

LETTER OF COMMENT NO.

----Original Message----

From: joemath2@verizon.net [mailto:joemath2@verizon.net]

Sent: Wednesday, May 28, 2008 6:43 PM

To: Director - FASB Cc: Joemath2@verizon.net

Subject: Ref. 1550-100 on Financial Instruments et al.

To : Director@fasb.org

From : Dr. Joseph S. Maresca

Subject : Financial Instruments-Characteristics

of Equity

Ref. :1550-100

Background

The issuance seeks input on whether or not the "Basic Ownership Approach" provides an improvement over alternate approaches; such as, the REO. There are other issues. For instance, perpetual instruments are in the nature of equity. Liability instruments without a "settlement certain date" are discussed.

Dividend rights do not transfer with the stock after an ex dividend date so current ownership may be indeterminate. Par. 44 seeks to classify the instrument according to its substance.

Under the current system, derivatives are measured at fair value with any changes reported as net income. The basic ownership instrument is redeemable if:

- (a) the redemption is the same as the share of the issuer's net assets for which the holder is entitled in a liquidation on the classification date.
- (b) the terms of the instrument prohibit redemption if the redemption would impair claims of any instrument with greater priority than the basic instrument

These redemption options appear both necessary and fair in planned implementation.

Critique

Ref. 1-6

There should be a full presentation of the impact of the redemption on the primary and fully diluted earnings per share. Historically , the

⁽¹⁾ The dividend right does not transfer with the stock after the exdividend date. This is logical because the ownership may not be determinable.

⁽²⁾ How should an equity instrument with redemption requirements be treated for purposes of EPS (Earnings Per Share) ? Ref. 6,7

following disclosures are most pertinent, if dilutive in the primary and fully diluted earnings per share:

- o options and warrants
- o contingent issuance agreements

Anti-dilutive securities cannot be used to offset dilutive securities. An anti-dilutive security may create an increase in earnings per share or a decrease in net loss per common share.

Sometimes, the exercise price is higher than the market price with respect to options and warrants. In this case, the security is anti-dilutive.

Generally, the anti-dilutive securities are ignored in computing primary or fully diluted earnings per share.

The theoretic justification was that the applicable governing bodies sought to inform investors of possible dilution in the reported earnings per share. There was less concern about securities that, if converted, or exercised would increase earnings per share (thereby creating an anti-dilutive effect) .

Historically , contingent consideration presented special problems in determining the cost of an acquired company. This consideration consisted of cash, other assets, options, warrants or stocks issuable in the future. The issuance was conditioned by future events with indeterminate probabilities of occurrence (or indeterminate conditional probabilities of occurrence) or target earnings levels which may or may not be achievable or a designated future market price of the stock contingent upon market conditions non-existent currently. The current Statement treats these issues only tangentially. Ref. pp. 69

(3) Should the liability required to be settled with equity instruments be reported separately from those instruments settled with cash?

Yes. A separate disclosure will provide more precise information to the readers of the financial statements.

(4) Liabilities with equity instruments may impact leverage or capitalization ratios in instances where a company seeks to maintain low capitalization ratios. These phenomena may apply to specific financial institution monitoring by the FDIC or Quasi-Reorganizations in Bankruptcy. In reorganizations, the intent is to formulate a new mission or direction.

This goal cannot be achieved if the institution continues to engage in activity with higher risks as evidenced by an increased capitalization ratio.

Ref. pp. 11

(5) The ownership settlement approach separates convertible debt instruments and accretion of discount or amortization of premium on the debt component over the period until the probability weighted settlement date. Ref. pp. 13

The Statement provides an example of a probability weighted settlement date. The example is naive because probabilities can be conditioned upon a ranking of events in the future which may or may not occur. These conditional probabilities can generate "tree diagrams" in order to analyze the various conditions precedent which are mapped to likelihoods and payouts.

- (6) I agree that financial activities should be separated from business activities. Ref. pp. 14
- (7) The Basic Ownership Approach set forth on Ref. pp.15 gets more involved for liquidating claims in a Quasi-Reorganization.
- (8) The legal form of an interest on Ref. pp. 16 can get more complicated for franchisors/franchisees and certain affiliate partner relationships and transactions pertinent to these alternative organizational entities.
- (9) Embedded derivatives have characteristics of hybrid financial instruments. Ref. pp. 31 Hybrid financial instruments may have components which are part of the entity capitalization ratio or the fair determination of that ratio.
- (10) Non-recall perpetual basic ownership instruments remain outstanding in perpetuity. In liquidation, the holder gets a share after senior claims are disposed.

 Accounting for these types of instruments may get more complicated in a

Quasi-Reorganization.

Ref. pp. 37

(11) The most conservative form of settlement disclosure is the one with the least risky economic payoff for investors.

Therefore, the outcomes with the highest payouts may have the greatest potential for risk of loss to investors. The disclosure should alert investors to the differential level of risk-taking. Ref. pp. 42-46

(12) Instruments that dilute currently outstanding shareholders may be in the nature of liabilities.

If so, the capitalization ratio may be increased in response to added debt accumulation. Ref. 42-46

Dr. Joseph S. Maresca