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Ms. Nancy M. Morris
Federal Advisory Committee Management Officer
Securities and Exchange Commission
100 F Street N.E.
Washington, DC 20549-1090

Progress Report of the Advisory Committee on Improvements to Financial Reporting, Release No. 33-8896; File No. 265-24

Dear Ms. Morris:

We appreciate the opportunity to comment on the Progress Report of the Advisory Committee on Improvements to Financial Reporting ("Committee"). We support the Committee's work on reducing avoidable complexity and making financial information more useful, and we believe the overall direction of the Progress Report, as summarized in its Executive Overview and Introduction, is generally appropriate.

Many of the developed proposals and conceptual approaches in the Progress Report would help produce the paradigmatic shift we believe is necessary to achieve the Committee's ambitious objectives. However, we also believe these proposals and approaches should be pursued in a manner that will anticipate and avoid unintended negative consequences. In this letter, we share our observations on certain issues in the Progress Report that we believe are most critical to the success of the Committee's work.

While we generally support the recommendations and conceptual approaches set out in the Progress Report, we have identified for comment certain areas of particular interest in the sections below. We have presented these under the Chapters of the Progress Report for ease of reference and not as an indication of the relative importance of any item.

<u>Chapter 1: Substantive Complexity</u>

Principles-Based Accounting Standards

We agree with the notion that more intelligently designed accounting standards can make financial information easier to prepare, audit, and use. Overall, our views in this area are consistent with the paper on "Principles-Based Accounting Standards" released in

January 2008 by the six largest international audit networks and the SEC's "Study on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System" released in 2003. We believe that accounting standards should be principles-based and objectives-oriented, with a clearly defined and sufficiently broad scope and few if any alternatives and exceptions. Standard setters should develop operational accounting principles that include a measured amount of application guidance, and resist calls for application guidance to addresses every possible fact pattern. Further, bright lines should be avoided unless they are relevant to the determination of the substance of a transaction, and room should be left for professional judgment based on a consideration of all available evidence and factors. We believe that such an approach will contribute to greater understandability of financial statements and will limit opportunities for financial engineering.

Activities-Based Accounting and Elimination of Industry-Based Guidance

Consistent with the Committee's proposals, we believe that optimal accounting standards should result in similar accounting for similar activities, regardless of industry. However, we have concerns about the assertion that accounting should be based on activities and that industry-specific accounting and guidance should be eliminated. The activities of entities are generally reflective of the industry in which the entities operate. The activities of natural resource extraction and production are very different than the activities of an insurance company or a consulting firm. Although revenue generation can be asserted to be an activity that is common to all of these entities, the processes by which revenue is generated are significantly different and industry guidance is useful in identifying the events that define the culmination of the earnings process. We concur that standard setters should strive to issue standards that broadly define activities in order to reduce the likelihood that similar activities will be accounted for in dissimilar manners. However, we also believe that industry guidance serves an important role in identifying the significant transactions and issues that preparers and auditors must address in industry specific financial reporting.

Therefore, we do not concur with the recommendation to eliminate industry guidance. We believe there is a distinction to be made between industry-specific accounting principles and industry application guidance. Even if the same accounting principle is applied to two different industries, participants in each industry will still need to implement that principle in the context of industry-specific facts and circumstances. If the standard setter does not provide such industry application guidance, other non-authoritative sources will fill the gap, and we believe that appropriate standard setter oversight of the development of industry guidance is preferable to ad hoc non-authoritative development. In some cases, we believe it will be best for the standard setter to provide guidance on the industry-specific application of an accounting principle, especially when that industry has unique characteristics. For example, we believe that many of the AICPA Audit & Accounting industry guides currently perform this function, and we do not believe eliminating those guides would improve financial reporting. Further, even when industry guidance clearly establishes an industry-specific accounting principle we do not believe it would be appropriate to eliminate such guidance unless and until a more general principle becomes available.

