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August 28, 2008

Technical Director
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

By electronic submission: www.iasb.org comment letters page

Re: IASB Discussion Paper: ***Financial Instruments with Characteristics of Equity***

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 discussion paper. The NYSSCPA thanks the IASB for the opportunity to comment.

The NYSSCPA's International Accounting and Auditing Committee deliberated the discussion paper and prepared the attached comments. If you would like additional discussion with us, please contact William M. Stocker III, Chair of the International Accounting and Auditing Committee, at (212) 503-8875, or Ernest J. Markezin, NYSSCPA staff at (212) 719-8303.

Sincerely,

Sharon Sabba Fierstein

Sharon Sabba Fierstein
President

Attachment

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COMMENTS ON IASB DISCUSSION PAPER: *FINANCIAL INSTRUMENTS WITH CHARACTERISTICS OF EQUITY*

August 28, 2008

<u>Principal Drafter</u>

William M. Stocker III

New York State Society of Certified Public Accountants

International Accounting and Auditing Committee

Comments on International Accounting Standards Board (IASB) Discussion Paper on Financial Instruments with Characteristics of Equity

General Comments

The International Accounting and Auditing Committee of the New York State Society of Certified Public Accountants has reviewed the Discussion Paper, *Financial Instruments with Characteristics of Equity* and has prepared the following responses to certain of the questions posed. Included in our responses are references to the New York State Society of Certified Public Accountant's comment letter on the FASB *Preliminary Views, Financial Instruments with Characteristics of Equity* ("FASB Preliminary Views"), which is attached as an appendix to this letter.

Comments on Specific Questions *(From* "Appendix B, Additional questions for respondents"*)*

Question B1 - *Are the three approaches expressed in the FASB Preliminary Views document a suitable starting point for a project to improve and simplify IAS 32? If not, why?*

(a) *Do you believe that the three approaches would be feasible to implement? If not, what aspects do you believe could be difficult to apply and why?*

(b) *Are there alternative approaches to improve and simplify IAS 32 that you would recommend? What are those approaches and what would be the benefit of those alternatives to users of financial statements?*

<u>Response</u>: The responses to the questions in the attached comment letter on the FASB Preliminary Views address question (a) above and are relevant to the IASB's project to revise IAS 32. In this comment letter, we address some concerns specific to IFRS, as well as add some further general views on the subject of classifying legal ownership interests.

As discussed in our response to the FASB, we support an effort to define equity rather than to simply allow it to be the residual of assets (having a definition) and liabilities (also with a definition). We are concerned, however, about simply changing which item in the triad is considered a residual. We believe that the current IFRS definition of a liability is appropriate and that all three elements of the financial statement should have a definition. We understand that this means that some instruments would not be included in any of the three elements and we would welcome this development.

In filings with the United States Securities and Exchange Commission there is a category commonly called "temporary equity" or "mezzanine" equity in U.S. accounting and finance idiom. This principally relates to Redeemable Preferred Stocks under Accounting Series Release ("ASR") 268. ASR 268 prohibits including in Stockholders' Equity any preferred stock subject to mandatory redemption or whose redemption is outside the control of the issuer. Virtually all instruments that belong in this category would be classified as liabilities under IFRS. We believe that IFRS is appropriate in this regard. However, we understand the usefulness of a "middle" category that is not part of the three defined categories. Such a category would, under the basic ownership approach, include those instruments which, in their entirety, are what the Ownership-Settlement Approach labels as "perpetual instruments," "indirect ownership instruments," and possibly others. The terms "temporary equity" and "mezzanine" would not be appropriate for such a category, but perhaps some better term might be utilized.

Expanding on our response to the FASB's question 9 calling for display of perpetual preferred stock, we believe that maintaining the liability category as a defined category, rather than as a residual, will be more useful to financial statement users in assessing an entity's liquidity and cash needs. This is most important to creditors, and is of interest to current and potential equity investors in assessing risk of an entity's failure. Another alternative is to define another category, "non-basic equity" (for lack of a better term), still leaving, perhaps hypothetically, the possibility of a residual that did not fit into any of the definitions.

The lack of a liability classification for "other" instruments would not preclude the requirement that transactions or changes in value in the instruments be included in the determination of profit and loss.

