new york state society of
NYSSCPA
certified public accountants

Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

May 30, 2008

Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116

By e-mail: director@fasb.org

**Re: FASB Preliminary Views –
Financial Instruments with Characteristics of Equity
File Reference No. 1550-100**

The New York State Society of Certified Public Accountants, representing 30,000 CPAs in public practice, industry, government and education, submits the following comments to you regarding the above captioned release. NYSSCPA thanks the FASB for the opportunity to comment.

The NYSSCPA's Financial Accounting Standards Committee deliberated the preliminary views and drafted the attached comments. If you would like additional discussion with us, please contact Edward P. Ichart, Chair of the Financial Accounting Standards Committee, at (516)-488-1200, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

David A. Lifson
President

Attachment

new york state society of
NYSSCPA
certified public accountants

Home of the Trusted Professional
3 park avenue, at 34th street, new york, ny 10016-5991
212.719.8300 • fax 212.719.3364
www.nysscpa.org

**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON FASB PRELIMINARY VIEWS
FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY**

File Reference No. 1550-100

May 30, 2008

Principal Drafters

**Robert A. Dyson
Edward P. Ichart
John J. McEnerney
Mark Mycio
Margaret A. Wood
Anna Zubets**

NYSSCPA 2007 – 2008 Board of Directors

David A. Lifson, *President*
Sharon Sabba Fierstein, *President-elect*
Mark Ellis, *Secretary*
Richard E. Piluso, *Treasurer*
Rosemarie A. Giovinazzo-Barnickel, *Vice President*
John J. Lauchert, *Vice President*
Edward J. Torres, *Vice President*
Louis Grumet, *ex officio*
Edward L. Arcara
Scott M. Adair
Susan M. Barossi
Thomas Boyd
Debbie A. Cutler
Joseph M. Falbo, Jr.
Myrna L. Fischman, PhD
Daniel M. Fordham
David R. Herman
Scott Hotalen
Robert L. Goecks
Martha A. Jaeckle
Suzanne M. Jensen
Lauren L. Kincaid
Gail M. Kinsella
Kevin Leifer
Elliot A. Lesser
Beatrix G. McKane
Mark L. Meinberg
Ian M. Nelson
Jason M. Palmer
Robert A. Pryba Jr.
Robert T. Quarte
Ita M. Rahilly
Thomas E. Riley
Judith I. Seidman
Anthony J. Tanzi
Thomas M. VanHatten
Liren Wei
Ellen L. Williams
Margaret A. Wood
Richard Zerah

NYSSCPA 2007 - 2008 Accounting & Auditing Oversight Committee

George I. Victor, *Chair*
Michael J. Aroyo
Robert W. Berliner
Thomas J. Goodfellow
Elliot L. Hendler
Edward P. Ichart
Thomas O. Linder
Rita M. Piazza
Yigal Rechtman
William M. Stocker III
Ira M. Talbi
Paul J. Wendell

NYSSCPA 2007 - 2008 Financial Accounting Standards Committee

Edward P. Ichart, *Chair*
Giautam Anumukonda
Robert A. Dyson
Roseanne T. Farley
Vincent Gaudiuso
Hashim Ghadiali
Jo Ann Golden
Fred R. Goldstein
Abraham E. Haspel
Joseph A. Maffia
John J. McEnerney
Mark Mycio
Robert M. Rollmann
Olu Sonola
Leonard J. Weinstock
Margaret A. Wood
Anna Zubets

NYSSCPA Staff

William R. Lalli
Ernest J. Markezin

New York State Society of Certified Public Accountants

Financial Accounting Standards Committee

Comments on FASB Preliminary Views, Financial Instruments with Characteristics of Equity

File Reference No. 1550-100

General Comments

The Financial Accounting Standards Committee of the New York State Society of Certified Public Accountants has reviewed *Preliminary Views, Financial Instruments with Characteristics of Equity* ("Preliminary Views") and is pleased to present the following comments:

1. Preliminary Views will result in changes to Statement of Financial Accounting Concepts No. 6, "Elements of Financial Statements," and related FASB's and APBs. In its introduction, Preliminary Views indicates twenty pieces of literature, as we now know them, will change. The investment community, lenders, regulators and users of financial statements will need to change the financial models, financial ratios and contracts by which they measure performance. In addition, the financial statements will require restatement to provide comparable information. This will be a major change and adoption. Adequate time after adoption of the new definitions of equity and liability will need to be provided between the adoption and effective date to permit the changing of the models and restatements that will be required.

