



Ernst & Young LLP
5 Times Square
New York, NY 10036
Tel: 212 773 3000
www.ey.com

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

January 31, 2011

Request for Comments on Discussion Paper, Effective Dates and Transition Methods (File Reference No. 1890-100)

Dear Ms. Seidman:

We appreciate the opportunity to comment on the Discussion Paper, *Effective Dates and Transition Methods* (the "Discussion Paper").

We fully support the Board's decision to consult constituents regarding the timing and method of adoption of the many new standards expected to be issued in 2011. The changes proposed in the new standards will significantly impact many fundamental areas of financial reporting. Therefore we welcome the Board's efforts to consider ways to reduce the burden of adopting the new financial reporting standards, as well as helping other stakeholders manage the pace of change.

While we have provided detailed responses to the specific questions in the Appendix to this letter, on an overall basis, we believe that:

- ▶ given the fundamental changes to financial reporting called for in the proposed standards, preparers and auditors will require a substantial lead time to effectively adopt such standards
- ▶ a single date adoption approach is preferable, and
- ▶ while retrospective adoption generally provides more useful information, such an approach will be complex and costly in the context of the proposed standards and we urge the Board to explore practical approaches to adoption to reduce the costs of, and minimize the potential use of hindsight in, developing estimates associated with past transactions.



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

Very Truly Yours,

Ernst & Young LLP

cc: International Accounting Standards Board

Appendix

Responses to Questions in the Discussion Paper, *Effective Dates and Transition Methods*

- Q1. Please describe the entity (or the individual) responding to this Discussion Paper. For example:
- a. Please indicate whether you are primarily a preparer of financial statements, an auditor, or an investor, creditor, or other user of financial statements (such as a regulator). Please also indicate whether you primarily prepare, use, or audit financial information prepared in accordance with U.S. GAAP, IFRSs, or both.
 - b. If you are a preparer of financial statements, please describe your primary business or businesses, their size (in terms of the number of employees or other relevant metric), and whether you have securities registered on a securities exchange.
 - c. If you are an auditor, please indicate the size of your firm and whether your practice focuses primarily on public companies, private entities, or both.
 - d. If you are an investor, creditor, or other user of financial statements, please describe your job function (buy side/sell side/regulator/credit analyst/lending officer), your investment perspective (long, long/short, equity, or fixed income), and the industries or sectors you specialize in, if any.
 - e. Please describe the degree to which each of the proposed new standards will likely affect you and the factors driving that effect (for example, preparers of financial statements might explain the frequency or materiality of the transactions to their business and investors might explain the significance of the transactions to the particular industries or sectors they follow).

Ernst & Young LLP is the US member of a global professional services organization operating in 140 countries. The audit practice in the US employs approximately 9,000 professionals, auditing approximately 5,000 private and public entities.

The proposed new standards will have a significant effect on the companies we audit and, therefore, on our internal training and accounting and auditing guidance. All audit professionals will need to be trained in the requirements of each new standard, and such training will require a significant investment to develop and deliver. The revisions to the accounting literature for financial instruments, revenue recognition, and leases will represent significant changes to current practice with far-reaching effects and, therefore, will require extensive, multi-day training sessions for most of our audit personnel. Insurance, while not

having broad applicability across sectors, will represent substantial change for professionals serving entities affected by these standards, and will also require extensive training. As we audit a considerable proportion of companies in the US, across all industries, we will be significantly impacted by all the new standards.

- Q2. Focusing only on those proposals that have been published as Exposure Drafts (accounting for financial instruments, other comprehensive income, revenue recognition, and leases):**
- a. How much time will you need to learn about each proposal, appropriately train personnel, plan for, and implement or otherwise adapt to each the new standard?**
 - b. What are the types of costs you expect to incur in planning for and adapting to the new requirements and what are the primary drivers of those costs? What is the relative significance of each cost component?**

The proposed standard on other comprehensive income will not require significant effort on our part. However, as discussed above, the proposed statements on financial instruments, revenue recognition, leases and insurance represent truly fundamental changes to the existing accounting models and will require incremental investments to train our people, help educate preparers, and develop and publish implementation guidance on each standard. We expect that this investment will be significant and at a level unlike anything we have experienced in the recent past. We expect to need approximately 18 months from the time a final standard is issued to develop our interpretive guidance and training materials and train our professionals.

For preparers, the changes are likely to impact IT systems, internal controls and business processes. Preparers will incur significant time and costs developing and maintaining models and processes necessary to make the extensive estimates and judgments' required by the proposed standards for financial instruments, leases and revenue. Many of the proposed standards will result in changes to operating measures and key performance indicators. These changes will need to be reflected in budgets and may require some changes to budgeting processes and incentive programs. Preparers will need sufficient time to consider the effects, to make the necessary changes and communicate those changes to affected personnel. There are also likely to be costs associated with reviewing and revising certain contracts and business arrangements, such as incentive plans and debt covenants. Increased investor education will also be needed.

The burden to audit the significant accounting estimates and judgments inherent in the new standards will also likely increase and audit costs may rise as a result.

