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Mr. Lawrence W. Smith
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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 two recently 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 150-c—Effective Date and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities of FASB Statement No. 150, ***Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity***

With respect to the deferral provision in paragraphs 1, 2, 3, and 5 of the proposed FSP, we have the following comments:

1. Many implementation issues have arisen with respect to the application of the provisions of paragraph 9 of Statement 150. These application issues are not isolated to nonpublic entities as defined in Statement 150 or as defined in proposed FSP 150-c. As a result, we encourage the Board to consider a deferral of all the provisions in paragraphs 9 and 10 of Statement 150 for all entities.

2. Some entities have a limited-life, which may result by contract, by law, or by some other means. Examples of limited-life entities could include trusts that issue trust preferred securities, partnerships that issue partnership interests, and certain non-U.S. corporations that issue common stock. If the limited-life entity is consolidated by the parent company, Statement 150 requires, in many instances, the minority interests in that entity (that is, the noncontrolling interests) to be reported as a liability upon consolidation, because the limited-life entity must redeem its equity for cash or by distribution of its assets at the entity's termination.

The following issues are relevant when applying the provisions of paragraph 9 of Statement 150 to limited-life entities:

a. Should the consolidating entity apply the transition provisions of Statement 150 or should step-acquisition accounting be applied since Statement 150 implies that the consolidating entity is now the 100% owner of the consolidated entity as the noncontrolling interests are now considered a liability?
b. If step-acquisition accounting should be used, should that accounting be as of the date of adoption of Statement 150 or the actual date the entity was formed or purchased, whichever is later? Should push-down accounting be applied?
c. When applying the transition provisions of Statement 150 to limited-life entities that are consolidated, how should the last sentence of paragraph 30 and the guidance in footnote h to paragraph A30 of Statement 150 be applied in the consolidated financial statements?
d. If there were an equity transaction between the consolidated entity and one of its shareholders, how should that equity transaction be treated in consolidation? Should the provisions of SAB 51 be applied?
e. If there were an equity transaction between the consolidating entity and one or more of the consolidated entity's shareholders, how should that equity transaction be treated in consolidation? How should the transaction be reflected in the limited-life entity's financial statements?
f. If the documents creating the limited-life entity are changed such that the consolidating entity no longer is required to report the noncontrolling interests as a liability, how should the derecognition of the liability be treated in consolidation?

3. It is not clear if Statement 150 should be applied in the equity method of accounting when the investee is a limited-life entity, since paragraph 6 b. of APB 18, *The Equity Method of Accounting for Investments in Common Stock*, requires "adjustments similar to those made in preparing consolidated financial statements…."

4. It is not clear if the staff intended to supercede or amend EITF Issues No. 87-23, *Book Value Purchase Plans*, and No. 88-6, *Book Value Stock Plans in an Initial Public Offering,* upon the issuance of the FSP. The final FSP should clarify the status of these EITF Issues.

With respect to the guidance provided in paragraph 4 of the proposed FSP, we have the following comments:

1. Key to the application of any of the provisions in Statement 150 is deciding whether an instrument is a freestanding financial instrument. While we agree further guidance is necessary in order to apply the definition of a freestanding financial instrument as provided in Statement 150, we believe this FSP may not provide the operative guidance to facilitate a more uniform approach to the application of the standard. Instead, we believe the Board should provide comprehensive guidance in the form of a principle that can be applied consistently for all instruments and all entities.

2. Statement 150 defines a freestanding financial instrument as a financial instrument that is entered into separately and apart from any of the entity's other financial instruments or equity transactions, or that is entered into in conjunction with some other transaction and is legally detachable and separately exercisable. This definition is identical to the definition provided in EITF Issue 96-13, which was later codified in the same titled issue, EITF Issue 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.* The EITF attempted to provide broad guidance relating to a similar issue for when separate financial instruments should be combined and regarded as one instrument for accounting purposes in EITF Issue 02-2, *When Separate Contracts That Meet the Definition of Financial Instruments Should Be Combined for Accounting Purposes*; however, the EITF terminated its discussions on the broad guidance as a result of current Board projects that may address the issue in the future. As a result, while the use of the terminology is familiar, determining when an instrument is freestanding and when an instrument is part of an overall arrangement continues to result in significant diversity in practice.

