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**Exposure Draft: Proposed FASB Statement, *Accounting Changes and Error Corrections* – a replacement of *APB Opinion No. 20* and *FASB Statement No. 3*  
(File Reference No. 1200-400)**

Dear Ms. Bielstein

We support the Board's ongoing efforts to improve U.S. generally accepted accounting principles and, for the topics identified for short-term convergence, to converge U.S. GAAP with international accounting standards. We agree with the Board that accounting changes and error corrections is an issue that is suitable for the joint short-term convergence project, and that the FASB could improve U.S. GAAP by converging with the IASB's revisions to IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*. Accordingly, we agree with the Board's conclusion that, in general, a voluntary change in accounting principle should be accounted for retrospectively. Our comments on specific aspects of the Exposure Draft (ED) are discussed in the remainder of this letter.

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### **Accounting changes**

Paragraph 5 of the ED states that when more than one accounting treatment is permitted, management is required to determine the accounting treatment that provides users with the most relevant information about the transactions. We believe that the guidance proposed in this paragraph may establish a new threshold for initial adoption of an accounting principle. While we concur with that proposal, we believe that the replacement of APB 20 should include additional guidance about the factors that management should consider to determine whether an accounting principle provides users with the most relevant information.

### **Retrospective application for changes in accounting principle**

We agree with the proposal in paragraph 7 of the ED that a change in accounting principle should be reported by retrospective application unless it is impracticable to determine either the cumulative effect or the period-specific effects of the change.

We believe that retrospective application by amending the comparative information presented for prior periods is preferable to the current requirement to include in net income of the period of the change the cumulative effect of changing to a new accounting principle. Because information presented about prior periods would be prepared on the same basis as information about the current period, the information would provide a more useful tool for trend analysis. We agree that the advantage of an enhanced interperiod comparability and greater consistency among periods outweighs the benefit of accounting for a change as a cumulative effect under which the effect of the change is more prominently displayed on the face of the financial statements. We also agree with the Board's view that consistently-reported information outweighs dilution of investor confidence that might result from retrospective adjustments.

### **Impracticable to apply the effects of a change retrospectively**

We agree with the proposed guidance in paragraph 11 of the ED that retrospective application should be deemed impracticable if the retrospective application requires assumptions about management's intent in a prior period (paragraph 11 (b)), or if it requires significant estimates as of a prior period and it is not possible to objectively determine whether information used to develop those estimates would have been available at the time the affected transactions would have been recognized (paragraph 11 (c)).



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However, to make the standard more operational the Board should incorporate into paragraph 11(a) additional guidance about when the effects of retrospective application are not determinable. We understand that the effects would not be determinable if the enterprise, after making a reasonable effort, is unable to obtain the information necessary to present the retrospective application. We suggest that, similar to IFRS, the notion of an undue cost or effort could be incorporated into paragraph 11(a), particularly for entities that are reporting under U.S. GAAP for the first time (e.g., foreign private issuers that are seeking listing on a stock exchange in the United States). If the information is not determinable, the entity should be required to disclose the reasons why it is not able to determine the information required to apply the change retrospectively.

#### **Application to changes in accounting principle required by the issuance of new pronouncements**

We agree with the Board's proposal that, in the absence of specific transition provisions, retrospective application should be the standard transition model in newly issued accounting standards in which a change in an accounting principle is effected to conform to the new standard. We believe that retrospective application of new accounting pronouncements in combination with the disclosure requirements in paragraph 19 of the ED will facilitate analysis and understanding of the financial statements and improve financial reporting. However, we believe that the FASB should contemplate prospective application of new accounting standards for future standards that require the use of fair value measures based on significant judgments.

#### **Change in depreciation method be accounted for as a change in accounting estimate**

The ED proposes that a change in depreciation method constitutes a change in principle that is inseparable from a change in estimate. The concept that underlies this conclusion is not clear to us in all circumstances. However, in the interests of achieving greater convergence with international standards, we would not object to this treatment as long as the Board retains its proposed requirement that the change must be justified by management as preferable.

