnings effects produced by these
requirements are appropriate and representationally faithful. Accordingly, we expect that application of these principles will severely tax a company’s internal controls and its ability to file timely financial reports. Further, given the potentially broad scope of the definition proposed, we expect that there will be a significant increase in the likelihood of future restatements, as companies discover ex-post conditional assets and liabilities they missed in earlier periods.

We believe that disclosure, not recognition and measurement, is a far better solution for the challenges posed by these highly uncertain phenomena. As the Board enters into deliberations and before proceeding further in development of these proposals, we believe that the scope of the analysis should be expanded to consider all aspects and potential consequences of this approach.

Convergence

We strongly support the objectives of the Board’s convergence efforts. However, a fundamental underlying tenet of that support is that the end result is a set of equivalent standards that individually as well as collectively improve financial reporting. In this case, we have the IASB attempting to converge to certain principles that underlie Statement 143 and Interpretation 45. We observe that these two documents have led to numerous implementation problems, many of which have been brought to the Board’s attention. We believe that applying these principles even more broadly through a new international standard would serve only to exacerbate those issues.

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In our view, the IASB ED perpetuates the recent trend of proposed standards that require judgments and measurements that eclipse the abilities of accountants to comply. These proposed standards, individually and collectively, add new dimensions and depth to the complexity that already exists in the global financial reporting system. Given the fundamental nature of the principles proposed, CCR is very interested in understanding how the Board will resolve the issues discussed above. We would be pleased to make available knowledgeable members who can assist the Staff and Board in better understanding our concerns. We also encourage you to reach out to your Valuation Resource Group, Investor Task Force and others for their insight as you move forward on this project. Please contact me at 215-981-8514 if you would like to arrange a discussion with any of our members.

Sincerely,

Lawrence J. Salva
Chair, Committee on Corporate Reporting
Financial Executives International
Responses to Individual Questions in Invitation to Comment

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

No. We believe that the notion of contingent assets is well understood and has not been the source of significant financial reporting issues. We also believe that assets should be recognized when they are probable of occurring. We do not see how ED’s approach of recognizing unlikely potential future economic benefits improves financial reporting. Additionally, we do not understand the relevance to investors of making a distinction between contingent and conditional assets.

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?

No. We find the analysis to be almost entirely a conceptual exercise that has very little, if any relevance to investment decisions. This point is made very clear in the examples provided: we do not think investors find the concept of an unconditional right embedded in a lawsuit to be something that they have ever thought about or that is terribly useful to financial analysis.

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?

As discussed above, we find the concept of embedded unconditional rights to be unhelpful and irrelevant to investment decisions. We find the examples provided to be unrealistic applications of the principles. In paragraph BC 11 of Appendix A, the ED explains that the IASB believes that unconditional means “nothing other than the passage of time is required to make its performance due” which does not appear to be the case for the examples provided of unconditional obligations. We believe that the current approach under SFAS 5 that focuses on the likelihood of the embedded conditional rights in determining recognition will result in superior financial reporting.

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

No. We believe that the probability that a conditional right will result in future economic benefits is a critically important factor in the decision to recognize an asset. A standard that only factors uncertainty into measurement will not improve financial reporting.

Question 5: Do you agree with eliminating the notion of contingent liability? If not, why not?
No. We believe that the current approach under SFAS 5, including appropriate disclosure of contingencies, provides for better financial reporting.

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?

While we acknowledge that the distinction between unconditional and conditional obligations has proved to be a useful construct for resolving recognition issues related to guarantees, we do not think that it makes sense to extend this approach to non-financial contingent liabilities such as lawsuits.

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 the example in paragraph 41 of this Invitation to Comment? If not, why not?

We struggle to understand how an entity would determine the probabilistic fair value for the unconditional obligation to stand ready to perform as directed by the courts and how this theoretical computation of reasonably possible or remote occurrences results in improved financial reporting.

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

No. We believe that the determination of the probability of the future sacrifice of economic benefits is an important element of liability recognition.

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

No. We continue to struggle to apply current accounting requirements to determine the probabilistic fair value of asset retirement obligations and conditional asset retirement obligations. We are concerned to see this approach applied more broadly.