

KPMG LLP

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Mr. Lawrence W. Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Proposed FASB Staff Positions re: FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

Dear Mr. Smith:

Our comments on the recent proposed FASB Staff Positions (FSPs) regarding FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* are discussed below.

Proposed FSP—Issuer’s Accounting for Freestanding Financial Instruments Composed of More Than One Option of Forward Contract Embodying Obligations under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

1. With regard to Question 1, we agree with the staff’s proposed response. We believe that paragraph 7 and footnote 1 to EITF Issue 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock*, is also relevant when analyzing the fact patterns provided in examples 1 and 2. As such, the staff should consider cross-referencing to that EITF Issue and footnote.
2. We also agree with the staff’s proposed response to Question 2. In practice, we have noted that companies appear to understand the basic premise of paragraph 12 of Statement 150, and Examples 3, 4, 5, and 6 provide illustrations of that basic premise. Although the basic premise of paragraph 12 may be understood, we believe the staff should provide further guidance with regard to the application of that basic premise. That is, the difficulties encountered in practice center around how to determine whether the monetary value of the obligation is based solely or predominately on one of the characteristics noted in paragraph 12. We believe the examples provided in Question 2 would better address the practical issue if they were expanded to illustrate how that determination is made so that the provisions of paragraph 12 are consistently applied by constituents and diversity in practice does not develop.

Proposed FSP—Accounting for Mandatorily Redeemable Shares Requiring Redemption by Payment of an Amount that Differs from the Book Value of Those Shares, under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

1. We understand that the proposed FSP is required in order to apply the measurement requirements of paragraph 22 of Statement 150 for companies that have outstanding shares, all of which are subject to mandatory redemption on the occurrence of events that are certain to occur. The proposed FSP appears to contradict the requirements in paragraphs 19 and 28 of Statement 150 in that if all of an entity's shares are considered mandatorily redeemable, the entity should not have equity. That is, the proposed FSP requires an entity to report the excess of the fair value of the shares over the book value within equity in the balance sheet and the excess of the book value of the shares over the fair value also within equity in the balance sheet. Although the actual shareholders suffer the loss and are entitled to the gains as the fair value of the shares changes as compared to the book value, the proposed FSP provides that such losses and gains are reported separately from those shares. The staff's proposed classification of "the excess of the fair value of the shares over the book value" or "the excess of the book value of the shares over the fair value" as equity also appears inconsistent with the definition of equity in Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*.

If the provisions of Statement 150 are not fully reconcilable to the Concepts Statements, the staff could consider an alternative approach. One such approach would be that if all or a significant majority of the outstanding shares of an entity are subject to mandatory redemption (e.g., at book value, fair value, stated amount, formula value, etc.) on the occurrence of events that are certain to occur, the entity should not be subject to the provisions of paragraphs 9 – 10 of Statement 150. In essence, this exception would preserve the basic accounting of the individual financial instrument (i.e., the shares) since the shareholders have the same risks and rewards and separating those risks and rewards in different parts of the balance sheet would confuse users. In addition, the amounts for such shares should be entitled "Shares subject to mandatory redemption" in the equity section and footnote disclosure should fully describe the redemption terms and conditions.

2. If the FSP is not revised, we believe the following footnote should be added at the end of the third sentence in the opening paragraph:

If the redemption price is the book value of the shares on the redemption date, Statement 150 requires the mandatorily redeemable shares to be reported as a liability at the book value of the shares. As a result, at the date of adoption of Statement 150, all amounts previously recognized in all equity accounts would be eliminated. After adoption of Statement 150, the entity would adjust the liability to the book value of the entity with an offset to income and, therefore, the entity would always report a net income (loss) amount of zero in the statement of income.

While the above footnote is not the subject of the FSP, we believe it will eliminate any misapplication of Statement 150 for private entities that have outstanding shares, all of which

are subject to mandatory redemption at book value on the occurrence of events that are certain to occur.

3. If the FSP is not revised, the title "equity" on the balance sheet would be better described as "Excess of redemption amount of shares subject to redemption classified as a liability over adjusted cost basis attributable to those shares" or a similar title. Likewise, if the situation in example 2 applies, the title "equity" on the balance sheet would be better described as "Excess of adjusted cost basis attributable to shares subject to redemption classified as a liability over redemption amount" or a similar title. Presenting such titles may assist users in better understanding an entity's financial statements. If such titles are not required, it is unclear how entities should refer to the excess in example 1 in the equity section of its balance sheet. In addition, if such titles are not required, it is unclear how entities would decide what portion of existing equity accounts in the balance sheet would be adjusted (additional-paid-in-capital, retained earnings, OCI for FAS 115 and FAS 133, etc.).

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If you have questions about our comments or wish further to discuss any of the matters addressed herein, please contact John Guinan at (212) 909-5449 or Patrick Garguilo at (212) 909-5947.

Very truly yours,

KPMG LLP