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October 6, 2003

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

Dear Chairman Herz:

Martin, Hood, Friese & Associates, LLC strongly supports FASB's willingness to consider making Statement of Financial Accounting Standards No. 150 (FAS 150), *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, nonapplicable to privately held companies. We strongly urge the Board to take a stand in that direction.

FAS 150, as it now stands, will have a substantive negative effect on the equity of businesses, especially contractors, with a corresponding and potentially devastating negative effect on the economy as a whole.

In particular, it will have a substantial and severe negative impact on privately held construction companies (which make up a substantial portion of our current client base) in the areas of bonding, debt covenants, and the ability to use "push-down" accounting. It will also create significant book/tax differences and cause privately held construction companies to reassess their continuity planning.

#### **The Effect on Privately Held Construction Companies**

In general, the construction industry is largely comprised of privately held companies. However, and especially in the commercial construction sector, our clients are able to effectively compete with publicly held companies, even though they do not have the liquidity of their public counterparts. This is due, in part, to the widespread use of buy-sell agreements to establish a "market" for company shares. Without such a market, most people, including employees, would not buy shares in a company. The same is not true for publicly traded companies.

Under FAS 150, current financial instruments classified as equity (such as "mandatorily redeemable shares") will now be required to be classified as a liability. For the many privately held construction companies that utilize simple buy-sell agreements for share redemption, (whether or not these agreements are funded by life insurance policies or by equity "buy back" that can be paid over time), this new requirement will have disastrous and far-reaching consequences.

### **Surety & Lending Requirements**

For example, many sureties and financial institutions require contractors to have business continuity plans before they will underwrite credit. Buy-sell agreements such as first right of refusal, buy-back options, and mandatory redemption are all typical devices used by contractors for such business continuity planning.

These arrangements represent prudent financial conduct since they provide a meaningful market for securities in the event of a shareholder's death, disability, retirement, etc. For contractors, such arrangements mean that "business as usual" will continue and long-term contracts will be completed without additional or unknown financial risk to the surety or financial institution issuing credit.

Currently, the vast majority of our privately held construction clients are subject to loan covenants, surety bonding issues, and/or federal, state, and various authority licensing or pre-qualification requirements. Many of these containing financial covenants requiring certain ratios, loan, or surety criteria based on, specified minimal equity requirements. For privately held construction companies, FAS 150 will place all of these in jeopardy.

### **The Unintended Consequences of FAS 150**

The end result of FAS 150 in reducing our clients' equity will be to place loan agreements and surety bonds in default of these requirements, without any change in economic substance. If privately held contractors are considered in default of their loan(s) and/or surety bond(s) based on FAS 150, many of these companies will go out of business. The costs to our nation's already struggling economy will be large, and the effects swift and irreparable.

In addition, applying FAS 150 to privately held companies would provide an unfair advantage to publicly held companies. Many privately held contractors hold real estate and equipment showing fair market values greater than their historic cost basis. Consequently, the recognition and measurement of the liability of the potential buyback of equity under FAS 150 will, in many cases, produce a liability equal to or greater than 100% of their prior equity position.

The extreme effect this will have on the balance sheets and income statements of these construction companies will be to "uneven" the playing field by providing a decidedly unfair competitive advantage to publicly held companies.

### **Other Problematic Provisions for Privately Held Construction Companies**

**Interest Classification:** FAS 150 proposes to record future changes in the valuation of a liability as a charge or credit to earnings classified as "interest." This can produce large charges and credits from year to year in privately held companies where 100% of the shares are subject to the agreement without providing a better understanding of these companies' financial statements.

**Valuation Costs:** Many privately held construction companies have buy/sell agreements that use formulas and appraisals to determine the value of redeemable shares rather than setting a specific value on a routine basis. The company only incurs the cost of appraisals and other valuations in the event of redemption. FAS 150 requires the liability to be determined annually. This produces an undue hardship on privately held construction companies, requiring them to incur valuation expenses annually to determine the liability required to be revalued on an annual basis under FAS 150.

### Conclusion

Martin, Hood, Friese & Associates, LLC firmly believes that FAS 150 will have a disastrous effect on the construction industry if applied to privately held companies. For that reason, and because of all the consequences outlined in this letter, we strongly and respectfully urge the Board to exempt privately held companies from the requirements of this Statement.

If, however, its application must be made to nonpublic companies, please limit such application to disclosure issues only. We do not object to disclosing the existence of mandatory and other buy-sell redemption agreements and would support the setting of minimum disclosure requirements.

We would further suggest that the ruling not make it a requirement to disclose what the effect of FASB 150 would have been had it been employed, as this could also have long-ranging and detrimental effects in and of itself.

Thank you for this opportunity to provide you with our opinion in this matter.

Sincerely,

Martin, Hood, Friese & Associates, LLC



Denise V. Martin, CPA  
Member



David W. Hood, CPA  
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Mitch Schluter, CPA  
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