

AMERICAN ACCOUNTING ASSOCIATION

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May 30, 2008

Via Email to director@fasb.org

Technical Director Financial Accounting Standards Board 401 Merritt 7 Norwalk, CT 06856-5116 * 1 5 5 0 - 1 0 0 *

LETTER OF COMMENT NO. 36

Response to: FASB's Preliminary Views on Financial Instruments with Characteristics of Equity (File Reference No. 1550-100)

The American Accounting Association's Financial Accounting Standards Committee is pleased to express its views in the accompanying document on the FASB's Preliminary Views on Financial Instruments with Characteristics of Equity (File Reference No. 1550-100).

Please contact Tom Stober (<u>stober.1@nd.edu</u> or 574-631-7614), principal author, or me (<u>bob.colson@gt.com</u> or 212-624-5300) for clarifications or discussion.

Sincerely,

Robert H. Colson

Robert H Colon

Chair, AAA Financial Accounting Standards Committee 2007 - 2008

This comment was developed by American Accounting Association's Financial Accounting Standards Committee and does not represent an official position of the American Accounting Association.

American Accounting Association's Financial Accounting Standards Committee May 30, 2008

Response to the FASB's Preliminary Views on Financial Instruments with Characteristics of Equity (File Reference No. 1550-100)

INTRODUCTION

The Financial Accounting Standards Committee of the American Accounting Association (the Committee) is charged with responding to requests for comments from standard-setters on issues related to financial reporting. The committee appreciates the opportunity to respond to the FASB's Preliminary Views on Financial Instruments with Characteristics of Equity (PV). This comment was developed by American Accounting Association's Financial Accounting Standards Committee and does not represent an official position of the American Accounting Association.

The AAA's Financial Accounting Standards Committee (FASC 1992; 1999; 2001) previously published three comment letters related to liability-and-equity classification issues. In addition, members of the organizing committee for the 2004 AAA/FASB conference published an award-winning commentary related to accounting for liabilities (Botosan et al. 2005). The Committee recommends that the FASB and staff consult FASC (1992), FASC (1999), FASC (2001), as well as Botosan et al. (2005) to help it evaluate the conceptual issues raised in its regarding the fundamental distinction between liabilities and equity. Further, the PV introduces concepts and definitions involving financial statement elements that more properly would be considered at the conceptual framework level.

PROCESS IN STANDARDS SETTING

The Committee acknowledges that issues related to distinguishing between liabilities and equity have been troublesome for the Board and consumed a considerable amount of the FASB's time and attention since the Board first added a financial instruments project to its agenda in 1986, as is evident from the history of the liabilities and equities project in Appendix E of the PV, which documents multiple attempts to resolve these issues at the conceptual level. Now the Board evidently is attempting to resolve the conceptual issues in the PV without adequate consideration of the consequences at the conceptual level. Fundamental changes to concepts and definitions have far reaching effects, possibly leading to radical departures from the application of present accounting standards.

For example, the following three questions raised in the Board's Preliminary Views (PV) document acknowledge that the Board has not fully considered the implications of its PV for EPS measurement.

The Board has not discussed the implications of the basic ownership approach for the EPS calculation in detail; however, it acknowledges that the approach will have a significant effect on the computation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider? (PV Page vi, Question 11 on the basic ownership approach)

The Board has not discussed the implications of the ownership-settlement approach for the EPS calculation in detail. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider? (PV Page vii, Question 6 on the ownership settlement approach)

The Board has not discussed the implications of the REO approach for the EPS calculation in detail; however, it acknowledges that the approach will have a significant effect on the calculation. How should equity instruments with redemption requirements be treated for EPS purposes? What EPS implications related to this approach, if any, should the Board be aware of or consider? (PV page vii, question 3 on the REO approach)

To help answer such questions, the Board and its staff could consult the monograph by Christensen and Feltham (2002) for their classic analysis of anticipated equity transactions (see section 9.4 of that monograph) or the recent white paper released by the Center for Excellence in Accounting and Security Analysis at Columbia University (Ohlson and Pemnan, 2005), which explores the implications of a restricted view of equity instruments for income determination.

This Committee has challenged in the past fundamental aspects of the FASB's conceptual framework, such as the asset and liability view and the lack of emphasis on the stewardship function of accounting. Nonetheless, if the Board expects its constituents to take seriously its representation that the conceptual framework guides its work, then issues involving definitions of fundamental financial statement elements should be exposed and debated as part of the conceptual framework project rather than in a PV on a proposed standard. In the case of this PV, the Board proposes changes to fundamental aspects of the reporting model that are contrary to long established views and practice. While the Board may desire changes to the basic definitions of financial statement elements that depart from those familiar to generations of users, such fundamental changes should take place at the level of the conceptual framework.

RELATION TO PRIOR ACCOUNTING LITERATURE

Also troubling is the FASB's invention of new accounting terminology and concepts in its

PV without careful reference to the extensive prior literature about liabilities and equities. In

addition to the four articles referenced in the introduction above, the extensive accounting

literature on the proprietary view of equity and alternatives to it, which dates back to such

classics as Paton (1922) and Sprague (1907), deserves more consideration when contemplating changes in the fundamental dividing line between liabilities and equity. In conjunction with this, the Committe encourages the Board and its staff to reevaluate how the proposed changes would impact the usefulness of general purpose financial statements for evaluating management stewardship.

RECOMMENDATION

The Committee respectfully requests that FASB take no further action regarding the proposed standard exposed in the Preliminary Views on Financial Instruments with Characteristics of Equity until the conceptual and definitional issues are resolved at the conceptual framework level.

American Accounting Association

Financial Accounting Standards Committee 2007 – 2008

Douglas C. Carmichael, Baruch College, CUNY (Unable to participate in the process for these comments)

Theodore E. Christensen, Brigham Young University

Robert H. Colson (Chair), Grant Thornton LLP

Karim Jamal, University of Alberta

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Ross L. Watts, Massachusetts Institute of Technology

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