The costs incurred by preparers will also be substantively affected by whether the changes apply retrospectively, as retrospective changes require significant time to revisit past transactions and analyze the impact and make adjustments if needed. Where prospective application is used, entities are likely to require less effort and cost to adopt (provided there is sufficient adoption lead time included in the new standards).

Q3. Do you foresee other effects on the broader financial reporting system arising from these new standards? For example, will the new financial reporting requirements conflict with other regulatory or tax reporting requirements? Will they give rise to a need for changes in auditing standards?

Preparers

We believe there will be significant effects on the broader financial reporting system. Any contractual or regulatory requirement that is underpinned by an accounting concept could be affected by changes to accounting standards. Preparers such as banks and insurance companies will also face regulatory implications that could be significant. We recommend that the Board consider the practical implications associated with these issues as it concludes on the adoption plan for these new standards.

Auditors

We have concerns about an auditor's ability to audit some of the proposed accounting requirements and, due to the judgemental nature of some of the requirements of the proposed standards, there may be a lower level of auditable evidence to support those judgements. We draw your attention to the following examples:

- ▶ Both the leases ED and the revenue ED require use of probability-weighted estimates to determine contingent payments. We are concerned that the inputs required to calculate those estimates will be difficult for preparers to develop and for auditors to substantiate with sufficient evidence.
- ▶ The leases ED requires that the lease term be determined based upon an assessment of the probability of occurrence of renewals/terminations. Preparers' assessments of the probability of occurrence of renewals and terminations will often represent very subjective estimates of future actions. Under the proposed model, the determination of the appropriate lease term could have a significant effect on the amounts recognized (i.e., the measurement of recognized assets and liabilities and the timing and characterisation of amounts recognized in earnings). Auditors may find it difficult to substantiate the estimates and assertions of preparers with

sufficient evidence.

- ▶ The financial instruments impairment model originally proposed by the IASB required preparers to estimate changing economic conditions when estimating future cash flows over the entire life of a financial asset. This provision would have required an entity to make assumptions about economic conditions that might exist far into the future (e.g., 20 years). These estimates are highly judgemental and there likely will be a lower level of auditable evidence to support the entity's assumptions. We support the Boards' tentative decision to allow a preparer to forecast changes in economic conditions for a reasonable forecast period beyond the balance sheet, using supportable assumptions of future economic conditions. While the use of any forecast requires judgement and creates auditing challenges, the proposed changes would better allow auditors to audit the cash flow estimates and validate management's forecasts.

Another example of the impact the proposed standards may have on audit firms relates to the auditor independence requirements. Current SEC independence rules permit auditing firms to enter into a leasing arrangement with an SEC registrant audit client if the lease is an operating lease and certain other conditions are met. The elimination of the distinction between operating and capital/finance leases may mean that auditors would have to change their leasing arrangements to remain independent within the SEC rules, or that the independence requirements in this area may need to be revisited.

While we understand that the Board's primary objective is to develop high quality accounting standards that provide information of value to all users of financial statements, we believe that the ability of the auditors to audit those requirements should not be overlooked and request that the Board consider our concerns.

Q4. In the context of a broad implementation plan covering all the new requirements, do you agree with the transition method as proposed for each project? If not, what changes would you recommend and why? In particular, please explain the primary advantages of your recommended changes and their affect on the cost of adapting to the new reporting requirements.

Retrospective application is generally preferable for new standards to aid comparability. However, there are a number of circumstances in which full retrospective application may not be appropriate. Our comment letters on the individual projects describe our views.

Retrospective transition provides more useful information to users, but comes at a significant cost and in many cases (e.g., revenue and leases) will require new estimates to be made for historical transactions. We believe the Board

should explore practical approaches to adoption to reduce the costs of, and minimize the potential use of hindsight in, developing estimates associated with past transactions. For example, the suggestion provided in our comment letter on the leases project, or considering approaches providing for prospective adoption (from the first comparative period presented with remeasurement of outstanding arrangements at the beginning of the first period presented in the statement of profit or loss), would reduce implementation burdens as compared to full retrospective adoption.

- Q5. In thinking about an overall implementation plan covering all of the standards that are the subject of this Discussion Paper:**
- a. Do you prefer the single date approach or the sequential approach? Why? What are the advantages and disadvantages of your preferred approach? How would your preferred approach minimize the cost of implementation or bring other benefits? Please describe the sources of those benefits (for example, economies of scale, minimizing disruption, or other synergistic benefits).**
 - b. Under a single date approach, what should the mandatory effective date be and why?**
 - c. Under the sequential approach, how should the new standards be sequenced (or grouped) and what should the mandatory effective dates for each group be? Please explain the primary factors that drive your recommended adoption sequence, such as the impact of interdependencies among the new standards.**
 - d. Do you think another approach would be viable and preferable? If so, please describe that approach and its advantages.**

(a) From our perspective as independent auditors, we see advantages and disadvantages to both the single date and sequential adoption approaches. A sequential approach would allow us to better allocate resources to preparing implementation guidance and training materials, as well as training our professionals, but would come at costs for users and preparers described further below.

