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April 13, 2004

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

Re: December 15, 2003 International Convergence Exposure Drafts (EDs) of Proposed Statements of Financial Accounting Standards (SFASs):

- Inventory Costs, an amendment of Accounting Research Bulletin (ARB) No. 43, Chapter 4 [File Reference 1200-100]
- Exchanges of Productive Assets, an amendment of APB Opinion No. 29 [File Reference 1200-300]
- Accounting Changes and Error Corrections, a replacement of APB Opinion No. 20 and FASB Statement No. 3 [File Reference 1200-400]

Dear Mr. Smith:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the above-referenced EDs and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC agrees in principle with the accounting changes proposed in each of the above-referenced EDs. The Specific Comments below present our concerns and recommendations for the final standards.

SPECIFIC COMMENTS

Inventory Costs ED

TIC believes the proposed revisions to ARB No. 43, Chapter 4, *Inventory Pricing*, provide improved guidance regarding the proper accounting for idle capacity, spoilage, double freight and rehandling costs. The ED has clarified the line between production

costs and period costs and will promote greater comparability among companies with similar issues.

Exchanges of Productive Assets ED

TIC concurs with the conclusion in the ED that exchanges of productive assets should be accounted for at fair value unless the exchange transaction lacks "commercial substance." However, TIC encourages the Board to clarify some of the provisions of the ED through revised language or examples.

Issue 1 Commercial Substance
Paragraph 4 of the ED provides revised language for paragraphs 20 and 21 of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. TIC found the verbiage in paragraph 20b, *Exchange Transaction to Facilitate Sales to Customers*, to be overly complex and confusing. TIC recommends that paragraph 20b be revised to more closely mirror the text that is in the International Accounting Standards Board (IASB) ED on Improvements to International Accounting Standards (the Improvements ED), which is cited in paragraph A4 of the FASB ED:

> *...an exchange of assets for sale in the normal course of business for assets for sale in the same line of business (inventory exchanges).*

The language in the IASB ED is preferable because it is stated in plain English and includes a short illustrative example at the end of the sentence. Paragraph 20b in the FASB ED includes specific words to replace "assets" (i.e., "product or property") and introduces the phrase, "...to facilitate sales to customers other than the parties to the exchange" without explaining why the changes were necessary, how the revised language is different from the IASB language or giving an illustrative example. Paragraph 20b implies that certain inventory exchanges should be accounted for at fair value rather than recorded value but does not provide discussion or examples of any fair value exceptions. TIC is uncertain whether the added phrase was meant to address the issue identified in paragraph A12 of the FASB ED (circularity of reasoning regarding tax cash flows). If the Board believes that paragraph 20b is appropriately phrased, then, at a minimum, illustrative examples should be added to clarify the Board's intent.

Issue 3 Real Estate Transactions
TIC agrees with the Board's conclusions that nonmonetary exchanges of real estate should be evaluated based on the model established in this ED. The revised standard will eliminate the current practice of effectively deferring gains on transactions that, in most cases, have commercial substance and readily determinable fair values.

TIC recommends the FASB issue contemporaneous implementation/Q&A guidance addressing common questions, issues and computations many entities face. Specifically, examples of the before-and-after cash flows and entity specific values would be helpful.

TIC also recommends that all of the remaining relevant literature from APB Opinion No. 29 be comprehensively added to the final standard so that authoritative guidance on nonmonetary transactions is not spread between two different statements.

Accounting Changes and Error Corrections ED

TIC concurs with the conclusions in the ED that a change in depreciation, amortization or depletion method should be reported as a change in accounting estimate rather than a change in accounting principle. TIC also agrees with the theory of the retrospective application approach for reporting a change in accounting principle since it should result in greater financial statement comparability between periods.

However, TIC has identified some practical issues and a number of terminology problems within the ED. Further details on the issues and TIC's recommendations for improving the clarity of the final standard are presented below.

Practical Issues

The need to report accounting principle changes through retrospective application rather than a cumulative effect adjustment could have the effect of discouraging many private companies from preparing comparative financial statements in the year of the change because it will cost them more to do so.

TIC is particularly concerned about this issue in connection with reporting a change in accounting principle made in an interim period (paragraph 22 of the ED). These requirements would be applicable to all entities that follow GAAP, even when the financial statements are compiled or reviewed, and would be especially onerous for small entities when their accountants prepare monthly or quarterly compiled financial statements. The ED states that entities are not permitted to opt out of retrospective application simply because it is impracticable to apply the standard. Companies may avoid presenting comparative interim financial statements to keep costs down as such data may not be readily accessible. Companies that are obligated to present comparative financial statements for their users will not only incur additional costs to implement the new standard but may often have difficulty obtaining the necessary comparative data in the manner desired and for the necessary time period..

