



October 28, 2003

Lawrence Smith
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Financial Accounting Standards Board
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File Reference No. FAS 150-c
Effective Date and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

File Reference No. FAS 150-d
Issuers' Accounting for Employee Stock Ownership Plans under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

Dear Mr. Smith:

We are pleased to comment on the Proposed FASB Staff Position No. FAS 150-c, "Effective Date and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*" ("FSP 150-c"), and the Proposed FASB Staff Position No. FAS 150-d, "Issuers' Accounting for Employee Stock Ownership Plans under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*" ("FSP 150-d").

In general, we support FSP 150-c, which proposes to extend the effective date for certain nonpublic entities, as defined, with regard to accounting for mandatorily redeemable financial instruments as liabilities under paragraph 9 of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* ("FAS 150"). We also support the proposed guidance in FSP 150-d, which is to clarify the scope exception with regard to employee stock ownership plans currently

accounted for under other authoritative literatures, (e.g., APB Opinion No. 25, *Accounting for Stock Issued to Employees*, FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and AICPA Statement of Position 93-6, *Employers' Accounting for Employee Stock Ownership Plans*). However, we would like to raise two concerns in relation to FSP 150-c, which are summarized as follows:

1. Paragraph 4 of FSP 150-c provides general guidance over when a redemption feature is “not separately exercisable” and therefore, is “not freestanding” in accordance with the definition of a “freestanding financial instrument” in Appendix D to FAS 150. We applaud the Board’s effort to clarify what is or is not a “freestanding financial instrument.” However, we believe that issue is of such significance that it should be addressed by itself, possibly in a separately issued FASB Staff Position.
2. The definition of a “nonpublic entity” in FSP 150-c appears to be more restrictive than the definition used in FAS 150. The definition in FSP 150-c excludes (a) entities with debt securities that are currently tradable or will be tradable in a public market and (2) entities that are required to file financial statements with the SEC, regardless of whether those entities have securities that trade in a public market.

Additionally, we note that in the FASB Action Alert No. 03-42, revised on October 27, 2003, that the board will discuss issues related to mandatorily redeemable noncontrolling interests at its meeting on October 29, 2003. As discussed below, we believe that there are several complex accounting issues resulting from the accounting required by FAS 150, as it is applied to mandatorily redeemable interests where redemption is required to occur only upon liquidation or termination of the issuer (i.e., mandatorily redeemable noncontrolling interests).

- There are diverse views on whether certain noncontrolling interests in consolidated subsidiaries are within the scope of FAS 150. In some circumstances, a partnership agreement is established with a stated termination date (e.g., 15 years after inception of the partnership); however, the partnership agreement is silent as to what occurs upon the stated termination date.¹ We understand that in some cases, if the partnership agreement does not provide for specific actions (e.g. distribution of net assets or sale of assets and distribution of proceeds) to occur at the termination date, the partnership continues in its current form until the partners negotiate further terms. Should the probability of outcomes be considered (i.e., the probability that the noncontrolling interests will be redeemed) for purposes of determining whether the noncontrolling interests

¹ It is our understanding that termination dates may be required by state law for partnerships and other pass-through structures.

should be accounted for as a liability or should the fact that there is a stated termination date automatically result in liability classification?²

- Upon adoption of FAS 150, the minority interest in a limited-life subsidiary is reclassified to a liability, and, presumably is not subject to purchase accounting under Statement of Financial Accounting Standards No. 141, *Business Combinations*. We are having trouble reconciling the fact there is no minority interest (instead, there is now an obligation) – suggesting that the parent has 100% ownership of the subsidiary – even though purchase accounting has been applied only to the legal (rather than the accounting) ownership held by the parent. Similar questions can be legitimately raised about accounting adjustments to the obligation. FAS 150 indicates that these adjustments are interest expense; are there any instances whereby the adjustments represent an adjustment to the cost of acquiring the minority interest under purchase accounting?
- Many entities are in the process of modifying partnership and similar agreements to remove stated termination dates (to avoid classification of a liability going forward). However, it is unclear as to how to account for the change in classification of a previously mandatorily redeemable noncontrolling interest from a liability back to minority interest. A number of alternatives exist for accounting for the transaction and guidance is needed.

We recommend extending the deferral of the provisions of FAS 150 for interests determined to be mandatorily redeemable for the reporting entity, but are not mandatorily redeemable for the consolidated issuer because redemption is required to occur only upon liquidation or termination of the issuer (i.e., mandatorily redeemable noncontrolling interests in consolidated subsidiaries). We believe such provisions within FAS 150 should be deferred until the FASB can resolve the significant issues around these instruments.

Each of the concerns noted as 1. and 2. above is explained in more detail in the Appendix to this letter.

We appreciate your consideration of our comments. Should you have any questions regarding our response, please contact Robert Uhl at (203) 761-3705 or James Johnson at (203) 761-3709.

² We have encountered situations where it is unlikely assets will be sold and proceeds distributed due to the operating nature of the limited life company. There are often other provisions to provide the minority interest holder with an “exit” strategy (e.g. puts and/or calls). However, other guidance of FAS 150 would apply to the accounting for certain of these instruments.

Comment Letter
File Reference No. FAS 150-c and FAS 150-d
October 20, 2003

Yours truly,

Deloitte & Touche LLP

APPENDIX
DELOITTE & TOUCHE LLP COMMENTS
Proposed FASB Staff Position No. FAS 150-c

1. Need to Clarify the Definition of a Freestanding Financial Instrument

Paragraph 4 of FSP 150-c states, in part:

Some entities have shares that are required to be redeemed under related agreements. If the shares cannot be issued without the redemption agreement, and the required redemption relates to those specific underlying shares, the shares are mandatorily redeemable. That is because the redemption agreement entered into in conjunction with the shares is not separately exercisable, and therefore, is not freestanding of the shares.

We believe that the aforementioned paragraph provides general guidance over when a redemption feature is “not separately exercisable” and therefore, is not a “freestanding financial instrument” as defined in Appendix D to FAS 150, which states:

Freestanding Financial Instrument

A financial instrument that is entered into separately and apart from any of the entity’s other financial instruments or equity transactions, or that is entered into in conjunction with some other transaction and is legally detachable and separately exercisable. [Emphasis added]

Given the intended limited application of FSP 150-c (i.e., to provide nonpublic entities, as defined, an extension of the date upon which they are required to apply provisions associated with mandatorily redeemable financial instruments in FAS 150), and the significance of properly determining whether one or more financial instruments can be viewed as embedded in another financial instrument or as single freestanding financial instruments in their entirety, we believe it would be more appropriate to address the issue of “freestanding financial instrument” in a separate FASB staff position.

The determination that one or more financial instruments should be viewed as embedded in another financial instrument or as single freestanding financial instruments in their entirety will lead to different accounting treatment for the same set of financial instruments when FAS 150 is applied. Consider “Derivative 2” illustrated in EITF Issue No. 00-4, *Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary*:

A controlling majority owner (parent) holds 80 percent of a subsidiary's equity shares. The remaining 20 percent (the minority interest) is owned by an unrelated entity (the minority interest holder). Simultaneous with the acquisition of the

minority interest, the minority interest holder and the parent enter into a derivative contract that is indexed to the subsidiary's equity shares. The terms of the derivative contract may be any of the following:

Derivative 2—The parent has a call option to buy the other 20 percent at a fixed price at a stated future date, and the minority interest holder has a put option to sell the other 20 percent to the parent under those same terms, that is, the fixed price of the call is equal to the fixed price of the put option

If the written put and the purchased call options are viewed as a single freestanding financial instrument not embedded in the 20 percent minority interest in the subsidiary, the written put and the purchased call option, in combination, will be accounted for as a liability, pursuant to paragraph 11 of FAS 150, which states, in part:

A financial instrument, other than an outstanding share, that, at inception, (a) embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and (b) requires or may require the issuer to settle the obligation by transferring assets shall be classified as a liability (or an asset in some circumstances). [Footnotes omitted]

If the written put and the purchased call options are viewed as two separate freestanding financial instruments, neither of them embedded in the 20 percent minority interest in the subsidiary, the written put option will be accounted for as a liability, pursuant to paragraph 11 of FAS 150, whereas the purchased call option will be accounted for under EITF Issue No. 00-6, *Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary*.

If both the written put and the purchased call options are embedded in the 20 percent minority interest in the subsidiary but such minority interest is not mandatorily redeemable, the minority interest with the embedded written put and purchased call options will be scoped out of FAS 150, pursuant to paragraph 15, which states, in part:

This Statement does not apply to features embedded in a financial instrument that is not a derivative in its entirety.

2. Need to Clarify the Definition of a Nonpublic Entity

Footnote 2 to FSP 150-c states:

For the purpose of this FSP, SEC registrants are entities, or entities that are controlled by entities, that have issued or will issue debt or equity securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets), that are required to file financial statements with the SEC, or that provide financial statements for the purpose of issuing any class of securities in a public market. [Emphasis added]

Appendix D to FAS 150 defines a “nonpublic entity” as follows:

Any entity other than one (a) whose equity securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally, (b) that makes a filing with a regulatory agency in preparation for the sale of any class of equity securities in a public market, or (c) that is controlled by an entity covered by (a) or (b). [Statement 123, paragraph 395]

There are two primary differences between the definitions provided in FSP 150-c and in FAS 150: 1) the addition of debt securities that are currently tradable or will be tradable in a public market, and 2) the addition of the wording “that are required to file financial statements with the SEC.”

As a result of the second difference, nonpublic entities, for the purpose of FSP 150-c, would exclude brokers/dealers that are required to file annual audited financial statements with the SEC (pursuant to the rules and regulations by the SEC and the National Association of Security Dealers) but do not have tradable debt or equity securities in a public market or are not in the process of issuing debt or equity securities that are tradable in a public market. The second difference would also exclude co-operatives that file quarterly unaudited (on Form 10-Q) and annual audited (on Form 10-K) financial statements pursuant to certain SEC reporting rules and regulations but do not have tradable debt or equity securities in a public market or are not in the process of issuing debt or equity securities that are tradable in a public market. If it is the intention of the FASB Staff to modify the definition of a “nonpublic entity” for the purpose of FSP 150-c, the rationale should be provided.