We also note that "activity" implies a flow or performance measure, whereas standard setting over the last number of years has tended to focus on recognizing and measuring similar assets and liabilities in a consistent fashion. Perhaps there are certain areas where activities are the appropriate approach (e.g., long-term compensation arrangements) and others that should be based on the type of asset or liability (e.g., financial instruments). We suggest further consideration of the relationship between an activities based accounting approach and the current asset/liability approach to standard setting before final recommendations are made that accounting should be activity based.

Bright Lines

Conceptual Approach 1.A introduces an accounting approach in which proportionate recognition would be applied in lieu of the all-or-none approach to recognition that is sometimes applied when current accounting standards include "bright line" recognition requirements. Since this is in the conceptual stage, it may be too early in the process to evaluate how this approach will develop, however we have concerns about the practicability of this approach and question how such an approach will reduce complexity in reporting. As the Committee continues its deliberations it will be important that one complexity is not substituted for another complexity.

Mixed Attribute Model and Use of Fair Value

Conceptual Approach 1.D suggests the use of fair value in accounting not be expanded until completion of a comprehensive measurement framework. We do not concur with the direction that would limit the use of fair value in future standard setting. Accounting currently uses a mix of historical value and current value measures, often with current value being considered in impairment testing even when historical values are otherwise used. Further, the FASB has consistently held the view that current value is the most relevant measurement attribute for financial instruments for many years, and the use of current value measurement attributes in this area has generally been supported by financial statement users. We support the reporting of financial instruments, with the possible exception of an entity's own debt, at fair value through earnings. We believe this approach will increase the comparability and transparency of financial information by (a) eliminating alternative treatments and exceptions permitted by U.S. GAAP, (b) eliminating the challenges associated with identifying other-than-temporary impairments, (c) reducing the need to apply the often complex requirements for fair value hedge accounting, and (d) eliminating the need to identify and separate many embedded derivatives. Consistent with this view and as addressed in Conceptual Approach 1.E of the Progress Report, we encourage the Committee to support continued field testing of the FASB's Financial Statement Presentation Project and the timely completion of this project.

While we agree that the use of fair value in any particular area should be evaluated relative to its costs and benefits (including the verifiability of fair values in the audit process), we do not concur that a moratorium on fair value in accounting standard setting will result in improved financial reporting in the short or long term.

Chapter 2: Standards-Setting Process

Enhanced Investor Involvement in Standard Setting

We are supportive of increasing the emphasis of the investor perspective in the financial reporting system although we would not emphasize the investor's perspective as "pre-eminent" over all others in the standards setting process. The investor is the primary consumer of financial information and it is appropriate to design the product (financial information) with the customer (the investor) in mind. With respect to standard setting, we believe that robust investor involvement will focus financial reporting on its usefulness, reducing the likelihood that highly theoretical considerations will pre-empt considerations of utility. However, we also believe that regulators, preparers, and auditors have valuable contributions to make to financial reporting perspectives. While we support having investor representation on the FASB, we believe the composition of the Board needs to include sufficient expertise in accounting and auditing to ensure that GAAP develops in a consistent and operational fashion that conforms to the conceptual foundations of accounting. While there may be some investors who have an expert level of knowledge of accounting, these individual investors will likely have come from a preparer, auditor, or regulator background.

We generally are supportive of the concept of an Agenda Advisory Group, which is addressed in Developed Proposal 2.3. We note an inconsistency in the construction of Developed Proposal 2.3 and the supporting discussion that follows such proposal; the Developed Proposal uses the word "or" when referring to auditor involvement and the supporting discussion uses the word "and" when referring to auditor involvement. If such a group is established, we believe it is imperative to include auditors. As the Committee notes, the FASB has a number of existing advisory groups and committees that it consults about agenda and project priorities. We observe that the attainment of the Committee's objective, to increase FASB's accountability to the FAF on agenda-setting and project priorities, may be met through a reconsideration and change of focus of one or more existing advisory groups, versus the creation of an additional group.