TIC therefore requests a private company exemption from the retrospective application requirement for reporting a change in accounting principle in an interim period if such application is not practicable. The ED does not adequately justify the need for such a strict requirement in interim v. annual financial statements.

TIC also sees practical issues involving accounting principle changes that occur after an entity has changed auditors/accountants (accountants). Predecessor accountants generally do not reissue and present their reports on the prior period; rather, successor accountants generally refer to the report of the predecessor. Under this new standard, successor accountants would have to engage in more frequent communications with the predecessor

in order to understand the full effect of the retrospective adjustments. Successor accountants may not gain adequate comfort regarding the expanded adjustments and disclosures and therefore may not provide assurance on the adjustments. The amount of work (and related cost) as well as timing considerations involved could further discourage preparation of comparative financial statements.

Retrospective application v. retroactive restatement
TIC is concerned that the term "retrospective application" will be confused with "retroactive restatement." The distinction between the terms is discussed only in the Basis of Conclusions (paragraph A9 of the ED). At first, paragraph A9 states that these are two different terms for the same principle. However, the FASB appears to have decided that the respective meanings of these terms should be different as well. "Retrospective application" will be used to describe the reporting of a change in accounting principle, while the term "restatement" will only be used to describe the correction of an error. To enhance the visibility of the terms and their respective definitions, TIC recommends that the term "retroactive restatement" be added to the glossary in paragraph 2 of the ED, accompanied by language that would make the desired distinction. This revision will greatly simplify transition to the new terminology.

Prior-Period Adjustments
Paragraph 26 of the ED states,

> *Any correction of an error in the financial statements of a prior period discovered subsequent to their issuance shall be reported as a prior-period adjustment.* [Emphasis added]

TIC is uncertain whether the quoted phrase above is phrased as the Board intended or is an oversight caused by carrying over the "prior-period adjustment" terminology from the original source. If the term "prior-period adjustment" is meant to be synonymous with restatement, TIC recommends that this be made clear in the glossary in paragraph 2. Paragraph 26 is an important source of information regarding how to present a prior-period adjustment, so it is especially important for terminology used in the paragraph to be clear.

Paragraph 26 of the ED defines prior period adjustments in the context of financial statements restated for correction of an error. Different words are used to describe the mechanics of "retrospective application" (paragraph 2h), but both paragraphs seem to be saying the same thing. TIC believes proper and consistent use of terminology, accompanied by adequate explanations for verbiage differences, are essential in writing clear standards that be readily understandable and achieve desired objectives.

Change in Reporting Entity
TIC believes confusion exists in practice as to the meaning of a change in reporting entity. The circumstances under which a change in reporting entity would apply are unclear in the authoritative literature and may not be consistently applied. The elements of the current definition are very general and do not adequately distinguish the types of

transactions that would qualify as reporting entity changes in the context of either consolidated or combined financial statements. Given the consolidation provisions of SFAS No. 94, *Consolidation of All Majority-Owned Subsidiaries*, and SFAS No. 141, *Business Combinations*, and more recently, FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities (Revised)*, it would seem there are very few, if any, circumstances where reporting entity changes would be reported in a consolidation.

One source of confusion is whether step acquisitions and dispositions of an entity constitute such a change. (AICPA *Professional Standards*, Vol. 1, Section AU 420.07-.09, and AICPA *Technical Practice Aids*, Section 9030.09, "Change in Reporting Entity," provide guidance regarding when certain changes of this type result in a consistency paragraph in the auditor's report but do not discuss what types of transactions trigger restatement.) One theory that has evolved is that reporting entity accounting changes only occur when management can exercise its discretion to change consolidation or combination policy. That is, financial statements would not be restated for reporting entity changes that occur as a result of a transaction or event. Since the Board is replacing APB Opinion No. 20 with a new standard, TIC suggests that this guidance be clarified and common examples provided to ensure consistency of application.

TIC also noted an apparent inconsistency between paragraph A9 and paragraph 18 of the ED. Paragraph A9 states that the term "restatement" is used only when describing the correction of an error. However, paragraph 18 talks about "restating financial statements" in connection with a change in the reporting entity. TIC believes the Board's intention was to use retrospective application to present a change in the reporting entity.

Incorporating Disclosures from APB Opinion 9

Paragraphs 26 and 27 of the ED refer to APB Opinion No. 9, *Reporting the Results of Operations*, paragraphs 18 and 26, for required disclosures for prior-period adjustments. TIC suggests that the new standard simply incorporate those disclosures to avoid the need to refer to another pronouncement for basic requirements, especially since the disclosures in APB Opinion No. 9 are relatively short.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Stephen M. McEachern, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees