

CONSTRUCTION FINANCIAL MANAGEMENT ASSOCIATION

The Source and Resource for Construction Financial Professionals

September 25, 2003

Mr. Robert Herz Chairman, Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856

Dear Chairman Herz:

The Construction Financial Management Association (CFMA) is in receipt of your letter dated September 2, 2003, regarding the decision of the Financial Accounting Standards Board not to exempt nonpublic entities from applying the provisions of Statement of Financial Accounting Standard No. 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.

We deeply appreciate the attention given to the issues raised by our organization and other affected stakeholders during FASB's Liability and Equity Board Meeting of August 23, 2003; however, the Board's response failed to provide any basis for its determination, other than commenting that the August letters it received on this Statement did not raise any issues that the Board has not already considered.

We are perplexed by this comment. The potentially disastrous effects to the construction industry outlined in our previous correspondence are real, not theoretical. Simply delaying implementation offers no consolation, nor does it alleviate the unreasonable and unjust burden placed on private industry.

So, in addition to our comments concerning FAS 150-b on page 3 of this letter — <u>and two other issues not previously mentioned that you will find on page 2</u>—we are reiterating our serious concerns and intense opposition to applying FAS 150 (in its present form) to privately held companies. We urge FASB to recognize the inevitable consequences this Statement will impose on the construction industry (as well as the entire nonpublic business sector) and reconsider its position.

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Proposed FSP on Statement 150 (FSP FAS 150-b)

Comment Letter No. 10

THE CRUX OF THE MATTER

In our original letter, we stressed that classifying mandatorily redeemable equity instruments as liabilities under the provisions of FAS 150 would have any or all of the following effects:

- Hinder the ability of privately held companies, particularly in the construction industry, to effectively compete with public entities.
- 2. Eliminate equity balances and give rise to negative equity balances.
- Force privately held construction companies to default on surety and lending requirements.
- Produce considerable and unstable non-cash interest costs that serve no relevant purpose, but that will be perceived as an increased cash expense.
- 5. Impose unreasonable and unnecessary annual valuation costs.
- Cause construction entities to arbitrarily change their buy/sell agreements in order to avoid the penalties of FAS 150.

Two Other Issues Not Previously Mentioned

But, there are other concerns, as well. For example, many federal, state, and local public agencies require contractors to "pre-qualify" in order to bid on public agency work. These requirements include the presentation of a financial statement (often audited) to show that the business has equity sufficient to demonstrate the financial ability to perform the work. Nonpublic contractors, forced into a negative equity position due to the requirements of FAS 150, will thus be unable to bid on such contracts.

Along those same lines, nonpublic contractors who self-insure are required to present an audited financial statement reflecting an equity position that demonstrates the ability to finance this obligation. Under FAS 150, these contractors would be denied this opportunity.

Asking for Guidance

If FASB chooses not to substantiate its decision, we respectfully request that it offer circumstantial guidance on these issues to all nonpublic businesses – which compose the vast majority of organizations operating within the United States – and to the users of their financial statements.

Further, we question FASB's claim that the financial recognition and measurement changes effected by FAS 150 "result in financial statements that are more representationally faithful and present a more complete depiction of an entity's liabilities that will assist users in assessing the future cash flows...of an entity."

COMMENTS SPECIFIC TO FAS 150-b

Proposed FASB Staff Position No. FAS 150-b, Accounting for Mandatorily Redeemable Shares Requiring Redemption by Payment of an Amount that Differs from the Book Value of These Shares, requires that all mandatorily redeemable shares be reclassified as a liability at the fair value of the shares at redemption, assuming there exists a determinable date of redemption, on the statement of financial position.

The entity's outstanding shares and paid-in capital accounts, which represent cash and/or other assets contributed by shareholders, suddenly vanish or transmute into a negative contribution. The difference between the carrying value and the fair value is then offset by a cumulative effect "transition adjustment loss" on the statement of income, which could be quite significant for an event that never actually occurred.

To add insult to injury, the business could incur appraisal fees to value these instruments annually. Appreciation in value, normally viewed as a positive attribute, instead results in increased liabilities and larger deficits in the equity account under the "improved" reporting procedures of FAS 150.

Meanwhile, the financial and economic positions of the entity remain exactly the same as before this reshuffling of numbers took place. From the user's standpoint, however, the organization appears to be insolvent. We humbly ask that the FASB please elaborate on its definition of the term "representationally faithful" in its claim of the usefulness of this Statement.

SEEKING A MIDDLE GROUND

CFMA fully understands that FASB's mission is to "establish and improve standards of financial accounting and reporting" and that FAS 150 is an attempt to fulfill this mission. The overall benefits derived by the preparers and users of the financial information of nonpublic entities, however, cannot counterbalance the devastating financial and economic costs imposed by this Statement, which go far beyond the mere "one-time costs" of applying the required changes.

However, as mentioned in our original letter, feasible alternatives exist to the rigid guidelines specified by FAS 150.

DISCLOSURE

Limiting application for privately held companies to disclosure issues is one possible option. CFMA does not object to disclosing the existence of mandatory and other buy/sell redemption agreements and would support the setting of minimum disclosure requirements.

By allowing disclosure of mandatorily redeemable financial instruments for private industry, the basic premise of FAS 150 remains intact – the users are made aware of any underlying agreements attached to equity instruments. Additionally, for nonpublic entities, we believe that disclosure of the terms of the buy/sell agreements would accomplish the goals of the statement without imposing the huge burdens and consequences that would result from FAS 150.

We strongly suggest, though, that any potential ruling exclude the requirement to disclose what the effect of FAS 150 would have been had it been employed. Footnote presentation of this information possesses the same deceptive and irrelevant qualities as reclassification.

TWO CRITICAL POINTS TO CONSIDER

We must also remember that the users of the financial information of nonpublic companies have very different needs than those of SEC registrants. Further, these users have the distinct advantage of obtaining additional information on an "as needed" basis and on demand. Incorporating superfluous and confusing information in the footnotes of the financial statements violates basic elements of accounting's conceptual framework mainly because the user's ability to make reasonable judgments based on this information is hindered.

One cannot fathom that a prestigious and prudent standard-setting body, such as the Financial Accounting Standards Board, would simply cast the majority of business enterprises (i.e., non-SEC registrants) aside and effect the procedures of FAS 150-b. For those nonpublic entities struggling to stay true to the generally accepted accounting principles that govern their SEC registrant counterparts, following the guidelines in FAS 150 could potentially lead to their ultimate demise.

When promulgating GAAP, FASB must necessarily give weight to all business units that comprise the U.S. marketplace. The Board must also consider the impact its rulings have on the economy. The provisions set forth in FAS 150 exhibit firm evidence contrary to both of these very basic concepts.

The Construction Industry makes up 5% of the GDP, and the majority of contractors that make up our industry are nonpublic entities. CFMA implores the Financial Accounting Standards Board to re-evaluate the issues raised in our original correspondence and consider the grave consequences facing the construction industry, as well as the entire nonpublic business population.

Thank you.

Sincerely.

Herbert W. Brownett President, CFMA

Habet V. Betts