Interpretive Implementation Guidance

We agree that in the ideal authoritative accounting standards should be issued by a single party, currently the FASB. However, we also believe it is axiomatic that authoritative accounting standards must be interpreted in the normal course of business by preparers, auditors, and regulators. Further, we believe it is appropriate for all of these parties (and others) to publicly give voice to non-authoritative interpretations of the authoritative literature, subject to an appropriate degree of restraint, discretion, and dialogue. As such, we are concerned by statements in the Progress Report that suggest that this public dialogue should be "curbed".

The Progress Report states that "the FASB and SEC have not sufficiently curbed the creation of other non-authoritative interpretive implementation guidance, such as that from the audit firms, preparer and industry groups, academia, the Center for Audit Quality, and other regulators". It is unclear to us how or why the FASB, SEC, or any other body would limit the non-authoritative discussion and interpretation of accounting standards. On the contrary, non-authoritative thinking is a critical part of the dissemination of accounting information, the surfacing of implementation issues and points of divergence, and the healthy functioning of the reporting system. Any effort to limit such a dialogue could detract from the processes by which issues are surfaced, debated and resolved.

Developed Proposal 2.4 recommends that the SEC should limit its interpretive guidance to broadly applicable guidance in limited situations. While we concur that the SEC should be judicious in the manner in which it issues guidance, we also believe it is critical that a regulator be permitted to dialogue with those it regulates and make its views known. We do not believe it would be appropriate for the Committee to recommend curtailing the SEC's ability to communicate its views to registrants and others who are responsible for auditing or using financial information. Instead, it may be more useful for the Committee to focus on recommending protocols to the SEC for releasing information, the necessary level of due process, including recommendations about the level of dialogue the SEC should have with the standard setter, the channels through which communications should flow, and the process by which SEC views can be reconsidered.

We have concerns about the discussion on page 47 of the Report that suggests that "the SEC should make clear that comments provided to a specific registrant are not binding on other registrants." When we as auditors become aware of SEC staff positions on a particular matter, we believe we have a professional responsibility to consider the applicability of that position to other registrant clients that have the same issue in the same or similar circumstances. A preferable course of action in this regard that is consistent with the recommendation in the preceding paragraph concerning SEC protocols for the dissemination of SEC positions, would be to request that whenever the SEC staff takes a position with respect to a particular registrant situation that is likely to have applicability to multiple registrants, the SEC staff should adopt a mechanism to clearly disseminate its views concerning the issue and its relevant considerations.

We also believe there is a tension between moving towards more principles-driven standards and curtailing the ability of financial market participants to express their views on application matters. In a world of principles-driven standards, the standard setter will likely be called upon less often to adjudicate application matters through new standard setting. As such, the role of non-authoritative thinking, guidance, and interpretation is likely to become more important, not less. Following the model currently used by the IASB and IFRIC, it is only when a sufficient amount of disagreement between regulators, preparers, and/or auditors develops that the standard setter will likely be called upon to address application issues.

Further, even when new standards or guidance are needed, it may take a number of years for the standard setter to complete a project. In these cases, regulators and auditors will need to interpret existing requirements while better standards are being developed. A good example of this is the current state of revenue recognition accounting, in which generally accepted interpretations by the SEC, the auditing firms, and long standing industry practices often stand in for the lack of a comprehensive standard.

Overall, instead of attempting to curtail the free flow of ideas between preparers, auditors, regulators, academics, and others, we recommend that the Committee focus on recommendations to better identify the non-authoritative status of such information and articulating best practices for its production and dissemination.

The Progress Report notes various other recommendations the Committee is considering with respect to standard setting, many of which we support. We support the FASB developing a conceptual framework for financial statement measurement and disclosure as part of its Conceptual Framework Project, and we are highly supportive of the FASB's Financial Statement Presentation Project, which we believe may mitigate many of the transparency issues financial statement users currently face in a mixed measurement attribute financial reporting environment. We also believe it is important to reexamine the efficiency of the standard setting process noting that three of the Board's five major projects (revenue recognition, financial statement presentation, and liability versus equity) have been on the agenda for over five years and are still the subject of uncertain future progress.

<u>Chapter 3: Audit Process and Compliance</u>

Materiality

We support the Committee's developed proposals to reaffirm the reasonable investor perspective and a consideration of the "total mix of information" in making materiality evaluations. We also agree that errors (other than de minimus items) should be corrected in the normal course as they are discovered as a good internal control practice.

We note the Committee's discussion relative to the "dark period" between the initial notification to the SEC and investors that financial information can no longer be relied upon and the filing of restated financial information. Our experience is that issuers in this situation do provide disclosures of certain periodic financial or operating information during the restatement process. The Committee notes that these companies should be encouraged to provide any reasonably reliable financial information that they can, accompanied by appropriate disclosure of the manner in which this disclosed information may be affected by the restatement process which is not complete. In order for this discussion to be operational, the SEC will need to provide guidance on the concept of "reasonably reliable financial information" and what level of due care and liability attaches to such financial information.

We note the discussion supporting Developed Proposal 3.3 relative to interim materiality and prior interim period events. We concur with the Developed Proposal that the assessment of materiality in an interim period must be made from the perspective of a reasonable investor and that principles for correction of material errors in interim periods should be consistent with principles for correction of material errors in annual periods.

Professional Judgment

We support the general concept inherent in Developed Proposal 3.4 that there should be appropriate recognition given to the necessity for professional judgment in financial reporting matters. Professional judgment is inherent in all stages of the financial reporting process. We believe it is appropriate to provide formal public recognition to reaffirm a respect for appropriate judgments to counter the perception that differences in judgments are sometimes not respected due to the inability to accept the fact that individuals can have reasonable but nevertheless supportable divergence in views. We believe a reaffirmation of the role of judgment by auditors, regulators, and preparers can have a beneficial effect on the use of and respect for appropriately supported and documented professional judgments.

An SEC policy statement relative to a professional judgment framework must be consistent with the public interest and the protection of investors. To meet that objective, the creation of a framework should improve the quality of financial information provided to investors. Such a framework should be principles based focusing on the important responsibilities of financial reporting participants to identify, analyze and transparently report financial information in a manner that is informative for financial statement users. We contemplate that principles in such a framework would include the importance of careful consideration of appropriate authoritative financial reporting guidance, a consideration of reasonable alternatives, and the basis for significant conclusions reached; all timely documented. It would be appropriate for a policy statement to outline factors that may be relevant in evaluating judgments, however, any policy statement should make clear that there is no single set of criteria for evaluating all judgments and that the factors identified in any one situation may be more or less relevant for any particular judgment.

We are aware of concerns expressed by some persons outside of the Committee that a professional judgment framework may be applied inappropriately. They are concerned that instead of encouraging professionals to develop their best judgments, a framework might be used as a mechanical exercise to support judgments with boilerplate framework-compliant documentation. The Committee should be careful to avoid unintended consequences as we go down this path and ensure that the framework is developed in an appropriate principles-based, and not rules-based, form so that we can achieve the sought after benefits of superior application and documentation of professional judgment.

With that objective in mind, we provide these observations relative to Developed Proposal 3.4 and the Committee's discussion relative to the Developed Proposal:

- First, we are concerned that the discussion does not distinguish the very different roles played in the financial reporting process by auditors and regulators. On a number of occasions, auditors and regulators are combined in the discussion when referring to preparers' judgments. We are not supportive of any framework that can be used by preparers to compromise the auditor's role in the financial reporting process. While we appreciate the language in footnote 60 to the Progress Report, we remain concerned by the construction of the Committee's discussion. An independent auditor is engaged to form an independent opinion on whether the financial statements, taken as a whole, are fairly presented in accordance with the accounting framework. Regulators, in turn, are not charged with forming such opinions on the fair presentation of financial statements, and perform their duties in the financial reporting process generally after the preparer and its independent auditor have reached their judgments. In our view, it is critical that these different roles of independent auditors and regulators be considered and factored into a professional judgment framework.

- Second, the creation of a professional judgment framework should be coupled with a recommendation for increased and more transparent disclosures of critical accounting judgments. We observe the discussion of disclosures in the Progress Report under "Components of a Framework," but believe that to meet the objectives above, the existing disclosure requirements should be enhanced. Additionally, the last sentence of the section "Critical and Good Faith Thought Process" is confusing in its direction to "take into account the disclosure relevant to the judgment." Does this statement imply that good disclosure might mitigate a questionable judgment, or does the judgment "fail" if the disclosure is somehow lacking?

- Finally, we note the discussion of "hindsight" in the subsequent evaluations of judgment. We agree with the Committee's observations on the difficulty of determining what facts were known or should have been known, and the inappropriateness of a regulator using facts not available at the time of the judgment to evaluate a judgment. In that regard, we believe that any professional judgment framework should articulate principles and considerations relative to the use of hindsight in a regulator's evaluation of judgments. The inclusion of such principles and considerations will serve to provide transparency to those who make judgments and discipline to the regulators in assessing judgments after the fact.

Overall, we are supportive of the Committee continuing to pursue a professional judgment framework concept through an SEC policy statement, subject to our comments discussed above.

Chapter 4: Delivering Financial Information

XBRL and Increased Use of Corporate Web Sites

We are supportive of recommendations on XBRL and corporate website disclosures that have the potential to make information more readily available and usable by financial statement users.

With respect to XBRL, we agree with the recommendation for a phased-in approach because we believe that this approach will provide significant benefits as the learning process will inform increased use.

Further, while it may be appropriate to experiment with auditor assurance in the early phase-in period, auditor assurance should only be required after adequate consideration and deliberation has taken place to determine what the extent and form that auditor assurance should take. We are prepared to work with the SEC, PCAOB and other marketplace participants in the development of both a pilot "assurance project" and the ultimate recommendations that may emanate from such a pilot program.

With respect to corporate website disclosures, obviously we and others have an interest in the issuance of guidance concerning the liability associated with isolated information that is outside of the context of a complete disclosure document. However, we believe that there are significant benefits that would accrue from the increased use of corporate websites. As noted in the Progress Report, the role of technology and corporate websites has evolved greatly in recent years and continues to evolve. In the current environment it is common to see URLs presented as a reference in scholarly research, a sign of our times that electronic media is a critical and sometimes the only source of information. Today it is easier to find, analyze, capture, store and retrieve electronic media than to perform the same processes with paper. Further, those who undertake electronic searches are likely to advance in a logical and intuitive path so that research is conducted using the desired target identifiers. Thus an accumulation of information in an SEC archive is less likely to be the most readily accessed source of information about a particular company than information found at the company's own website. We believe that companies should be encouraged to enhance information available on their websites and should be provided with guidance that will encourage best practices as well as relieve unnecessary burdens of anxiety over potential legal exposure.

International Financial Reporting Standards (IFRS).

While we understand that the Progress Report takes the point of view that U.S. GAAP will exist for the foreseeable future, we also believe it is impossible to ignore the fact that IFRS is likely to be the world's single set of high quality accounting standards from a long term perspective. As the SEC has been considering possible paths to convergence on accounting standards, we note that many of the proposals in the Progress Report could be affected by those considerations. In particular, any mandate to use XBRL should consider the likely timeline for U.S. companies to switch to IFRS and the relative state of the IFRS XBRL taxonomy. The Committee also may want to consider recommendations relating to the SEC and FASB in the context of likely convergence strategies.

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If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Larry Leva at (212) 872-5589 or Teresa Iannaconi at (212) 909-5426.

Sincerely,

KPMG LLP

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