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Proposed FASB Staff Positions (Nos. FAS 150-c and FAS 150-d) on Certain Issues Related to FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

We appreciate the opportunity to comment on these proposed FASB Staff Positions (FSPs). We believe that the guidance in Proposed FSP No. FAS 150-d regarding the scope exclusion for Employee Stock Ownership Plans will assist preparers and auditors in applying the requirements of Statement 150 and in enhancing consistency in its application. We also are supportive of the proposal (FSP No. 150-c) to defer the application of Statement 150 to mandatorily redeemable shares of nonpublic companies, **although we believe that the deferral should be expanded to mandatorily redeemable interests of all companies** as described further below. We continue to be deeply troubled by the potential implications of Statement 150 on noncontrolling interests in consolidated limited-life subsidiaries, and believe the deferral of Statement 150 for all mandatorily redeemable interests would allow sufficient time to address the implementation issues associated with those interests. Our concerns are discussed further below.

Application to Limited-Life Subsidiaries

As discussed in our previous comment letter dated October 1, 2003, we are very concerned about the effect of Statement 150 on noncontrolling interests of limited-life subsidiaries. Statement 150 requires such interests to be accounted for as liabilities measured at settlement value. As discussed in our previous comment letter, we believe that, because most of the assets and liabilities of the limited-life subsidiaries are carried at historical cost, the resulting liability measurement and characterization of changes in the liability as "interest cost" are tremendously misleading to users of financial statements. We have heard anecdotal comments from analysts in the real estate industry that confirm this view.

We also believe that there are many complex accounting issues associated with the accounting required by Statement 150 for these noncontrolling interests in limited-life subsidiaries. For example, upon adoption of Statement 150, the initial reclassification of the minority interest to a liability is not accounted for as the purchase of a minority interest, even though the minority interest is not accounted for as an ownership interest in the subsidiary going forward. As a result, the pro-rata net assets underlying that interest would not be subject to purchase accounting

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as currently required by FASB Statement No. 141, *Business Combinations*, even if the minority interest liability eventually is acquired by the parent company.

Questions about the appropriate application of consolidation accounting also arise because of the classification of these subsidiary interests as liabilities. For example, many companies intend to amend their partnership agreements to remove the stated liquidation dates (effectively changing the partnerships to perpetual life entities), which are largely viewed as a nonsubstantive features by the majority owners and minority owners alike. The accounting for this event in the fourth quarter presumably would result in the reclassification of the liability back to minority interest (currently classified in practice between liabilities and equity). However, because the minority interest liability was being recognized at settlement value without a corresponding adjustment of the underlying net assets, it is not clear how the consolidation literature should be applied going forward (e.g., whether earnings allocated to the minority interest should be adjusted to reflect the new carrying amount of the minority interest). It is also unclear whether the satisfaction of the liability by issuing "new" noncontrolling interests would result in a gain or loss on the transaction (e.g., by analogy to APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, or SEC Staff Accounting Bulletin 51, *Accounting for Sales of Stock by a Subsidiary*).

We believe that it is highly unlikely that the FASB understood the broad scope of and numerous implementation issues resulting from the conclusion that noncontrolling interests in limited-life subsidiaries are liabilities that must be measured at settlement value. If the FASB did in fact understand these implications, we would have expected that the FASB would have made the implications clearer in the standard and would have provided more time for transition. Statement 150 applied immediately to new financial instruments (presumably including new noncontrolling interests in limited-life subsidiaries) issued after May 31, 2003 (Statement 150 was issued on May 15, 2003), and to all other interests in limited-life subsidiaries in the first fiscal period after June 15, 2003 (July 1, 2003 for calendar-quarter companies). We believe that this transition period is insufficient for the work that must be completed to implement the standard. For example, companies will have to determine the fair value of the assets (perhaps requiring the engagement of valuation specialists), calculate the settlement value of the liabilities (some of which may include complex prepayment provisions), and perform complex waterfall calculations (that likely differ for each subsidiary) for each limited-life subsidiary (which may number in the hundreds). Additionally, appropriate processes and internal controls must be developed to ensure that the estimates are appropriately developed and incorporated into the company's financial systems and, ultimately, the financial statements that must be certified by the company's executives. Auditors must review all the estimates and assumptions used in this effort in connection with their quarterly reviews. Finally, financial statement users must be educated about the effects of this new and significantly different financial reporting principle. We believe that the remarkably brief 45-day transition period is without precedent and, for companies with limited-life subsidiaries, will require an extraordinary effort to implement the