Footnote 2 to paragraph 17 states that "an entity that changes its method of depreciation must establish that information available *about the pattern of consumption of the expected benefits* of the asset has changed such that the new method represents a better allocation of the cost of that asset to the periods benefited." (Emphasis added) It is unclear to us whether the FASB intends to create a new standard for depreciation, as this seems to focus on the pattern of consumption of the benefits rather than an allocation of



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cost. The current guidance on depreciation in ARB 43 (paragraph 5 of Chapter 9, Section C) indicates that the cost of facilities are to be allocated in a systematic and rational manner to periods during which the services are obtained from the use of the facilities. If the FASB intends to change the guidance on determining appropriate depreciation methods in ARB 43, we believe that more explanation should be provided than that included currently in footnote 2.

### **Restatement of financial statements**

We agree with the proposal in paragraph 27 to require an entity to disclose the effect of the error correction on each financial statement line item and any per-share amounts affected for the current period and all prior periods presented (*as previously reported and as restated*). This disclosure will enable users of the financial statements to understand and analyze the effect of the restatement.

We suggest that the final standard also require disclosure of the *nature and cause of the error*. The nature and cause of the error could include, for example, fraud, misapplication of GAAP, or weaknesses in the entity's internal control system. We believe that the nature of the error is important information to the users of the financial statements.

### **Retrospective vs. Restatement**

Because restatements are caused by errors (including fraud) while retrospective adjustments are caused by changes in accounting principle, we believe it is important that the financial statements clearly distinguish the reason for the change in the previously-reported information. We believe that the Board should require that the disclosures and adjusted financial statements clearly distinguish between financial statements that have been restated versus those that have been retrospectively adjusted. Finally, the Board should undertake to make clear to investors and others the significant difference between retrospective adjustments and restatements of financial statements.

### **GAAP hierarchy**

Paragraph 2(b) refers to categories a-d of the GAAP hierarchy as specified in SAS 69 (AU 411). We believe that this listing of the GAAP hierarchy represents an opportunity for the Board, working in conjunction with other appropriate bodies, such as the Public Company Accounting Oversight Board, to update the GAAP hierarchy and to clarify the status of certain types of documents. For example, in the listing of documents identified by the FASB in paragraph 2(b) are Concepts Statements and FSPs. Concepts Statements are not currently included in categories a-d of the GAAP hierarchy. FSPs (while clearly



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authoritative) are not on the list since the list pre-dates FSPs and we believe this standard to replace APB 20 presents an opportunity to formalize the authoritative status of FSPs. Additionally, we believe that the reference to AU 411 should be expanded to include a reference to the PCAOB's interim standards.

#### **Impracticability exception—only some prior periods restated**

We believe that the disclosures (paragraphs 19-21) should address issues discussed in paragraphs 8 and A.10 of the ED. Particularly, when the adjustment is applied to a prior period that is not the earliest period presented and the company is unable to retrospectively apply the change to all prior periods, the earlier periods should contain appropriate disclosure to distinguish those periods from the periods that have been retrospectively adjusted.

#### **Historical summaries of financial information**

We noted that the guidance in paragraph 39 (historical summaries of financial information) from APB 20 has not been carried forward in the ED. We believe that this guidance is helpful and should be retained in the final Statement.

#### **Incorporation of illustrative examples**

We believe that the final Statement should incorporate illustrative examples on the application of the standard similar to the examples in IAS 8.

#### **Basis for conclusions**

Paragraph A.20 discusses transition periods related to existing standards such as Statement 143 and states, "The provisions of Opinion 20 continue to apply to those pronouncements until the transition period is complete". In reality, it is the standards themselves (e.g., Statement 143) that contain the transition requirements, so a company is not applying APB 20 to that change. Instead, paragraph A.20 appears to be referring to the need to amend existing standards that refer to APB 20 for transition guidance.

#### **Effective date**

We understand that the Board's intention is that voluntary changes in accounting principles be adopted as of the beginning of a company's fiscal year. To clarify the Board's intention, we recommend that the effective date of the proposed standard be "as of the beginning of the fiscal year for periods beginning after December 15, 2004."



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If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or Paul Munter at (212) 909-5567.

Sincerely,

KPMG LLP