Letter of Comment No: 14
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August 22, 2003

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

RE: FASB Statement No. 150 "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity"

Dear Chairman Herz:

The National Rural Utilities Cooperative Finance Corporation (CFC) is a $20 billion cooperative founded to provide a source of private financing to about 930 electric cooperatives in 47 states. With $14.3 billion in loans outstanding to rural electrics, CFC is second only to the Federal government - Rural Utilities Service (RUS) - in total financing commitments to the industry.

We appreciate the opportunity to submit written comments on FASB Statement No. 150. As a major lender to the industry, CFC is concerned that this proposed change would significantly impact the accounting policies of its membership. CFC's primary concerns in the Statement are requirements concerning reclassification of mandatory redemptions of equity capital to decedent estates as a liability.

FASB Statement No. 150 would result in significant balance sheet distortion, and would, from a lender's perspective, provide little benefit to those who rely on the financial reports of the cooperatives to assess credit risk. Furthermore, the financial statement users in the industry have long understood the components and implications of equity as currently defined. This change will create unnecessary confusion, and does not meet FASB's long held standard that statement users should be able to easily understand financial information.

Significant portions of the statement which impact the cooperatives are:

- **Rural electric systems are subject to RUS and/or CFC loan documents which give the lender a significant amount of control over the retirement of patronage capital if certain financial performance requirements are not met.** – Changing the components of equity would immediately cause most electric cooperatives to have insufficient equity, as defined in loan documents, to retire patronage to their members without RUS and/or CFC consent.

- **Many financial documents on public market debt within the industry are based upon equity requirements as currently defined** – Implementation of this provision would require significant modification to existing documents, including CFC's indenture and those of individual cooperatives that issue public debt.

- **"Investors and creditors" of electric cooperatives, as defined on page 6 of FASB 150 do not apply to most electric cooperatives.** Because of their cooperative status, the only "investors" in the rural electrics are the members themselves, and "creditors" are generally limited to a few major lenders (CFC and RUS) and vendors who are accustomed to dealing with the rural electrics. Exceptions to this include a few cooperatives that issue bonds, and this rule change impairs the comparability of these cooperatives with investor-owned utilities.

- **Retained earnings from operations, allocated as patronage capital, are the only significant source of equity from an electric cooperative.** The only significant difference in these retained earnings and those from an investor-owned utility are that cooperatives immediately allocate the earnings to the individual members' patronage accounts.

- **<u>Distributions of patronage capital from a rural electric cooperative has always been subject to the approval of the local Board of Directors and the cooperative's financial position.</u>** The most likely reaction from the electric cooperatives to this statement would be to immediately cease the early settlement of decedent estates.

CFC respectfully recommends that the FASB consider the recommendations outlined by the National Rural Electric Cooperative Association (NRECA) in its recent response to the proposed rule change. Should you have question regarding this memorandum, please contact CFC staff Lynn Midgette (703-709-6726) or Martin Crowson (703-709-6721).

Sincerely yours,

Lynn Midgette
Vice President, Portfolio Management