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Ms. Nancy M. Morris
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street, NE
Washington, D.C. 20549-9303

Progress Report of the SEC Advisory Committee on Improvements to Financial Reporting (Release Nos. 33-8896; 34-57331) Commission File No. 265-24

Dear Ms. Morris:

Ernst & Young LLP is pleased to comment on the Progress Report (the Progress Report) of the Securities and Exchange Commission's (the Commission or the SEC) Advisory Committee on Improvements to Financial Reporting (CIFiR or the Advisory Committee). Following some general commentary, we have organized our comments to respond to the specific proposals and approaches in the Progress Report.

We appreciate and support the efforts of the Advisory Committee as a catalyst to improve financial reporting, particularly to address complexity. In part, complexity in accounting and financial reporting arises from the unavoidable complexity of some business transactions. However, complexity also can be unnecessarily introduced from other sources (e.g., the form and content of accounting requirements, the legal and regulatory environment, financial statement presentation and disclosure practices, transaction structuring to achieve a desired accounting result, the rate of change in promulgated accounting standards). Excessive complexity adversely affects all participants in the financial reporting process—preparers, auditors, investors and other users, regulators, and other stakeholders.

The current complexity of accounting and financial reporting is the cumulative result of its evolution over the last hundred years, as influenced by the prevailing legal and regulatory environment and the competing needs and desires of the participants in the financial reporting process. It is important to distinguish the root causes from the symptoms of complexity, but pervasive root causes will not be susceptible to "quick fixes" or short-term remediation efforts. Even once some of these root causes are addressed, it will require commitment and vigilance by the participants in the financial reporting process to avoid a resurgence of unnecessary complexity.

In our view, two primary root causes of complexity in accounting and financial reporting include:

- The risk of litigation, particularly related to financial restatements or unexpected losses.
- The lack of respect for professional judgment, particularly related to challenges by regulators, with the benefit of hindsight, of the real-time judgments of preparers and auditors.

As a predicate to reducing complexity, we strongly believe that these root causes must be addressed. In our view, the Advisory Committee's work with respect to materiality and professional judgment offer the best chance to begin that process. It is clear that our financial reporting system must return to a rational application of the concept of materiality. Just as important, preparers and auditors must be confident that their good faith and well-reasoned professional judgments will be respected. We look forward to working with the SEC, along with other participants in the financial reporting process, to begin to address these critical areas.

Substantive Complexity

Industry-Specific Guidance

Developed Proposal 1.1: GAAP should be based on business activities, rather than industries. As such, the SEC should recommend that any new projects undertaken jointly or separately by the FASB be scoped on the basis of business activities rather than industries. Any new projects should include the elimination of existing industry-specific guidance in relevant areas as a specific objective of those projects, unless, in rare circumstances, retaining industry guidance can be justified on the basis of cost-benefit considerations (discussed below). The SEC should also recommend that, in conjunction with its current codification project, the FASB add a project to its agenda to remove or minimize existing industry-specific guidance that conflicts with generalized GAAP, taking into account the pace of convergence efforts.

We generally agree with the premise of CIFiR's proposal (i.e., GAAP based on activities rather than industries is preferable), but we do not see industry-specific accounting literature as a prime culprit in the current complexity in financial reporting. While industry-specific accounting literature certainly contributes to the volume of literature that constituents must consider, it generally contributes to complexity in financial reporting only if an issuer is expected to use the literature by analogy even when it is not directly applicable. In our view, reducing existing industry-specific accounting literature should not be the highest priority initiative to address the complexity in financial reporting. Instead, the immediate focus should be to address some of the root causes and behaviors that create complexity.

In recent years, industry-specific accounting standards have not been a principal focus of the FASB's agenda. Rather than addressing industry-specific accounting standards, we agree that the FASB should concentrate on (1) improving its conceptual framework, (2) eliminating inconsistencies within existing accounting standards and between those standards and the conceptual framework, and (3) addressing accounting standards with broad applicability (e.g., revenue recognition). Accounting standards that are written based on fundamental principles, and that are consistent with the conceptual framework, should allow preparers across various industries to apply a standard based on their specific facts and circumstances. The Advisory Committee must acknowledge, however, that the application of principled standards with broad applicability (e.g., revenue recognition) to industries as diverse as software, life insurance, long-term construction contracting, real estate, title insurance and franchisors is not an easy task if the resultant accounting is to maintain its relevance.

While the FASB has a number of industry-specific accounting standards, many of those standards date from the time when the FASB was adopting as its own the existing AICPA Statements of Position. In addition, the FASB has issued its own industry-specific accounting standards, particularly for rate-regulated enterprises, oil and gas producers, and insurance companies. We generally agree that industry-specific accounting standards should receive a lower priority on the FASB agenda and that the FASB should undertake an industry-specific project only when a broader scope project could not adequately address the financial reporting issue.

The EITF more frequently addresses accounting issues that are specific to certain industries. However, consistent with the EITF's mission, EITF consensuses should merely resolve industry-specific issues within the framework of existing authoritative literature. And, of course, the AICPA has published a number of industry-based accounting and auditing guides. By cataloging and illustrating the appropriate application of existing accounting standards and principles to the business activities of a specific industry, such guides have served as valuable references and educational tools that promote consistency and comparability within the respective industry. The challenge, of course, is maintaining and updating the AICPA guides in the face of constantly evolving accounting standards and business conditions. In addition, preparers and auditors should understand that the AICPA guides are not the sole, or even primary, source for accounting and financial reporting guidance applicable to the respective industry.

Industry-specific guidance frequently addresses areas of accounting, such as revenue recognition criteria, in which there is no promulgated GAAP that is activities-based. We would support elimination of industry-specific guidance once "activities-based" standards have been developed. However, any attempt to eliminate industry-specific guidance is not feasible in the short-term without leaving a void where activities-based guidance does not exist.

We certainly agree that industry-specific accounting literature should be updated or superseded if it conflicts with accounting standards promulgated by the FASB. The current FASB codification project should provide such an opportunity. In addition, given the expected movement of U.S. public companies to IFRS, we urge the SEC, the FASB and other participants in the financial reporting process to comprehensively reconsider the existing body of industry-specific guidance within U.S. GAAP, with a view to identifying areas that can be eliminated once activities-based standards have been developed. Even with the adoption of IFRS, industry-specific guidance within U.S. GAAP still could influence decisions under IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

Alternative Accounting Policies

Developed Proposal 1.2: *GAAP should be based on a presumption that formally promulgated alternative accounting policies should not exist. The SEC should recommend that any new projects undertaken jointly or separately by the FASB not provide additional optionality, unless, in rare circumstances, it can be justified. Any new projects should include the elimination of existing alternative accounting policies in relevant areas as a specific objective of those projects, unless, in rare circumstances, the optionality can be justified.*

The alternative accounting policies listed in Appendix B of the Progress Report do not appear to need near-term remediation, nor is it likely that such remediation would significantly reduce the current complexity in financial reporting. Of course, over time, in the normal course of periodically reviewing existing accounting standards, it would be appropriate for the FASB to question the continued validity of certain alternative accounting policies. In some circumstances, it may be appropriate for the FASB to allow reasonable alternatives, particularly if an alternative is more practical and cost-effective than a conceptually pure accounting requirement. However, even if formally promulgated alternative accounting policies were entirely eliminated, there could continue to be diversity in the interpretation and application of accounting standards in specific circumstances that is within the bounds of reasonable professional judgment. While many have called for more principles-based and less prescriptive accounting standards, such standards could result in less comparability due to the exercise of professional judgment by the respective preparers and auditors.

Bright Lines

<u>Conceptual Approach 1.A:</u> *We are considering recommending expanded use of the following, in place of the current use of bright lines, to better reflect the economic substance of an activity:*

- *Proportionate recognition – We use the term "proportionate recognition" in contrast to the current all-or-nothing recognition approach in GAAP. For example, consider a lease in which the lessee has the right to use a machine, valued at $100, for four years. Also assume that the machine has a 10-year useful life. Under proportionate recognition, a lessee would recognize an asset for its right to use the machine (rather than for a proportion of the asset) at approximately $40 on its balance sheet. Under the current accounting literature, the lessee would either recognize the machine at $100 or recognize nothing on its balance sheet, depending on the results of certain bright line tests.*
- *Additional disclosure – We recognize that proportionate recognition is not universally applicable. In those cases, enhanced disclosure may be more appropriate. We have yet to define the possible scope of proportionate recognition and/or enhanced disclosure, but it may extend to areas such as leases, consolidation policy and off-balance sheet activity.*
- *Rules-of-thumb or presumptions, both coupled with additional considerations – We use rule-of-thumb and presumption to describe a method by which an accounting conclusion may be initially favored, subject to the consideration of additional factors. These are less stringent than bright lines, and may be appropriate where proportionate recognition may not apply.*

As CIFiR notes in its Progress Report, there is no question that bright-line tests have contributed to complexity in financial reporting. In our experience, bright-lines create opportunities for transaction structuring, which adds unnecessary complexity to transactions in an attempt to achieve a more desirable accounting result. While we would support the systematic reconsideration of accounting literature that contains bright-lines, we agree with the CIFiR observation that the alternative will require the exercise of, and respect for, reasonable professional judgments. As a result, we believe that protection for the exercise of professional judgments of preparers and auditors is a fundamental predicate to eliminating bright-lines and adopting a more principles-based and less complex set of accounting standards. Our comments on the Advisory Committee's proposed professional judgment framework are discussed later in this letter.

Although bright-lines should be challenged, proportionate recognition on its own does not appear to be the simple solution. In the example provided, what asset should be recognized if the lessee has a lease for the same machine with an initial term of four years and the right to renew for an additional three years? Should the lessee recognize 40% or 70% of the asset's value, or 40% plus the value of the right to renew, as its proportionate right to use the machine? Would the answer depend on the economic terms of the original lease period and the subsequent optional renewal periods? While we support the FASB and IASB joint project on lease accounting, we do not believe that CIFiR should prejudge that proportionate recognition is the appropriate solution for the accounting for leases or any other complex areas of accounting.

Conceptual Approach 1.B: *Further, we are considering a recommendation related to the education of students, as well as to the continuing education of investors, preparers, and auditors. The recommendation would encourage understanding of the economic substance and business purposes of transactions, in contrast to mechanical compliance with rules without sufficient context.*

Clearly, in order to exercise judgment in analyzing the appropriate accounting and financial reporting for complex transactions, financial professionals must be able to discern the business purposes of the parties to the transaction, as well as the economic substance of the transaction from the perspective of the various parties. Professionals generally develop these skills over time with seasoned business experience. We would support efforts to more effectively develop these skills through education to accelerate the benefit of practical experience.

Mixed Attribute Model and the Appropriate Use of Fair Value

Conceptual Approach 1.C: *Measurement framework – While we may not have time to fully address when fair value is the appropriate measurement attribute, we understand that the FASB's joint conceptual framework project includes a measurement phase. We intend to study this project further and are considering a recommendation for the SEC to endorse that, as part of this project, the FASB develop a decision framework to provide a systematic approach for consistently determining the most appropriate measurement attribute for similar activities or assets / liabilities based on consideration of the trade off between relevance and reliability, and the various constituents involved in the financial reporting process.*

We agree that the FASB should clarify its conceptual framework to address the relevant measurement attributes of various assets and liabilities. In that regard, we understand how the appropriate use of fair value could improve accounting and financial reporting. However, there has been a tendency on the part of standard setters and regulators to presume that fair values provide superior accounting without having clearly articulated to their constituents why this is the case. This fair value presumption has led to the standard setters pushing for greater use of fair values, constituents vehemently objecting, and resultant compromises causing an uneven, but increasing, use of fair values, often in a one-sided manner (e.g., use of historical cost, but write-down to fair value when impaired, with no write-up if fair value recovers) or different measurement attributes for the same transactions depending on such delineating characteristics as: the industry an entity is in, the intent of one or both of the parties to the transaction, the perception of an embedded derivative, the existence of a hedging relationship, or just free choice. The result is a mixed attribute model that is difficult for preparers and auditors to apply, and confusing for users who may not have the years of training required to understand when, or how, these measurement attributes are used or what they mean with respect to evaluating an entity's financial results. Thus, the time has come for the FASB to deal with measurement attributes within the conceptual framework in a process that obtains appropriate input from all its constituents, appropriately balances relevance and reliability, and considers the practical constraints on preparers to meet users' need for timely results that have been subjected to appropriate audit procedures.

<u>Conceptual Approach 1.D:</u> Judicious Use of Fair Value – Due to implementation complexities, as noted below, we are considering whether the SEC should request that the FASB be judicious about issuing new standards and interpretations that require the expanded use of fair value in areas where it is not already required, until completion of a measurement framework. Over the long-term, this framework would be used to determine measurement attributes systematically. We will also consider whether improvements related to certain existing, particularly-complex, standards that incorporate fair value, such as SFAS Nos. 133 and 140, are warranted in the near-term.

As noted above, we agree that the FASB should systematically review its conceptual framework to address the appropriate measurement attribute of the various elements of the financial statements. We believe that a comprehensive reevaluation of the conceptual framework in which inconsistencies are reconciled and "mixed attributes" are removed or minimized would result in clearer accounting standards that would be better understood, more easily applied, and less susceptible to financial engineering. In addition, the FASB should address certain aspects of the current conceptual framework that are incomplete, internally inconsistent, and ambiguous. Accordingly, we support the recommendation that the FASB be judicious about issuing new standards that require the expanded use of fair values in areas not already required until the measurement framework has been completed.

<u>Conceptual Approach 1.E:</u> Groupings in Financial Statement Presentation – We believe that a more consistently aggregated presentation of financial statements would alleviate some of the confusion and concerns regarding the use of fair value. Such presentation should result in the grouping of amounts and line items by nature of activity and measurement attribute within and across financial statements. We believe such a grouping would be more understandable to investors, particularly as it would more clearly delineate the nature of changes in income (e.g., fair value volatility, changes in estimate, and business activity). This presentation might also help investors assess the degree to which management controls each source of income.

As part of the financial statement presentation project, the FASB has tentatively decided to segregate the financial statements into business (further divided into operating and investing) and financing activities. The FASB has also tentatively decided to require a reconciliation of the statement of cash flows to the statement of comprehensive income. This reconciliation would disaggregate changes in assets and liabilities based on cash, accruals, and changes in fair value, among others.

We intend to study this project further and consider whether it would address the our leanings in this area and sufficiently facilitate investors' understanding of fair value.

We agree that there should be more transparency about the measurement attributes of elements of the financial statements. CIFiR has suggested an interesting alternative that the FASB and IASB should deliberate in their joint project on financial statement presentation. We hope that the completion of that project ultimately will allow the SEC to rescind much of Regulation S-X regarding the form and content of financial statements, which currently contributes to complexity.

Conceptual Approach 1.F: Additional Disclosure – We have identified potential areas for additional disclosure to more effectively signal to investors the level of uncertainty associated with fair value measurements in financial statements. Specifically, we note that in some cases, there is no "right" number in a probability distribution of figures, some of which may be more fairly representative of fair value than others. Potential areas to be considered for additional disclosure may include:

- *The valuation model*
- *Statistical confidence intervals associated with certain valuation models*
- *Key assumptions, including projections*
- *Sensitivity analyses depending on the selection of key assumptions*
- *The entity's position versus that of the entire market.*

We agree that additional effort is needed to find better ways to communicate the uncertainties and imprecision inherent in financial statement amounts, particularly those based on a concept of fair value. While there may be additional data (e.g., statistical confidence intervals) that would assist a sophisticated user, we also believe that disclosures about uncertainties and imprecision should be simple, straightforward and prominent to help communicate to a broad audience of users and stakeholders.

Conceptual Approach 1.G: Disclosure Framework – We seek to balance additional disclosure requirements, including, if any, those under conceptual approach 1.F, with: (1) the perception that amounts recognized in financial statements are generally subject to more precise calculations by preparers and higher degrees of scrutiny by investors compared to merely disclosing such amounts in the footnotes, and (2) concerns regarding disclosure redundancies. To minimize the effect of diminishing returns on potential new disclosure improvements identified during the course of our efforts and future standards-setting activity, we are considering recommending: (1) that the SEC request the FASB to develop a disclosure framework that integrates existing disclosure requirements into a cohesive whole (e.g., eliminate redundant disclosures and provide a single source of disclosure guidance across all accounting standards), (2) improvement to the piecemeal approach to establishing disclosures (i.e., standard-by-standard), and (3) that the SEC develop a process to regularly evaluate and, as appropriate, update its disclosure requirements as new FASB standards are issued.

The current state of financial statement disclosures is a patchwork of additive disclosures developed by a variety of standards setters over decades that is in great need of not just repair, but a major overhaul. Development of a cohesive framework for financial statement disclosures would be a start to evaluate what disclosures are needed to supplement the primary financial statements. The notes to financial statements are a critical element of financial reporting, yet there is no fundamental framework within which to evaluate the usefulness or sufficiency of existing or proposed disclosures. In our view it would be very helpful for the FASB to develop such a framework and to initiate an effort to review the propriety of all existing disclosure requirements, with a view to eliminating those that do not meet a cost/benefit standard, and defining fundamental and ancillary disclosures for purposes of any tiered reporting approach. This effort could codify all disclosure requirements in a single location, rather than the current piecemeal approach to establishing disclosure requirements.

Unfortunately, the quality and clarity of financial statement disclosures varies considerably. CIFiR also should consider ways to encourage preparers to draft disclosures using plain English and other presentation devices that would improve the transparency and value of the notes to financial statements and thus reduce complexity.

Standards-Setting Process

Investor Representation

Developed Proposal 2.1: Additional investor representation on standards-setting bodies is central to improving financial reporting. Only if investor perspectives are properly considered by all parties will the output of the financial reporting process meet the needs of those for whom it is primarily intended to serve. Therefore, the perspectives of investors should have pre-eminence. To achieve that pre-eminence in standards-setting, the SEC should encourage the following improvements:

- *Add investors to the Financial Accounting Foundation (FAF) to give more weight to the views of different types of investors, both large and small*
- *Give more representation on both the FASB and the FASB staff to experienced investors who regularly use financial statements to make investment decisions to ensure that standards-setting considers fully the usefulness of the resulting information.*

Changes recently adopted by the FAF will require each of the FASB members to have "knowledge of and experience in investing, accounting, finance, business, accounting education and research and a concern for the investor and the public interest in matters of investing, financial accounting and reporting." In addition, the FAF decision to reduce the size of the FASB from seven to five members will likely increase the relative influence of the member(s) whose primary perspective is that of an investor and user. While these changes will address an aspect of the CIFiR proposal, we question whether the perspectives of any one group, such as investors, should have "pre-eminence in standards-setting" as CIFiR is proposing. The key stakeholders of the FASB include preparers, who must apply the FASB's standards, independent auditors, who must opine on the application of those standards, and users, who utilize the information presented under those standards to make investment decisions. Each constituency should have fair and balanced representation in the standards-setting process, and no single group should dominate the process.

FAF and FASB Governance

<u>Developed Proposal 2.2:</u> *The SEC should assist the FAF with enhancing its governance of the FASB, as follows:*

- *By encouraging the FAF to develop performance metrics to assess the FASB's adherence to the goals in its mission statement, objectives, and precepts and to improve its efficiency*
- *By supporting the FAF's changes outlined in its "Request for Comments on Proposed Changes to Oversight, Structure and Operations of the FAF, FASB and GASB," with minor modifications regarding composition of the FAF and the FASB, as proposed in section II of this chapter, and agenda-setting, as proposed in section IV of this chapter*
- *By encouraging the FAF to amend the FASB's mission statement, stated objectives, and precepts to emphasize that an additional goal should be to minimize avoidable complexity.*

We would support a revision to the FASB's mission statement to establish an objective of avoiding unnecessary complexity and reducing existing complexity in financial accounting and reporting. Even without a formal amendment of its mission statement, we would encourage the FASB to undertake these commitments.

We strongly support private-sector standard setting, and we respect the independence and deliberative process of the FASB. We are generally supportive of the FAF's recent efforts to enhance the effectiveness of its oversight of the standard-setting process, although we strongly objected to the reduction in the number of members of the FASB. We encourage the FAF to continue to regularly reevaluate that process and to assess the performance of the FASB, particularly the effectiveness of a five-member Board.

We hope that the SEC will continue to endorse and support the FASB as the private sector body responsible for establishing standards of financial accounting and reporting, consistent with Section 108 of the Sarbanes-Oxley Act of 2002. In addition, we hope that the SEC staff will continue to respect the independence of the FASB and its deliberative due process for considering the views of all constituents.

We acknowledge that, at times, the FASB's process results in an extended period between the identification of an important project and issuance of a final standard. We support efforts to accelerate the FASB's process, but only if those efforts are consistent with the development of high quality accounting standards. The adoption of new accounting standards often requires preparers, independent auditors, and users of financial statements to incur considerable effort and expense. Accordingly, while reasonable speed in standard setting is desirable, we believe that issuing carefully deliberated standards that have been subject to rigorous due process is of paramount importance to improving financial reporting.

Standards-Setting Process Improvements

<u>Developed Proposal 2.3:</u> *The SEC should encourage the FASB to further improve its standards-setting process and timeliness, as follows:*

- *Create a formal Agenda Advisory Group that includes strong representation from investors, the SEC, the PCAOB, and other constituents, such as preparers or auditors, to make recommendations for actively managing U.S. standards-setting priorities*
- *Refine procedures for issuing new standards by: (1) implementing investor pre-reviews designed to assess perceived benefits to investors, (2) enhancing cost-benefit analyses, and (3) requiring improved field visits and field tests*
- *Improve review processes for new standards by conducting post-adoption reviews of every significant new standard, generally within one to two years of its effective date, to address interpretive questions and reduce the diversity of practice in applying the standard, if needed*
- *Improve processes to keep existing standards current and to reflect changes in the business environment by conducting periodic assessments of existing standards.*

Given the FAF's recent decision to change the FASB's agenda-setting process and vest the FASB chair with the authority, following appropriate consultation, to set the FASB project plans, agenda and priority of projects, we agree it is important to reassess the process for the FASB chair to receive input on agenda decisions.

We observe that Financial Accounting Standards Advisory Council (FASAC) was designed to provide input to the FASB on its agenda, but with over thirty members, FASAC is not sufficiently nimble to provide timely and regular agenda input to the FASB chair. We suggest that the function proposed by CIFiR be created within the existing FASAC framework. Specifically, we suggest that FAF create an executive committee within FASAC to serve the proposed function. In our view, a FASAC executive committee should include at least one representative from each of the preparer, auditor and user communities. The results of deliberations involving the FASB chair and the FASAC executive committee should be a matter of public record in order to provide needed transparency about agenda deliberations and recommendations.

We would support more robust pre-adoption and post-adoption reviews of new accounting standards. Notwithstanding the often time-consuming, deliberative process required to adopt a new accounting standard, preparers and auditors must be given sufficient time to plan for the orderly implementation of new accounting standards. Accordingly, transition periods for new standards should be sufficiently long to provide preparers and auditors the opportunity to identify implementation issues in advance of the required adoption date. This would allow the FASB to issue guidance on those implementation issues, if appropriate. Longer transition periods also would allow smaller companies and smaller accounting firms to benefit from efforts to identify and resolve issues prior to implementation. Also, to facilitate preparer adoption of new standards and minimize the number of accounting changes that complicate users' analysis of financial statements, there should be common transition dates for standards (e.g., one transition date for all standards to be adopted in the upcoming year). In addition, a retrospective evaluation process, conducted one or two years after most entities have adopted an accounting standard, also could be highly useful. We expect such a reevaluation could result in important fine tuning of a standard that could aid in its consistent and cost-effective implementation going forward, as well as the possibility that the FASB would learn lessons that it could apply to the development of future standards.

Interpretive Implementation Guidance

<u>Developed Proposal 2.4:</u> *The number of parties that either formally or informally interprets GAAP and the volume of interpretative implementation guidance should continue to be reduced. The SEC should coordinate with the FASB to clarify roles and responsibilities regarding the issuance of interpretive implementation guidance, as follows:*

- *The FASB Codification, a draft of which was released for verification on January 16, 2008, should be completed in a timely manner. In order to fully realize the benefits of the FASB's codification efforts, the SEC should ensure that the literature it deems to be authoritative is integrated into the FASB Codification to the extent possible, or separately re-codified, as necessary.*

  To the extent practical, going forward, there should be a single standards-setter for all authoritative accounting standards and interpretive implementation guidance that are applicable to a particular set of accounting standards, such as GAAP or IFRS. For GAAP, the FASB should continue to serve this function. To that end, the SEC should only issue broadly applicable interpretive implementation guidance in limited situations (see section VI).
- *All other sources of interpretive implementation guidance should be considered non-authoritative and should not be required to be given more credence than any other non-authoritative sources that are evaluated using well-reasoned, documented professional judgments made in good faith.*

One aspect of complexity is the level of effort necessary to identify all of the sources of financial reporting requirements applicable to a set of financial statements. As the Progress Report observes, there have been multiple sources of authoritative accounting guidance (e.g., FASB, EITF, AcSEC, AICPA, SEC, and SEC staff). The intricate hierarchy, historical context and unclear relationship of this guidance make it difficult to apply, either directly or by analogy. Further, the scope of various standards is defined in a way that creates inconsistencies in practice, as well as uncertainty as to the standards' applicability. This patchwork approach introduces complexity in financial reporting.

The FASB's project to codify GAAP in a single reference source should be a great step forward and provides an excellent opportunity to rationalize the complex patchwork of accounting standards. We agree with CIFiR's proposal that the FASB codification should subsume the accounting and financial statement disclosure guidance issued by the SEC and its staff over the years, including the content of numerous SEC Staff Accounting Bulletins and portions of Regulation S-X. Once the respective portions have been integrated into the codification, the SEC should amend Regulation S-X to remove the redundant provisions and the SEC staff should similarly update its SAB codification to eliminate financial accounting and disclosure requirements. Thereafter, to deter complexity, the SEC and its staff should not serve as another source of financial statement disclosure requirements and accounting interpretations with which preparers are expected to comply. That is, the SEC and its staff should curtail rulemaking activity and formal interpretive actions involving financial accounting and disclosures. Instead, such activity should be limited to addressing financial statement filing requirements (e.g., entities, periods, updating), such as many of the subjects currently addressed in the "SEC Staff Training Manual."

The Progress Report states, "actions taken by the FASB and the SEC have not sufficiently curbed the creation of other non-authoritative interpretive implementation guidance, such as that from audit firms, preparer and industry groups, academia, the Center for Audit Quality (CAQ), and other regulators." We are very concerned about the implications of this assertion. Our clients and the market expect Ernst & Young and other major accounting firms to provide analysis and insight regarding the requirements and application of accounting standards. While our views and publications are not authoritative, we expect to continue to express our views and make them public. Our efforts, as well as those of other accounting firms, professional organizations, preparers and academia, provide a healthy discourse, which we believe ultimately improves the quality of financial reporting. We do not believe that our non-authoritative views add to the complexity of financial reporting.

Our publications are a necessary component of our ongoing education of our professional staff by promoting a good understanding of the principles in new standards, how those standards change or complement existing standards, and how to assess, on a consistent basis, that our clients across all industries have appropriately assessed and implemented the new standards. It is only natural that our clients and others would want to understand our thoughts on these matters and how we are training our staff on the implementation of the new standards. Clearly, however, efforts by the FASB to write clear standards that are consistent with a revised and internally coherent conceptual framework and that provide realistic examples of implementation guidance should limit the extent to which we would need to issue additional guidance for our purposes. Nevertheless, in addition to our staff, our clients will still expect us to communicate our understanding of the Board's thinking and acceptable approaches/ best practices for actual implementation.

<u>Conceptual Approach 2.A:</u> *To further reduce interpretive implementation guidance associated with GAAP, we are considering proposing that the SEC further clarify its role vis-à-vis the FASB, as well as its internal roles and responsibilities, to mitigate the risk of its actions unintentionally driving behavior by market participants, as follows:*

- *The SEC should clarify that registrant-specific matters are not authoritative forms of interpretive implementation guidance under GAAP and, accordingly, registrants other than the specific registrant in question are not required to take into account such registrant-specific matters.*
- *The SEC staff should refrain from informally communicating broadly applicable interpretive implementation guidance (e.g., staff speeches) that are likely to be perceived as changing the application of GAAP. Rather, such communications should be used to highlight authoritative interpretive implementation guidance that has already been issued.*
- *In instances in which the SEC staff identifies registrant-specific accounting matters that it believes may result in the need for broader interpretive implementation guidance or a clarification of an accounting standard under GAAP, the SEC staff should refer these items to the FASB as part of the Agenda Advisory Group.*
- *When it is necessary for the SEC or its staff to issue broadly applicable interpretive implementation guidance, it should try to provide such guidance: (1) in a clear communication identified as authoritative, (2) so that it can easily and immediately be integrated into a codification of SEC literature (as proposed in section V of this chapter), and (3) when expected to significantly change the application of GAAP, only after transparent due process and public comment to the extent practicable.*
- *The SEC staff should revisit internal procedures and take further steps necessary to improve the consistency of its views on the application of GAAP.*

Just as we do not view our own publications as the final authoritative word, we agree that SEC staff speeches also should not be considered authoritative. However, notwithstanding the standard disclaimer that usually precedes remarks by members of the SEC staff, we find that members of the SEC staff often expect preparers and auditors to adhere to positions expressed in SEC staff speeches. Further, we find that the SEC staff is often reluctant to accept a position that justifiably differs from the "precedent" set by a similar issue on which the SEC staff reached a conclusion with respect to another registrant. These behaviors must change for there to be meaningful improvements in the current dynamic of public company accounting and financial reporting.

We agree that only accounting interpretations arising from the due process of the applicable standard setter should be considered authoritative. We encourage the SEC staff to support this due process by continuing to identify concerns and refer issues for consideration by the FASB and EITF. We also encourage members of the SEC staff to be judicious when making public remarks, so that their remarks are not seen as ending any debate on the subject.

Unfortunately, the public release of SEC staff comment letters and registrant responses contributes to complexity. In order to avoid inappropriate inferences about SEC positions on the interpretation and application of accounting standards, it has become even more important for the SEC staff to follow rigorous quality control procedures in drafting and reviewing comment letters before they are issued to registrants. In light of the considerable time and effort required to formally respond to a SEC comment letter with the knowledge that the response ultimately will become a matter of public record, the SEC staff should be judicious in determining which comments are sufficiently consequential to merit a formal written comment. We would encourage the SEC staff to consider the greater use of oral communication during the initial phases of its review of a registrant's filing(s).

To facilitate a consistent interpretation of the volume of published comments, the SEC staff periodically should summarize and publish common concerns being raised in SEC comment letters about compliance with accounting and financial disclosure requirements, and with SEC rules and regulations. Such an initiative would provide helpful input to the internal control processes of preparers, the risk assessments of auditors, and the agenda of accounting standard setters.

Approach to Standards-Setting

Conceptual Approach 2.B: We are considering proposing that the SEC continue to encourage improvement in the way standards are written, as follows:

- *By supporting the writing of accounting standards according to an agreed-upon framework of what constitutes an optimal standard. Such standards should not strive to answer every question and close every loophole, but should be written with more clearly stated objectives and principles that may be applied to broad categories of transactions.*
- *By supporting the writing of accounting standards in a manner that promotes trust and confidence in efficient markets by encouraging the use of professional judgments made in good faith. Specifically, preparers and auditors should apply the standards faithfully, and regulators should monitor and address abusive application of the standards.*

We support the concept that accounting standards should provide few, if any, exceptions. Much of the complexity in today's accounting standards is the result of numerous exceptions to the general concepts provided in the standards. We acknowledge that many of these exceptions are provided for practicality reasons; however, the majority of exceptions appear to have been provided because the FASB has accommodated a specific constituency or has narrowed the scope of a standard in order to provide more timely guidance.

Ideally, accounting standards should not have to include specific provisions intended to address anticipated abuses. Instead, any potentially unacceptable applications of a standard and its objectives should be identified by preparers, auditors, users and regulators during the implementation and application of that standard. We would welcome the opportunity to assist CIFiR and the SEC in finding ways to bring more transparency, fairness and consistent due process to the identification and remediation of inappropriate accounting practices.

Accounting standards should be articulated in plain English, with a clear explanation of their scope and objective, a reference to the applicable concepts in the conceptual framework, and realistic examples that illustrate application of the standard in more difficult situations, as opposed to situations that are so extreme in their simplicity that the answer is obvious. The examples also should provide a discussion as to how the result is consistent with the principles and objectives set out in the standard.

<u>*Conceptual Approach 2.C:*</u> *In addition to considering the other proposals in this report (and subject to the conclusions reached in our future deliberations of international considerations), we are considering proposing that the SEC encourage a re-prioritization of the standards-setting agenda that balances the need for international convergence, improvements to the conceptual framework, and maintaining existing GAAP. Further, we are deliberating whether the FASB and the SEC should add to their agendas a second phase of the codification project to consider systematically revisiting GAAP to:*

- *Be more coherent after codification*
- *Remove conflicts between standards or with the conceptual framework*
- *Be less complex, where possible*
- *Be designed more optimally as discussed above*
- *Readdress frequent practice problems (as identified by restatement volumes, input from the SEC, implementation guidance issued, or frequently asked questions)*
- *Remove redundancies between SEC disclosure requirements and other sources of GAAP*
- *Amend, replace, or remove outdated standards.*

We would support a second phase of the FASB's codification project. In particular, we think that such an initiative should focus on (1) aligning the consistency of accounting standards with the conceptual framework, (2) addressing inconsistencies between accounting standards, (3) adopting, as appropriate, existing accounting and disclosure requirements published by the SEC and its staff, and (4) adopting a plain English approach to the extent possible.

<u>Audit Process and Compliance</u>

Materiality

<u>*Developed Proposal 3.1:*</u> *The FASB or the SEC, as appropriate, should issue guidance reinforcing the following concepts:*

- *Those who evaluate the materiality of an error should make the decision based upon the perspective of a reasonable investor.*
- *Materiality should be judged based on how an error affects the total mix of information available to a reasonable investor.*
- *Just as qualitative factors may lead to a conclusion that a quantitatively small error is material, qualitative factors also may lead to a conclusion that a quantitatively large error is not material. The evaluation of errors should be on a "sliding scale."*

The FASB or the SEC, as appropriate, should also conduct both education sessions internally and outreach efforts to financial statement preparers and auditors to raise awareness of these issues and to promote more consistent application of the concept of materiality.

Because materiality is fundamental to the application of accounting standards and to financial reporting in general, we would prefer that guidance regarding materiality be provided by the FASB within its conceptual framework. We recommend that the FASB reconsider the existing discussion of materiality in its Concepts Statements to assess consistency with the applicable U.S. Supreme Court decisions (e.g., perspective of a reasonable investor, effect on the total mix of information). Such reconsideration also could address consistency with materiality concepts in the IASB's conceptual framework and standards.