We hope that our support of definitions for both liabilities and equity does not encourage the development of definitions for the two elements structured for the purpose of bifurcating all instruments into the two components. We support the simplicity of the Ownership-Settlement Approach.

Question B2 - *Is the scope of the project as set out in paragraph 15 of the FASB Preliminary Views document appropriate? If not, why? What other scope would you recommend and why?*

<u>Response</u>: Regarding the scope of the project, we believe that paragraph 15 of the FASB Preliminary Views document adequately describes those instruments in need of consideration under U.S. GAAP, especially when one considers the legal structures utilized in the U.S. We believe that some expansion is needed for the project as it relates to IFRS.

It is likely that any instrument that is in the legal form of a liability would be classified as a liability under U.S. GAAP. This is not necessarily the case under IFRS. An instrument in the legal form of a liability that is subordinated to all other liabilities and under which the reporting entity can only be required to pay on liquidation of the entity, might be classified as equity under IAS 32. Item a, in paragraph 15 of the FASB Preliminary Views, considers this possibility by including basic ownership instruments regardless of legal form. Paragraph 23 of the FASB Preliminary Views includes instruments of unclear legal form. Instruments that are not basic ownership instruments and which require payment only upon liquidation (i.e., perpetual instruments in a legal form other than equity) are left out of the scope of the FASB Preliminary Views. Such instruments (i.e., instruments classified as equity under current IFRS that are not equity in legal form) should be part of the FASB's project scope.

Question B3 - *Are the principles behind the basic ownership instrument inappropriate to any type of entities or in any jurisdictions? If so, to which types of entities or in which jurisdictions are they inappropriate, and why?*

Response: Certain Cayman Islands companies are organized with nominal shares, sometimes referred to as "management shares," that have full voting control and are classified as equity under current IFRS. Theoretically, they have the lowest claim on assets at a *de minimus* stated value. All profit and loss is allocated to investor shares that are redeemable on demand and generally classified as liabilities under IAS 32. Upon actual liquidation, any outstanding investor shares would absorb losses first so they might be considered the basic ownership units. Conversely, all of the holders might demand redemption just prior to liquidation and leave the management shares with the residual loss and thus possibly the basic ownership status. This point relates to a more general issue as discussed in our response to B5 below.

Question B5 - *Please provide comments on any other matters raised by the discussion paper.*

Response: Consideration should be given to how the requirements of IAS 1, paragraphs 124A, B and C would be affected by the adoption of a new definition of equity and liabilities. We believe that the principal effect would be to make the disclosures more important. The instances in which capital, as defined and managed by management on the one hand, and equity, as defined by IFRS on the other, are more likely to be significantly different upon the adoption of a new framework. Depending on the results of the project, more specific disclosure requirements might be appropriate.

In the basic ownership model, there might be cases in which voting control of the entity is significantly, or totally, in the hands of the holders of instruments that are not basic ownership instruments. It should be considered whether specific mandatory disclosures are necessary in the case of control by the holders of non-basic ownership instruments, especially in those cases in which they have significant variability in value.

Such mandatory disclosures might include pro forma disclosure of equity and profit and loss assuming that these instruments, rather than those that are actually so classified, were the basic ownership instrument interests. For example, consider that ABC Co. has perpetual preferred stock, superior in liquidation preference only to common, with a liquidation preference of 100,000 currency units (“cu”) and a preferred dividend of 12%. Assume the holders of the perpetual preferred stock have a majority of the voting rights. Assume further that the fair value of ABC Co.’s assets are 10,000 cu and the fair value of its liabilities, other than the perpetual preferred stock, are 9,000 cu for a net combined value of 1,000 cu for the perpetual preferred stock and common stock. In such a situation, the legal common stock is nearly valueless and providing the financial position and results of operations (including per share amounts) from the viewpoint of the perpetual preferred stockholder could be extremely useful.

Instead of, or in addition to, the pro forma disclosure, the financial statement preparer might be called upon by the new standards to determine if any class of instruments that initially meets the definition of a “basic ownership interest” should be disregarded if the instruments as a class were not material to the entity.

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APPENDIX

NYSSCPA Comment Letter on FASB *Preliminary Views, Financial Instruments with Characteristics of Equity* ("FASB Preliminary Views")

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May 30, 2008

Technical Director
Financial Accounting Standards Board
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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

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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

<u>Principal Drafters</u>

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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.