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standard. We also believe that this brief transition period will create an extremely high risk of restatement for companies that are making a good faith effort to comply with the standard. This would be an unfortunate result in the current environment in which the credibility of reported results is subject to extraordinary scrutiny.

For the reasons described in our October 1, 2003 letter, as well as those described above, we urge the FASB to reconsider its decision regarding the deferral of the application of the standard to mandatorily redeemable interests of public companies. Further, a deferral also would allow time for preparers, auditors, the FASB staff, and the FASB to resolve the numerous complex implementation issues associated with the application of Statement 150 to noncontrolling interests in limited-life subsidiaries. Accordingly, we believe a deferral of the requirements of Statement 150 as they apply to all mandatorily redeemable interests, not just those of nonpublic companies, should be implemented by the FASB as soon as possible as described in this proposed FSP.

As a reminder, companies are currently struggling to comply with the provisions of Statement 150 for the quarter ended September 30, 2003. The earnings release season for this quarter is already upon us, and Forms 10-Q must be filed with the SEC by November 14, 2003. As a result, quick action by the FASB is critical to avoid potential disruptions to capital markets.

Transition for Nonpublic Companies

In the unfortunate event that the FASB chooses not to defer the application of Statement 150 to all mandatorily redeemable financial instruments until fiscal periods beginning after December 15, 2004, we believe that the transition in the proposed FSP still should be changed. The current transition requirements of Statement 150 are complex in that they provide three different transition dates depending on (a) for mandatorily redeemable shares, whether a company is public or nonpublic and, for public companies, whether the instruments were issued before or after May 31, 2003, and (b) for other instruments, whether the financial instruments are issued before or after May 31, 2003. The proposed FSP will further complicate that transition. Proposed FSP 150-c not only provides an additional transition date, but also provides a definition of an "SEC Registrant" that differs from the definition of "nonpublic" that currently is used in Statement 150. As a result, there will be four different transition dates for the application of the guidance in Statement 150:

1. May 31, 2003, for financial instruments issued after that date by companies that are "public," which are defined as those companies that (a) have publicly traded equity, (b) are subsidiaries of companies with publicly traded equity, or (c) make a filing with a regulatory agency in preparation for the sale of any class of equity securities in a public market.

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2. Financial statements for periods beginning after June 15, 2003, for (a) financial instruments issued on or before May 31, 2003 by companies described in (1) above and (b) financial instruments (other than mandatorily redeemable shares) issued on or before May 31, 2003 by entities that are “nonpublic.”
3. Financial statements for periods beginning after December 15, 2004, for mandatorily redeemable shares of nonpublic companies that are not SEC registrants.
4. Financial statements for periods beginning after December 15, 2003, for mandatorily redeemable shares of nonpublic companies that are SEC registrants (e.g., a company that has no class of equity shares that trade in a public market but has debt that is registered with the SEC).

The FASB is sometimes criticized for the complexity of their standards. While much of the discussion around this issue focuses on whether the standard is appropriately grounded in “principles” or “objectives,” the transition for Statement 150 is an illustration of the complexity that can arise in a standard for no compelling reason. While we strongly support the deferral of the application of the guidance regarding mandatorily redeemable shares for nonpublic companies, we encourage the FASB to reconsider whether the transition can be simplified by applying the same deferred transition guidance to SEC registrants that meet the “nonpublic” criteria in Statement 150 as to other nonpublic companies. We also strongly encourage the FASB to avoid unnecessarily complex transition provisions in future standards.

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