In our view, the FASB's conceptual guidance should be brief and consistent with a "principles-based" approach. We agree that the fundamental principles of materiality are the perspective of a reasonable investor and the effect on the total mix of information available to such an investor. Beyond those fundamental principles, attempts to parse the materiality judgment between quantitative and qualitative factors inevitably lead to a structured, formulaic approach that exacerbates second-guessing by those not directly involved in the financial reporting process. Unfortunately, CIFiR's reference to a "sliding scale" approach implies that quantitative and qualitative factors can be objectively and inversely balanced. In the end, materiality judgments are inherently difficult whenever the decision is a "close call," and a "sliding scale" approach might lead to inappropriately conservative materiality conclusions when some factors suggest an error could be material. Instead, consistent with the fundamental principles of materiality, CIFiR should simply conclude that, while a quantitatively small error can be material based on the total mix of information, a quantitatively large error can nonetheless be immaterial based on the total mix of information.

Until the FASB has completed its deliberations and issued materiality guidance, we support the SEC's initiative to issue guidance or a revision to SAB 99 to reflect some of the concepts proposed by the Advisory Committee and to clarify filing requirements for reporting a correction of an error.

<u>*Developed Proposal 3.2:*</u> *The FASB or the SEC, as appropriate, should issue guidance on how to correct an error consistent with the principles outlined below:*

- *Prior period financial statements should only be restated for errors that are material to those prior periods.*
- *The determination of how to correct a material error should be based on the needs of current investors. For example, a material error that has no relevance to a current investor's assessment of the annual financial statements would not require restatement of the annual financial statements in which the error occurred, but would need to be disclosed in an appropriate document, and, to the extent that the error remains uncorrected in the current period, corrected in the current period.*
- *There may be no need for the filing of amendments to previously filed annual or interim reports to reflect restated financial statements, if the next annual or interim period report is being filed in the near future and that report will contain all of the relevant information.*
- *Restatements of interim periods do not necessarily need to result in a restatement of an annual period.*
- *All errors, other than clearly insignificant errors, should be corrected no later than in the financial statements of the period in which the error is discovered. All material errors should be disclosed when they are corrected.*
- *The current disclosure during the period in which the restatement is being prepared, about the need for a restatement and about the restatement itself, is not consistently adequate for the needs of investors and should be enhanced.*

We strongly support the efforts of the Advisory Committee to explore ways to reduce the incidence of restatements and to avoid unnecessary restatements. Reducing the number of restatements will benefit the health and confidence of the capital markets.

We agree that prior year financial statements should not be required to be restated for immaterial errors. This should significantly reduce the number of unnecessary restatements. Instead, an issuer should be able to correct an immaterial prior period error by recording an adjustment in its current annual period. We agree with CIFiR's recommendation to explore alternatives to immaterial restatements (e.g., as a direct adjustment to beginning retained earnings, as a cumulative effect adjustment through current year net income). Nevertheless, in order to improve comparability, an issuer should be able to correct classification errors in previously issued financial statements, with appropriate disclosure, when those financial statements are reissued in comparative form.

We believe a significant cause of restatements, and in our view, certain unnecessary restatements, has been the differing views that exist as to whether an interim period is a discrete period or an integral part of annual financial statements. In particular, paragraph 29 of APB Opinion No. 28, *Interim Financial Reporting*, has been the subject of different interpretations. As discussed further below, in our view, interim periods and their financial statements represent an integral part of the respective annual period. That is, we do not believe that interim periods should be viewed as discrete periods, for which a reasonable investor would expect the same relative precision as an annual period. Interim accounting principles and filing requirements are much different than those applicable to annual periods, and the extent of auditor involvement is considerably less. Accordingly, we do not believe that an issuer should be required to restate an interim period of a prior fiscal year to record a prior period adjustment unless the issuer concludes that the error is sufficiently material to necessitate a restatement of that year's annual financial statements. If restatement is required, we believe that both the interim and annual periods should be restated. That is, the materiality of a prior period error, and the need for any restatement of prior annual and interim periods, should be evaluated based on the total mix of information in the context of the annual period, including the effect on trends in the financial statements. When an issuer restates the annual financial statements of a prior fiscal year to correct a material error, we agree that the SEC should address the related filing requirements (e.g., whether the issuer must amend the Form 10-Q for the respective quarters of the prior years, whether the issuer can disclose the effects of correcting the error in its quarterly data table).

We also agree that the FASB should issue additional guidance to clarify the accounting and disclosure requirements to prospectively correct immaterial prior period errors. Such guidance should address:

- The assessment of the materiality of an out-of-period adjustment to both the annual period and any interim period within which the correction is recorded.
- When the prior period adjustment would be material to the annual period within which it is corrected, how the issuer should record the error (e.g., as a direct adjustment to beginning retained earnings, as a cumulative effect adjustment through current year net income, or otherwise).

We also agree that the approach to correcting a material error should be based on the needs of current investors. To the extent that the financial statements of earlier periods included a material error, current investors would not appear to be served by an administrative exercise of amending the SEC annual reports of earlier periods. Instead, we agree that the SEC should issue additional guidance to clarify the appropriate filing requirements in such circumstances. Such guidance should address:

- In what circumstances may the restatement of a prior year be made in the next Form 10-K filing rather than an amendment of the most recent Form 10-K.

- Whether the restatement of a prior year requires the filing of amended Forms 10-Q for that year, or whether the effect of the restatement can be reported in quarterly data table and in the comparative interim periods presented in the Form 10-Q filings for the current fiscal year.

Much of the tension regarding uncorrected errors relates to timing issues (e.g., errors that are identified between the date an issuer publicly reports its earnings and the date that it issues its financial statements, as determined by the SEC staff's guidance in EITF Topic D-86). Because the responsibility to consider subsequent events is integral to financial reporting, we believe that the accounting and financial reporting consequences of subsequent events should be addressed by the FASB, not the SEC and PCAOB (e.g., AU 560). Also, carrying subsequent events considerations through the publication of annual or interim financial statements contributes to complexity for preparers and auditors. Consideration should be given to developing a more practical "cut-off" (e.g., circumstances known or knowable as of the balance sheet date; the date on which the company issues an earnings release including its primary financial statements; a specified date, such as one week, prior to the publication of financial statements that comply with GAAP). Such an initiative also would allow the FASB to consider the corresponding IFRS principles and opportunities for convergence.

<u>*Developed Proposal 3.3:*</u> *The FASB or the SEC, as appropriate, should develop and issue guidance on applying materiality to errors identified in prior interim periods and how to correct these errors. This guidance should reflect the following principles:*

- *Materiality in interim period financial statements must be assessed based on the perspective of the reasonable investor*
- *When there is a material error in an interim period, the guidance on how to correct that error should be consistent with the principles outlined in developed proposal 3.2.*

As discussed previously, we believe that the premise of the accounting standards applicable to interim periods (i.e., APB 28, as amended) is that interim periods are integral parts of the corresponding annual period, not discrete financial reporting periods. Therefore, in our view, it is critical that materiality assessments for interim periods be made within the same context. Interim accounting policies and practices, the related internal control over financial reporting, and the extent of auditor involvement are not calibrated to provide the same level of relative precision as annual financial statements. Accordingly, materiality evaluations in interim periods should remain consistent with the "integral" approach, absent a wholesale change to a "discrete" interim financial reporting framework. We believe a reasonable investor would evaluate an error related to a prior period in the context of the total mix of information, including the effects on trends, about the prior annual period, not the individual interim periods.

