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June 25, 2008

Mr. Russell G. Golden
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116



LETTER OF COMMENT NO.

65

File Reference No. 1550-100 Preliminary Views:

Re: Financial Instruments with Characteristics of Equity

Dear Mr. Golden:

Goldman Sachs appreciates the opportunity to comment on the FASB's preliminary views on distinguishing between equity and liabilities (PV). As a member firm, we have participated and agree with the comments set forth in the letter submitted by ISDA dated May 30, 2008. Due to the importance of the issue, we also wanted to provide our thoughts on this issue.

We recognize the importance and complexity of this issue and hence the need for it to be addressed. We support the Board's intention to converge with IFRS on this highly complex issue. However, we disagree with the FASB's preliminary view that the Basic Ownership Approach is the best choice among the three alternatives for classifying financial instruments in equity.

We question the need for a fundamental change in the principles and definitions of the basic building blocks of financial statements that any of the three of the proposed models would require. Any such fundamental revision to the elements of the balance sheet should be not be taken lightly, and would be better placed within the conceptual framework project than a standards level project. Improving the existing guidance found in IFRS and US GAAP may be a more expeditious and less conceptually challenging approach to the next step of this project.

FASB's stated reason for choosing the Basic Ownership Approach as the preferred approach is to reduce the complexity of financial reporting. While it is clear that the Basic Ownership Approach simplifies the classification of instruments between equity and non-

equity, it also introduces other elements of complexity to the financial statements. Hence the model replaces one aspect of complexity with another. If reduction of complexity is the only justification for the preference, it would appear not to meet that goal.

Fundamental shift in concept

Part of the core definition of equity under the Basic Ownership approach is dependent on the ranking of instruments upon liquidation. We question whether liquidation should be the basis for defining equity given that the going concern premise is fundamental to financial reporting. For example:

An investment grade enterprise issues two classes of stock: Class A and Class B. Each class of stock is perpetual and ranks equally as to any discretionary dividend payments. A repayment obligation cannot be triggered other than as a result of liquidation. However, in liquidation, Class A ranks ahead of Class B. Applying the Basic Ownership Approach, only one of these instruments would be classified as equity. If a going concern assumption underlies the financial statements, we believe a user would consider both Class A and Class B to be economically equivalent instruments and would expect similar financial statement classification with appropriate disclosure.

In addition to undermining the going concern premise, we also believe the model challenges the basic balance sheet equation that assets minus liabilities equals equity. Any such equation requires at least one dependent variable, and historically that dependent variable is equity. In other words, equity has always been the residual bucket for instruments that are neither assets nor liabilities.

All three of the proposed models attempt to define equity, which therefore means all three elements of the balance sheet are defined; assets, liabilities and equity. In such a model there likely will be situations where instruments will either meet none of the definitions, or will meet more than one. Most often the tension will arise between the liability and equity definition, with instruments either meeting the proposed definition of both a liability and an equity instrument (for instance puttable partnership interests) or meeting neither definition (for instance perpetual preferred shares).

The basic ownership model chooses to have one dependent variable on the balance sheet, that is, a liability. In practical terms, this means all perpetual instruments that do not meet the definition of a basic ownership instrument are classified as a liability, despite containing no obligation. Conceptually this is an enormous shift in both the preparation and understanding of financial statements, and we do not feel it has been thoroughly considered, both in implications for preparers, or for the understandability of the financial statements for users.

As mentioned above, the approaches proposed in the PV attempt to define equity. Doing so fundamentally changes the basic equilibrium of the balance sheet. It also allows a standards level project to define an element of the balance sheet. The PV proposes that priority on liquidation, along with participation in the performance of the entity, are the defining characteristics of equity. The PV does not justify or explain why these two criteria define equity which is key to fully understanding the models and applying them in practice.

Complexity created by the model

We believe the Basic Ownership Approach will not necessarily reduce the complexity of financial reporting as suggested by the PV document. Rather, it will exchange one form of complexity for another.

The definition of equity proposed under the Basic Ownership Approach excludes many instruments that are generally understood by users to be equity (e.g., financial instruments that lack settlement terms or have economically equivalent pay-off structures to a Basic Ownership Instrument). Excluding these instruments from equity will generally put them into the liability section of the balance sheet, expanding the potential population of that section substantially. Equally, in many situations instruments classified as liabilities under this model will not meet the conceptual framework definition of a liability. We believe complexities in reporting will arise as a result of the diversity of instruments that will be classified as liabilities. The liability category will include a diverse set of instruments ranging from simple senior debt with stated cash settlement terms, to subordinated perpetual instruments with discretionary coupons, to share-settled options indexed to an issuer's own stock. Other standards will need to address classification and reporting within the liability section of the balance sheet to address users' needs. Hence the classification decision is simply moved both to a different area of the balance sheet and a different accounting standard.

We also believe users will require expanded disclosures to understand the practical impact of the Basic Ownership Approach on the liquidity of the issuer, and on the dilution of equity holders. For example, certain financial instruments, such as physically settled options, will be classified as liabilities that have no impact on the liquidity of the issuer, but are dilutive to the residual shareholders. Furthermore, instruments with no settlement requirements, such as perpetual preferred shares, will be classified as liabilities but will not affect liquidity if the user assumes the issuer is a "going concern."

Additional disclosure and presentation requirements will have to be developed for the income statement. The expanded liability classification will likely contravene the long-standing principle that capital transactions should not be included in the determination of net income.

Finally, the expanded population of instruments classified as liabilities will lead to measurement complexities for many corporate issuers. It is likely that most of this new breed of liabilities and assets would be subsequently measured at fair value. The nature of these instruments will make fair value measurement innately complex, hence replacing a classification complexity with a measurement complexity.

Way forward

Of the three models proposed by the FASB, we believe that the Ownership-Settlement Approach is the most representationally faithful of the economic substance of equity instruments. We also would note that the Ownership-Settlement Approach, while not similar in concept or principle, is similar in results to the current models under US GAAP and IAS 32. Therefore, from a process and efficiency standpoint we would urge both the IASB and the FASB to consider working on improvements to the existing guidance rather than embarking on a completely new model that may produce broadly similar results. The

existing guidance has been “field-tested” by constituents and the weaknesses and areas requiring attention are well known.

At a high-level, we believe the following improvements to the Ownership-Settlement Approach would increase its usefulness:

- We do not believe that an instrument that contains a cash settlement option which is completely at the discretion of the issuer should preclude equity classification. Although we would generally disagree with the premise that the form of settlement should dictate the accounting classification for economically identical contracts, we agree asset / liability classification may be appropriate for contracts that the issuer can be forced to cash settle (transfer assets). However, the economic difference between a contract which must be settled in equity versus an identical contract which can be settled in equity or cash completely at the discretion of the issuer is negligible and we disagree with an accounting model which would provide for different treatment based solely on the inclusion of this feature.
- Economic Compulsion was effectively dealt with in the Basic Ownership Approach by classifying perpetual instruments that do not meet the definition of a basic ownership instrument as liability. Ownership-Settlement does not solve this issue, as perpetual instruments are classified as equity. Many constituents believe that the substantive terms principle will address this issue but it is not explicit or clear that that would be the case and this is a significant existing practice issue that requires attention. We would suggest clarification as to the application of the substantive terms principle to economic compulsion issues.

Please contact me if we can be of further assistance or if you have questions about our comments.

Sincerely

A handwritten signature in black ink that reads "Matthew L. Schroeder". The signature is written in a cursive style with a large, stylized 'M' and 'S'.

Matthew L. Schroeder