2. Preliminary Views does not appear to address how negative equity should be presented in years subsequent to the initial measurement of the basic ownership interest. In the case of a company with continuing losses, such as a developmental stage business, the basic ownership group would not have to repay the owners of the preferred interest if the company is liquidated. Preliminary Views does not address whether ownership interests in the basic ownership should be recorded at an amount that is less than zero. Does the Board propose that a company record retained earnings in excess of the amount of its basic ownership interest(?) or Would the Board propose that the liability interest with the preferred ownership which is treated as a liability be written down below fair value(?)

We applaud the Board for addressing the issue of defining equity. We consider the Basic Ownership Approach the preferred method because it addresses structuring created to affect advantageous accounting results and is the least complex of the alternatives offered. We commend the Board for its efforts to simplify the accounting requirements. The following section contains our responses to the questions on the Basic Ownership Approach.

Comments on Enumerated Issues

Question 1 – *Do you believe that the basic ownership approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you agree that the approach would significantly simplify the accounting for instruments within the scope of this Preliminary Views and provide minimal structuring opportunities?*

Response: The basic ownership approach represents an improvement in financial reporting. The Board has introduced, for the first time, a direct definition of equity. Previously, "Concepts 6" defined equity as "the residual or difference between an entity's assets and liabilities." This is an indirect definition and relied on defining equity as what it was not, that is, not an asset or a liability.

The underlying principles are clear. Principle 1, "The holder has a claim to a share of the assets of the entity that would have no priority over any other claims if the issuer were to liquidate on the date the classification decision is being made" (paragraph 18a), is currently used in practice when valuing the private equity interests on a liquidation basis using a "waterfall" computation. Principle 2 is based on simple mathematical operations (subtraction and division), and embodies what is commonly understood to be the "risks and rewards of ownership" concept.

The basic ownership approach would simplify the accounting and provide for minimum structuring opportunities. It is difficult to see how one would structure a basic ownership instrument to achieve a different economic result.

Perpetual Instruments

Question 2 – *Under the current practice, perpetual instruments are classified as equity. Under the basic ownership approach (and the REO approach, which is described in Appendix B) certain perpetual instruments, such as preferred shares, would be classified as liabilities. What potential operational concerns, if any, does this classification present?*

Response: Financial ratios and models used by lenders, the investment community and financial analysts will need to be modified to reflect the new definitions of equity and liabilities. After issuance of the new equity definition, sufficient time will need to be provided for the lending institutions and the investment community, including analysts, to develop new models, refine financial ratios and modify agreements containing financial covenants, to reflect the revised definition of equity prior to adoption of the new standards.

Question 3 – *The Board has not yet concluded how liability instruments without settlement requirements should be measured. What potential operational concerns, if any, do the potential measurement requirements in paragraph 34 present? The Board is* *interested in additional suggestions about subsequent measurement requirements for perpetual instruments that are classified as liabilities.*

Response: The method described in paragraph 34a ("do not remeasure, but instead, report dividends as an expense either when declared or at regular intervals"), was our preference. For consistency, cumulative dividends should be treated similarly if this approach is adopted.

"Remeasurement at fair value with changes reported in income" (paragraph 34b) appears to be a more theoretical approach based upon the current direction of fair value reporting. One concern with this approach would be the potential manipulation and recording of liabilities at prices less than the lenders would accept as full repayment in situations other than a troubled debt restructuring or liquidation.

"Determine an expected retirement date and an expected dividend stream and discount using a market-based rate" (paragraph 34c). We felt this choice was not practical. It has too many assumptions and variables, and would rely too much on modeling. This choice would be cumbersome for all but the most sophisticated companies.

Redeemable Basic Ownership Instruments

Question 4 – *Basic ownership instruments with redemption requirements may be classified as equity if they meet the criteria in paragraph 20. Are the criteria in paragraph 20 operational? For example, can compliance with criterion (a) be determined?*

Response: The criteria in paragraph 20(a) states "The redemption amount is the same as the share of the issuer's net assets to which the holder would be entitled if [the entity] were to liquidate on the classification date". This requirement will usually conflict with the requirement in paragraph 21, which states "The fair value of an instrument would be used to approximate the share of the issuer's net assets for purposes of the criterion in paragraph 20(a)." We agree that the criteria set forth are operational and appropriate if redemption is based on the instruments proportionate share of the entity's net assets. If it is based upon the quoted market price of the instrument, then it is operational but inappropriate since the market price of an instrument will rarely be equal to its proportionate share of net assets and, therefore, any redemptions at the market price (when higher) would impair the claims of higher interests.

As the word "impair" is used in criterion set forth in paragraph 20(b), the Board should consider adding it to the glossary.