We agree that it would be preferable for the FASB to issue additional guidance to clarify the application of materiality considerations to prior period errors in the context of both annual and interim financial statements, with examples illustrating the application of those considerations. In addition, the FASB should address how to report prior period adjustments that were corrected during an interim period of the current fiscal year on the assumption that the adjustments would be immaterial to the annual financial statements but that ultimately prove to be material to the current year financial statements (i.e., adjustments originally reported consistent with the guidance in paragraph 29 of APB 28).

Professional Judgment

Developed Proposal 3.4: *The SEC should adopt a judgment framework for accounting judgments. The PCAOB should also adopt a similar framework with respect to auditing judgments. Careful consideration should be given in implementing any framework to ensure that the framework does not limit the ability of auditors and regulators to ask appropriate questions regarding judgments and take actions to require correction of unreasonable judgments.*

The proposed framework applicable to accounting-related judgments would include the choice and application of accounting principles, as well as the estimates and evaluation of evidence related to the application of an accounting principle. We believe that a framework that is consistent with the principles outlined in this developed proposal to cover judgments made by auditors based on the application of PCAOB auditing standards would be very important and would be beneficial to investors, preparers, and auditors. Therefore, we propose that the PCAOB develop a professional judgment framework for the application and evaluations of judgments made based on PCAOB auditing standards.

The exercise of professional judgment by both preparers and auditors is fundamental to the financial reporting process, and we are concerned, as is the Advisory Committee, that the appropriate exercise of professional judgment is increasingly being challenged by regulators and securities plaintiffs. In the financial accounting and reporting arena, the threat of such challenges to the exercise of professional judgment is a major reason for the much greater extent of interpretive and implementation guidance in U.S. GAAP as compared to IFRS. Professionals – both preparers and auditors – need confidence that their judgments, appropriately exercised, will be respected. Without instilling confidence in the individual that a good faith and well-reasoned exercise of professional judgment will be respected by all authorities, we will struggle to converge with the world's capital markets and to implement IFRS with its less extensive interpretive and implementation guidance.

CIFiR's proposed framework will provide a number of benefits to investors. By enhancing the structure and discipline surrounding the decision-making process, the framework will increase the likelihood that the process used by preparers and auditors will consistently be robust, objective and appropriately documented. This will help improve the quality and increase the consistency of judgments relied upon by investors. The framework will remind the investing community that judgment is an inherent part of preparing and auditing financial reports, and that financial statements and audit reports should be read with that fact in mind. And the framework will reduce the number of unnecessary restatements, allowing investors to focus on a smaller number of important restatements in their decision-making. The numbers speak for themselves. Studies show that between 1997 and 2005, the number of restatements per year increased nearly five-fold and nearly 1,500 restatements of financial statements occurred in 2006 alone. Unnecessary restatements are damaging to the health of our capital markets, because they create doubt among investors regarding the quality and accuracy of U.S. financial reports. Reducing the number of unnecessary restatements will allow investors to focus on important matters and increase confidence in our financial reporting system, thereby increasing our markets' financial health and stability.

We are very supportive of the Advisory Committee's recommendations regarding a professional judgment framework and have only a few suggestions for improving them. First, the Advisory Committee should make clear that it is not suggesting that financial statement preparers need protection from review and analysis by their auditors. The appropriate relationship between preparers and auditors should include a robust exchange of views, particularly at the time accounting and reporting decisions initially are being made. We do not believe the Advisory Committee intended to affect the auditor-client relationship, which is already governed by substantial professional literature, or to weaken the role of an independent, objective audit, a role that is so essential to investors and the markets. The Advisory Committee's proposed framework should apply to evaluations by the SEC, PCAOB, and others of judgments made by preparers and auditors—not to an independent auditor's evaluation of a preparer's judgment in performing an audit in accordance with applicable professional standards. In several instances on pages 62 through 70 of the Progress Report, the Advisory Committee refers to decisions by preparers in making judgments in accordance with the proposed framework and then includes auditors with regulators, and in some references with other parties, as evaluators of such judgments. We recommend that all such references be revised to avoid any inference that the professional judgment framework "protects" financial statement preparers from their auditors. Similarly, we recommend that Developed Proposal 3.4 itself be reworded to (1) indicate that the framework does not limit the ability of regulators (not "auditors and regulators") to ask appropriate questions "of both preparers and auditors" and (2) add a separate sentence regarding the roles and responsibilities of auditors along the lines of footnote 60 to indicate that the auditors may issue an unqualified audit opinion only if they agree with the preparer's judgment.

Second, the Advisory Committee should consider how to best promote enhanced disclosures of critical accounting policies and estimates in connection with the proposed framework, whether through new requirements or improved disclosures under current requirements. As recognized in the Progress Report, the proposed framework does not necessarily establish additional or new disclosure requirements beyond those already required and recommended by the SEC. Increased transparency of important financial reporting decisions that reflect the significant use of professional judgment would provide another significant benefit to investors. In recent years, in response to calls by the SEC, there have been some improvements in disclosures about critical accounting policies and estimates, the key assumptions underlying key accounting estimates, the susceptibility of those key assumptions to change, and other reasonable judgments that might have materially affected the financial statements. As a result, certain leading companies have developed “best-in-class” disclosures that explain to investors the principles, critical judgments and assumptions underlying specific accounting areas. Unfortunately, many public companies have not embraced making informative and transparent disclosures about the key judgments underlying their financial statements. The Advisory Committee should consider recommending an initiative to identify leading practice disclosures and promote their adaptation by a broader group of issuers for the benefit of all investors.

Finally, the Progress Report recommends that the Commission implement a professional judgment framework but leaves the determination of the form of the framework to the Commission. Although a strong Commission policy statement would go a long way toward making sure that properly-exercised judgments are respected, we believe an SEC rule would be even more effective. A rule would carry the force of law and accordingly would be more likely to be accepted by regulatory staff and others as a definitive statement of how issues should be handled. A rule also would provide greater stability for issuers, auditors, and investors and, importantly, would enhance consistency in regulatory conduct. Additionally, a rule could have a more certain effect than a Commission policy statement in the context of unwarranted private litigation that challenges the well-intentioned exercise of professional judgment. A strong Commission policy statement establishing a framework perhaps would produce a positive benefit for issuers, auditors and investors, but due to the added strength and stability of a rule, the final CIFiR report should leave open the possibility for promulgation by the SEC of a professional judgment rule in the future, as the current draft does.

Delivering Financial Information

Tagging of Information (XBRL)

Developed Proposal 4.1: *The SEC should, over the long-term, mandate the filing of XBRL-tagged financial statements after the satisfaction of certain preconditions relating to: (1) successful XBRL U.S. GAAP Taxonomy testing, (2) capacity of reporting companies to file XBRL-tagged financial statements using the new XBRL U.S. GAAP Taxonomy on the SEC’s EDGAR system, and (3) the ability of the EDGAR system to provide an accurately rendered version of all such tagged information. The SEC should phase-in XBRL-tagged financial statements as follows:*

- *The largest 500 domestic public reporting companies based on unaffiliated market* *capitalization (public float) should be required to furnish to the SEC, as is the case in the voluntary program today, a document prepared separately from the reporting companies' financial statements that are filed as part of their periodic Exchange Act reports. This document would contain the following:*

- *XBRL-tagged face of the financial statements*
- *Block-tagged footnotes to the financial statements.*

- *Domestic large accelerated filers (as defined in SEC rules, which would include the initial 500 domestic public reporting companies) should be added to the category of companies, beginning one year after the start of the first phase, required to furnish XBRL-tagged financial statements to the SEC.*
- *Once the preconditions noted above have been satisfied and the second phase-in period has been implemented, the SEC should evaluate whether and when to move from furnishing to the SEC to the official filing of XBRL-tagged financial statements with the SEC for the domestic large accelerated filers, as well as the inclusion of all other reporting companies, as part of a company's Exchange Act periodic reports.*

Ernst & Young supports the objectives of enhanced electronic financial reporting to provide better, faster, cheaper and more consistent financial information in order to support more informed business and investing decisions. To facilitate collection and sharing of financial information in a transparent and reliable manner, data tagging appears to be a logical enhancement to financial reporting.