3. Solely for purposes of applying the provisions of Statement 150, we understand that most believe a freestanding financial instrument is either (a) a financial instrument that is entered into separately and apart from any of the entity's other financial instruments or equity transactions *or* (b) a financial instrument that is entered into in conjunction with some other transaction and is legally detachable and separately exercisable. The sole determination of a financial instrument that meets (a) above is whether the financial instrument was "papered" separately (i.e., its rights are conveyed in a separate document). That is, if an entity enters into two or more separate contracts, regardless of whether each contract is entered into with the same counterparty, in contemplation of one another and are not separately exercisable from

one another, each separate contract is considered freestanding to determine whether that contract is within the scope of Statement 150. Most believe this is the only resulting interpretive response given the examples provided in paragraphs A26 and A27 of Appendix A to the Statement, as well as paragraphs B50 – B54 of Appendix B to the Statement. When determining whether a financial instrument meets (b) above, an entity must review each contract to determine if any features within that contract can both be detached from the contract and then separately exercised such that the original contract continues to exist for accounting purposes (except for the detached feature) when the detached feature is exercised.

4. With respect to the proposed guidance, it appears the staff is changing the definition of a freestanding financial instrument by indicating that even though the shares and the redemption agreement are two different documents, they are considered one instrument because the redemption agreement is not separately excercisable without the shares. While we believe this is a logical and acceptable conclusion on the surface, as specified in item 3 above, we believe it is inconsistent with the other provisions of Statement 150. The proposed guidance indicates that the redemption agreement relates to specific underlying shares. We question how those shares should or must be specified when applying the proposed guidance. That is, would that guidance be applicable in the following situations:

   a. ABC has 100 shares of stock outstanding that is owned 30% by D, 30% by E and 40% by F. If ABC and D have a separate agreement that allows D to redeem 30 shares (but E and F do not have that agreement) at a fixed price, is that separate agreement freestanding or embedded within D's shares?
   b. Would the answer above change if D was or was not permitted to buy shares from E and F?
   c. Would the answer above change if D owned 30 shares but the separate agreement specified 10 shares?
   d. Would the answer above change if ABC was a public entity and was owned by 100 different shareholders and D was one of those shareholders?

Proposed FSP 150-d—Issuers' Accounting for Employee Stock Ownership Plans under FASB Statement No. 150, ***Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity***

1. We agree with the proposed guidance. Under the transition provisions of SOP 93-6, *Employers' Accounting for Employee Stock Ownership Plans*, employers were permitted to continue their accounting practices for ESOP shares purchased before December 31, 1992 and were required to adopt the provisions of SOP 93-6 for ESOP shares purchased after that date. We note that the accounting guidance in SOP 93-6 is more comprehensive than the accounting guidance that existed prior to the SOP. As a result, we believe the staff should clarify whether ESOP shares that are accounted for under pre SOP 93-6 guidance are also excluded from the scope of Statement 150.

2. The proposed FSP states, "By law, some employers with ESOP's must provide the employee with a put option or other redemption feature if the shares are not readily tradable…" We have been informed that due to recent market events, the Department of Labor (DOL) has been requiring some ESOP plans of public entities to amend the plan to allow the ESOP to put the publicly traded shares back to the entity. We believe such a requirement by the DOL would be accounted for pursuant to paragraphs 23 and 43 of SOP 93-6 and, accordingly, the put option is not within the scope of Statement 150. The staff should expand the discussion in the first paragraph of the proposed FSP to address put options or other redemption features if the ESOP shares are readily tradable.

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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