Separation

Question 5 – *A basic ownership instrument with a required dividend payment would be separated into liability and equity components. That classification is based on the Board's understanding of two facts. First, the dividend is an obligation that the entity has little or no discretion to avoid. Second, the dividend right does not transfer with the stock after a specified ex-dividend date, so it is not necessarily a transaction with a current* *owner. Has the Board properly interpreted the facts? Especially, is the dividend an obligation that the entity has little or no discretion to avoid? Does separating the instrument provide useful information?*

Response: We were unclear as to the facts. What is the Board considering as a required dividend payment? Is this a payment that is included as a term of the basic ownership instrument that is required to be made and not subject to a board approval or declaration by the company? Is the Board suggesting that the fair value of the dividend right be separated from the basic ownership instrument, and the right is recorded as a liability at fair value? If this is a dividend that is, in fact, called for by the instrument and is not subject to approval by the board, then we agree it should be a liability based upon falling outside the criteria set forth in paragraph 18.

Were the Board referring to a dividend declared by an entity's board, based upon performance or an event (but not a term of the basic ownership instrument), these dividends are recorded as a liability when declared under current practice.

Separating the instruments that do not meet the criteria of paragraph 18 is appropriate. We believe that this situation would not be different, and that it would provide useful information.

Substance

Question 6 – *Paragraph 44 would require an issuer to classify an instrument based on its substance. To do so, an issuer must consider factors that are stated in the contract and other factors that are not stated terms of the instrument. That proposed requirement is important under the ownership-settlement approach, which is described in Appendix A. However, the Board is unaware of any unstated factors that could affect an instrument's classification under the basic ownership approach. Is the substance principle necessary under the basic ownership approach? Are there factors or circumstances other than the stated terms of the instrument that could change an instrument's classification or measurement under the basic ownership approach? Additionally, do you believe that the basic ownership approach generally results in classification that is consistent with the economic substance of the instrument?*

Response: We did not note any unstated factors or circumstances other than the stated terms that would or could change an instrument's classification or measurement under the basic ownership approach. The basic ownership approach is consistent with the economic substance of the instrument.

Linkage

Question 7 – *Under what circumstance, if any, would the linkage principle in paragraph 41 not result in classification that reflects the economics of the transaction?*

Response: Determining if instruments that are not contractually linked are part of the same arrangement may be difficult to evaluate in practice. We did not identify any circumstances in which the linkage principle failed to result in a classification that reflects the economics of the transaction.

Measurement

Question 8 – *Under current accounting, many derivatives are measured at fair value with changes in value reported in net income. The basic ownership approach would increase the population of instruments subject to those requirements. Do you agree with that result? If not, why should the change in value of certain derivatives be excluded from current-period income?*

Response: We agree.

Presentation Issues

Question 9 – *Statement of financial position. Basic ownership instruments with redemption requirements would be reported separately from perpetual basic ownership instruments. The purpose of the separate display is to provide users with information about the liquidity requirements of the reporting entity. Are additional separate display requirements necessary for the liability section of the statement of financial position in order to provide more information about an entity's potential cash requirements? For example, should liabilities required to be settled with equity instruments be reported separately from those required to be settled with cash?*

Response: Separate display of perpetual basic ownership instruments and basic ownership instruments with redemption requirements is appropriate. We think that perpetual preferred stock with no specific redemption requirement should be reported separately from fixed-term liabilities. Lastly, we believe that separate display requirements are necessary for the liability section of the statement of financial position or in the notes to the financial statements in order to provide more information about an entity's potential cash requirements.

Question 10 – *Income statement. The Board has not reached tentative conclusions about how to display the effects on net income that are related to the change in the instrument's fair value. Should the amount be disaggregated and separately displayed? If so, the Board would be interested in suggestions about how to disaggregate and display the amount. For example, some constituents have suggested that interest expense should be displayed separately from the unrealized gains and losses.*

Response: We believe that separate display is appropriate.

Earnings per Share (EPS)

Question 11 – *The Board has not discussed the implications of the basic ownership approach for the EPS calculation in detail; however, it acknowledges that the approach will have a significant effect on the computation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implication related to this approach, if any, should the Board be aware of or consider?*

Response: Equity instruments with redemption requirements should be treated similar to other basic ownership instruments. This is analogous to the investment company requirement to disclose a financial highlights table wherein all instruments are required to be redeemed at the option of the holder.

As noted above, we believe that losses in excess of basic ownership interests are an issue that still needs to be addressed in the Board's explication of the basic ownership approach. By extension, the Board should consider what effect, if any, losses will have on EPS and, in particular, losses in excess of the basic ownership interest.