Given the evolution of EDGAR as the freely accessible repository of all public company financial reports, we have encouraged the Commission's interest in XBRL as a means to enhance the public accessibility, communication and analysis of financial and other filed information. Providing XBRL-tagged financial statements through EDGAR should allow investors, analysts and other financial market participants to more efficiently and reliably perform quantitative and qualitative analyses of information reported by public registrants.

Therefore, we generally agree with CIFiR's proposal regarding XBRL, in particular:

- Mandatory data tagging should be a long-term goal of the SEC.
- The XBRL US GAAP Taxonomy must be validated before the SEC mandates data tagging.
- There should be a phase-in of mandatory data tagging, beginning with the largest public companies that have sufficient resources to undertake such a mandate and the breadth of investor interest to optimize the benefits of tagged data.
- Auditor assurance regarding XBRL-tagged data should not be required during any phase-in of mandatory data tagging.

While we fundamentally believe that independent assurance would add value by increasing reliability and enhancing public confidence in XBRL documents, we also acknowledge that some, including CIFiR, are concerned that the cost and time incurred to obtain such assurance might outweigh the benefits to preparers and users. Therefore, we do not believe that the Commission should mandate auditor attestation during any phase-in of mandatory XBRL data tagging. Instead, issuers should be able to choose whether or not to engage their auditor to provide assurance in order to enhance the quality of their XBRL submissions. In this manner, the Commission would promote, and be able to evaluate, the market demand for, and the related costs and benefits of, auditor attestation to XBRL-tagged information. Therefore, we agree with CIFiR's suggestion that the SEC and PCAOB seek input from companies, investors, and other market participants as to the type, timing, and extent of assurance, if any, that should be provided after the initial phase-in periods. The SEC also should monitor error rates during the initial phase-in periods in order to assess the reliability of XBRL submissions without independent assurance.

At this early stage in XBRL's development and use, the term "assurance" is often used as if auditor assurance would be absolute and undifferentiated. In fact, auditor assurance could take a number of forms (e.g., positive assurance consistent with an audit or examination, negative assurance consistent with a less extensive review). In addition, there are a wide variety of assertions on which an auditor might be able to provide assurance, including but not limited to: whether the data in the XBRL instance document are the same as, or not inconsistent with, in all material respects, the data in the underlying financial statements; whether tags were appropriately applied to elements of the financial statements; whether tags were applied consistently with prior XBRL submissions; and whether any extensions used are necessary. In addition, it will be important to define how to apply the concept of materiality in providing assurance on tagged financial statements. Of necessity, the level of assurance, the nature of the assertions on which assurance is given, and the application of materiality concepts will affect the extent of the auditor's procedures and the associated costs.

In addition, we are concerned about a possible "expectation gap" regarding the extent of any assurance provided by the auditor with respect to tagged financial statements. Currently, the auditor expresses an opinion on the financial statements "taken as a whole," and not the fair presentation of any individual elements of those financial statements to which tags will be applied. We are concerned that providing assurance for XBRL-tagged information could be misinterpreted by investors or the courts as providing assurance not only as to the proper selection and application of the tags but also as to the accuracy and completeness of each tagged item. Accordingly, it will be important for the SEC and PCAOB to support efforts to educate investors as to the nature and limitations of any auditor assurance with respect to tagged financial statements and to prevent any inappropriate liability arising from such assurance.

During the initial phase-in, we encourage the SEC to be sensitive to the need to clearly address issues surrounding auditor association with tagged data. Users of tagged data should be able to clearly understand the degree of assurance regarding the propriety of data tagging provided by (1) the audit or review report on the issuer's financial statements, (2) the audit reports on internal control over financial reporting, and (3) any attestation report regarding tagged data. We recommend that disclosures in submissions of tagged data clearly set forth the issuer's responsibility for the accuracy of the data tagging and the extent of any auditor assurance thereon.

Consistent with the implementation of other new technologies and standards, there will be certain challenges associated with implementing and using XBRL for financial reporting. Accordingly, the initial implementation and use of XBRL for financial reporting might not be as effective and efficient as it could become in the future. We urge the Commission to provide adequate notice and transition periods before the implementation of any mandatory data tagging within SEC filings. For companies that have not participated in the Voluntary Program, data tagging might still represent an untested technology. Consequently, their personnel will require training; software will need to be created, adapted or purchased to perform the tagging; and consultants or internal resources will be needed to tag the financial information. Accordingly, the transition period should allow companies to make test submissions of tagged data before any mandatory compliance date. In addition, companies should be allowed, but not required, to provide tagged data with respect to filings of historical periods, so as to facilitate research and trend analysis by market participants.

CIFiR has proposed that, during the initial phase-in periods, issuers only should be required to furnish XBRL-tagged financial statements, with the financial statement notes each tagged only as block text (e.g., one tag per note). While we appreciate that such an approach would lower the implementation costs of the initial phase-in group, we are concerned that limiting the scope of mandatory data tagging also would limit its benefits to users. Accordingly, even if not initially required, we believe the SEC should encourage registrants to use the XBRL US GAAP Taxonomy to tag information in the notes to the financial statements at a more granular level than block-tagging. In addition, the SEC should consider limiting the block-tagging of financial statement notes to the initial year of compliance for each issuer. Such a phase-in of detailed tagging of financial statement notes would spread the implementation costs over two years, while providing market participants more useful information in a relatively short time.

Improved Corporate Website Use

> *<u>Developed Proposal 4.2:</u> The SEC should issue a new comprehensive interpretive release regarding the use of corporate websites for disclosures of corporate information, which addresses issues such as liability for information presented in a summary format, treatment of hyperlinked information from within or outside a company's website, treatment of non-GAAP disclosures and GAAP reconciliations, and clarification of the public availability of information disclosed on a reporting company's website.*
>
> *Industry participants should coordinate among themselves to develop uniform best practices on uses of corporate websites for delivering corporate information to investors and the market.*

Technology would appear to hold tremendous promise for improving the communication of corporate financial information to a variety of users with different needs. We encourage experimentation, and the adoption of best practices, in the use of corporate websites for communicating to investors. However, to facilitate such experimentation and progress, we agree that the SEC should resolve any doubts about the obligations and liabilities of issuers and their auditors with respect to financial presentations included on corporate websites.

* * * * *

We would be pleased to discuss our comments with the Commission or its staff at your convenience.

Very truly yours,

Ernst & Young LLP