From a preparer's perspective, a single date approach would help better manage and control costs and would avoid the inconvenience and disruption of a prolonged transition period. A single date approach (with appropriate lead time) would allow entities to plan all changes, including system changes, as one project. A single date approach may also be a more effective way for preparers to educate both staff and investors on the changes resulting from the new standards.

We acknowledge that for some entities, there may be disadvantages to the single date approach. Entities that are more significantly affected by the

changes, or are more resource constrained, may find making all the changes as one project an excessive burden. For those entities, costs may be significantly higher if they need to take on additional resources to deal with all the changes at once.

Overall, we believe a single date approach would be preferable to users as it would minimize confusion when trying to compare results for multiple periods. A sequential approach would result in multiple restatements of comparative financial information for a given year, which reduces the transparency and comparability of those financial statements.

- (b) Under a single date approach, we believe the most complex entities confronted with multiple new standards at the same time likely will need a minimum of 24 to 30 months to prepare for the changes, before the beginning of the comparative period when the changes are first applied. For SEC registrants that provide two years of comparative information, we believe the effective date should be no earlier than 1 January 2016. This would provide at least 24 months between the issuance of new standards in 2011 and the first date presented under the new standard for an SEC registrant (1 January 2014), assuming that the new standard must be applied in the first period presented.

Preparers will likely need time not only to implement new systems and internal controls, but also to communicate the impact of the changes to stakeholders. Contractual arrangements, such as debt agreements, may need to be modified and companies may need to modify their compensation plan arrangements. Regulators will need time to adapt their requirements and preparers and auditors will need time to become familiar with those new regulations.

- (c) If a sequential approach is adopted, we believe it may be appropriate for the insurance and financial instruments standards to have the same effective dates given (a) the significant effects of both standards for certain financial institutions and (b) certain insurance contracts contain embedded financial instruments. It would be appropriate for the revenue and leases standards to have the same effective dates given that service elements of leases would be accounted for by lessors under the revenue standard.

Timing of adoption would depend on the transition method. Assuming retrospective application and a grouped approach to sequential adoption, it would be difficult if the effective date for the first group of standards to be adopted is much earlier than 1 January 2016.

- (d) We are not aware of another viable alternative approach.

Q6. Should the Board give companies the option of adopting some or all of the new standards before their mandatory effective date? Why or why not? Which ones? What restrictions, if any, should there be on early adoption (for example, are there related requirements that should be adopted at the same time)?

Users would face significant challenges if companies with the same fiscal years were not adopting such significant standards at the same time. Therefore, we generally believe that early adoption should not be permitted for significant standards.

We see benefits of some companies adopting a new standard before others as it often helps identify implementation issues before the bulk of affected companies adopt the new standards. However, we do not believe that permitting voluntary early adoption is the best way to obtain this benefit. Instead, the FASB could consider phasing in the adoption dates of the standards for different categories of companies, as described in our response to Question 7.

Regarding restrictions on early adoption (e.g., standards that should be adopted together), see our comments on Question 5.c

Q7. For which standards, if any, should the Board provide particular types of entities a delayed effective date? How long should such a delay be and to which entities should it apply? What would be the primary advantages and disadvantages of the delay to each class of stakeholders (financial statement preparers, financial statement users, and auditors)? Should companies eligible for a delayed effective date have the option of adopting the requirements as of an earlier date?

We believe that allowing private companies a delayed effective date for the most significant new standards (i.e., financial instruments, revenue recognition and leasing) might alleviate the competition for scarce implementation resources and let private companies benefit from visibility into the implementation efforts of public companies. However, we also recognize that some users are required to analyze both public company and private company financial statements (e.g., banks) and, therefore, the different effective dates might complicate their analyses. While the Board should carefully consider user input on this issue, we are inclined to support delayed effective dates for private companies.

Q8. Should the FASB and IASB require the same effective dates and transition methods for their comparable standards? Why or why not?

Requiring the same effective dates under US GAAP and IFRS will enhance comparability and minimize issues if the US ultimately converts to IFRS. However,

given different pressures on the Boards, we do not believe that the effective dates necessarily need to be the same. For example, the IASB may prefer permitting entities to early adopt so that entities in countries moving to IFRS in the near term would not have to change certain practices twice (once when IFRS is adopted and again when IFRS is changed for the new standards). Those considerations are not relevant to entities applying US GAAP (absent a decision by the SEC to permit or require use of IFRS by US public entities) and, therefore, the FASB may chose to limit or prohibit early adoption to enhance comparability among US companies.

While we strongly support the Boards' convergence efforts, we believe that relatively small differences in effective dates are not a significant concern provided that the standards are fully converged.

Q9. How does the Foundation's ongoing evaluation of standards setting for private companies affect your views on the questions raised in this Discussion Paper?

The Foundations efforts in this area do not affect our conclusions. As discussed in our 14 September 2010 comment letter on the efforts of the AICPA/FAF/NASBA "Blue-Ribbon" Panel on Standard Setting for Private Companies, we do not support different recognition and measurement standards for private companies or a different standard setter for private companies. However, as discussed in our response to Question 7, we would support a delayed transition date for private companies.