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Certified Management Accountant Program  
Certified in Financial Management Program

April 13, 2004

Ms. Suzanne Bielstein  
Director of Major Projects and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Letter of Comment No: 21  
File Reference: 1200-200  
Date Received: 4/13/04

Dear Ms. Bielstein,

The Financial Reporting Committee (FRC) of the Institute of Management Accountants appreciates the opportunity to provide its views on the four Exposure Drafts related to the Board's short-term convergence project. For the convenience of staff, we have separated our responses to each of the ED's as individual attachments to this letter. The FRC supports the Board's efforts towards convergence with international accounting standards, including circumstances in which US GAAP must change in order to achieve this objective. That said, we also believe that convergence efforts must not simply accomplish conformity – they also must produce high-quality accounting standards. In studying the ED's, the FRC has identified aspects of the proposed statements that we believe the Board needs to address before proceeding further. Some may interpret our objections, which in certain areas are quite strong, as a lack of support for convergence. That is not the case. It is our hope that you will consider the issues raised in each of the responses on their merits and without prejudice as to our support on the broader issue of convergence. A brief summary of our views on each is provided below:

Inventory Costs (File Reference 1200-100)

We interpret the proposed modification to ARB 43 as doing more than conforming wording. In contrast to the Board's expectations, the way that the concept of normal capacity is employed will affect inventory accounting in more circumstances than those in which production is abnormally low. We are therefore concerned that the proposed standard will introduce changes in US practices that have not yet been researched by the Board. Moreover, we believe that in certain cases the accounting result is inappropriate. In the attachment we have provided further information about what we believe are unintended consequences of the change. If the Board decides to proceed with the change, we believe that the project time horizon needs to be extended to examine the effect on inventory accounting in greater depth. However, we also observe that this issue is not a priority in the near term and would therefore recommend that the Board simply suspend work on the ED.

Earnings Per Share (File Reference 1200-200)

We agree with the basic principles of the ED related to determining incremental shares. However, we oppose the requirement that shares to be issued upon conversion of a mandatorily convertible security be included in the computation of basic EPS from the date that conversion becomes mandatory. We believe there are instances where that presentation is not representationally faithful to the underlying economic substance during the period that the mandatorily convertible security is outstanding and not yet converted. In the attachment we have provided an example that illustrates our concern.

Exchanges of Productive Assets (File Reference 1200-300)

The FRC was unable to adopt a unified view on whether gain recognition was appropriate in all circumstances where the commercial substance test was satisfied. The two views could loosely be described as the "realization and culmination of the earnings process" view on the one hand, and the "accounting for a transaction with economic consequences" view, on the other. Even those who support the latter view, which is relatively consistent with the ED's concept of economic substance, could not reconcile the answers the ED produced across different fact patterns. In the attachment we have provided these examples for your consideration.

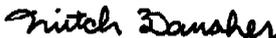
Accounting Changes and Error Corrections (File Reference 1200-400)

While we agree that retrospective application of changes in accounting principles enhance the interperiod comparability of financial information, we also believe that restating financial statements of prior periods on a regular basis will dilute public confidence in financial reporting and confuse the users of financial statements. Only time will tell whether the benefits of increased comparability outweigh these consequential effects. We also are concerned about the implications this may have on transition methods in other areas of the standard setting process (e.g., EITF Consensuses and FASB Staff Positions). If the Board proceeds with this proposed ED, we believe that it needs to carefully consider how to define the practicability exception as it relates to cost. Cost benefit judgments made in ordinary course of developing new standards are difficult by their very nature. The cost benefit implications to individual companies of retroactively applying a new standard for all prior periods presented will be highly dependent on the company's circumstances and capabilities and the Board is likely to have difficulty factoring this into its overall assessment. Therefore, the Board needs to include a mechanism, much like materiality, to ensure that the costs of retrospective application incurred by each company are not excessive.

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If you have questions regarding this letter or the attached responses, please feel free to contact me at (203) 373-3563.

Sincerely,



Chair, Financial Reporting Committee  
Institute of Management Accountants

**File Reference 1200-200 "Earnings Per Share"**

We agree with the ED's provisions that the number of incremental shares included in year-to-date diluted EPS be computed using the average market price of common shares for year-to-date period and with the elimination of the provisions of Statement 128 that allow an entity to rebut the presumption that contracts with the option of settling in either cash or stock will be settled in stock.

However, the FRC is opposed to the requirement that shares to be issued upon conversion of a mandatorily convertible security be included in the computation of basic EPS from the date that conversion becomes mandatory. We believe there are instances where that presentation is not representationally faithful to the economic substance during the period that the mandatorily convertible security is outstanding and not yet converted. The following example, which is based on billions of dollars of actual securities issued by U.S. companies in the past 10 years, is provided to illustrate our point:

Preferred stock is issued with a three-year life and a mandatory conversion into common stock at the end of three years. The number of common shares varies depending on the market price of the common stock at the end of three years, with a minimum of 5/6th of a common share per share of preferred and a maximum of 1 common share per share of preferred. During its three-year life, the preferred pays a dividend substantially higher than the dividend on common shares, either a fixed dividend or a formula dividend that changes with money market conditions. In the event of liquidation prior to the mandatory conversion date, the preferred stock has a claim prior to that of common shareholders to proceeds remaining after settling senior obligations.

Based on those facts, the assumed conversion of the security will almost always be anti-dilutive because the dividend on the preferred shares normally exceeds the earnings per if-converted common share. The FRC believes that assuming conversion for basic earnings per share obscures the real economic return that the preferred shareholders receive during the three-year life of the preferred stock and overstates the earnings available to the common shareholders during that period. We believe the appropriate presentation for basic EPS in this circumstance is to reflect the dividend to the holders of the mandatorily convertible security as a reduction of net income available to common shareholders. We believe that presentation is more appropriate than the proposed requirement to apply the if-converted method.

Prior to the mandatory conversion date, the convertible security has a similar impact on the determination of basic EPS as a class of common stock with dividend rights that are different from the rights on other outstanding common shares. Under Statement 128, that circumstance would require the use of the two-class method to determine basic EPS. We also note that the EITF recently reached a consensus on Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings Per Share," that all participating securities, whether or not convertible, should be included in the computation of basic EPS using the two-class method. That consensus resulted in the FASB staff agreeing to rescind EITF Abstracts, Topic No. D-95, "Effect of Participating Convertible Securities on the Computation of Basic Earnings per Share," which required entity's to make an accounting policy decision as to how participating convertible securities were to

- be included in the computation of basic EPS (using either the two-class method or the if-converted method, if the dilutive effect is greater than using the two-class method). Requiring the use of the if-converted method to mandatorily convertible securities seems inconsistent with the consensus on Issue 03-6 and the staff's decision to withdraw the guidance in Topic D-95.

Further, we do not believe mandatorily redeemable preferred shares meet the intent of paragraph 10 of Statement 128. Paragraph 10 states that, "Shares issuable for little or no cash consideration upon the satisfaction of certain conditions (contingently issuable shares) shall be considered outstanding common shares and included in the computation of basic EPS as of the date that all necessary conditions have been satisfied (in essence, when issuance of the shares is no longer contingent)."

The preferred shareholder is required to pay substantial non-cash consideration to obtain the common shares by giving up the preferred shares with their valuable dividend and liquidation preference rights. Although the preferred shareholders have no choice in the matter, from the company's point of view, the common shares will be issued in exchange for valuable consideration. As a result, we believe that the common shares should be included in basic earnings per share only at the time that they are issued. In the rare case in which conversion would be dilutive, the dilution will be captured in diluted earnings per share.