

# ISDA

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April 30, 2001

Mr. Timothy Lucas  
Director of Research and Technical Activities  
Financial Accounting Standards Board  
401 Merritt 7  
Norwalk, Connecticut 06856

Re: File Reference No. 213-B and 213-C

Dear Mr. Lucas:

The International Swaps and Derivatives Association (ISDA) would like to take this opportunity to express its views on the Financial Accounting Standards Board's Proposed Statement of Financial Accounting Standards, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity or Both* and the *Proposed Amendment to FASB Concept Statement No. 6 to Revise the Definition of Liabilities* (collectively the "Exposure Drafts" or "EDs"). ISDA is the global financial trade association representing leading participants in the privately negotiated derivatives industry. ISDA's 525 member institutions include commercial, merchant and investment banks, corporations, government entities, and other institutions engaged in the swaps and derivatives business as dealers, end-users, or service providers. A list of ISDA's members is attached in Appendix II.

## ***General Comments***

The current Exposure Drafts proposed by the Board will introduce significant changes to the accounting for many common, well-understood financial instruments. ISDA is unaware of problems with the existing base of literature that justify such changes. In fact, the Board, through the Emerging Issues Task Force (EITF), recently added guidance to the base of literature for equity derivative products to address certain practice issues that existed. These new EITF Issues, coupled with the prior existing guidance, provide a solid body of literature that is working well in practice.

We are concerned that there is not a sound conceptual basis for certain of the conclusions reached in the EDs. For example, we do not believe minority interest meets the definition of equity. Similarly, certain instruments will be classified as liabilities because of the way the contracts change in value (i.e., opposite to a company's share price), even though such instruments may only be settled by share issuance. These instruments allow for permanent equity to be created and are best classified as such.

The amount of change to the accounting model that has taken place in the past five years has been enormous. Such change has put a strain on the resources of both the financial statement preparer community as well as those of the financial statement users who are still trying to digest the significance of the new guidance so far and adjust their analytics accordingly. We strongly believe that further change should only be made in response to a real need for accounting guidance. We do not believe the case has been persuasively made that such a need exists in the case of accounting for liabilities and equity.

As a result of these concerns, ISDA cannot support the current EDs. We do not believe these changes represent an improvement in financial statement reporting. In fact, some of the proposed changes will render the financial statements *less* useful. We believe that the Board would better serve the financial statement user community by focusing their efforts on more pressing issues, such as completing the Business Combinations project and resolving issues that have developed with SFAS 133 and SFAS 140.

If the Board decides to continue with the issuance of a final standard, we strongly urge the Board to use the guidance developed in EITF Issues 96-13, 00-7 and 00-19 to form the basis of the accounting model for liabilities and equity. Specifically we recommend the following changes to the EDs.

1. The definition of liabilities and equity in FASB Concept Statement 6 and EITF Issues 96-13, 00-7 and 00-19 work well and should not be changed.
2. Minority interest should not be reclassified to the equity section of the balance sheet.
3. Financial instruments that contain components of both liabilities and equity should not be bifurcated.

Our detailed comments relating to these concerns are described below. Our response to specific issues raised in the EDs are in Appendix I.

**1. The definition of liabilities and equity in FASB Concept Statement 6 and EITF Issues 96-13, 00-7 and 00-19 works well and should not be changed**

We feel that the current definition of liabilities is adequate, as is the definition of equity as the "residual interest". We disagree with the proposed definition of an ownership relationship noted in paragraph 3.a. in the Amendment to Concept Statement 6. Specifically point (2):

“...A financial instrument component establishes an ownership relationship if it (1) is an outstanding equity share that is not subject to mandatory redemption provisions or (2) is an obligation that can or must be settled by issuance of the issuer’s equity shares and, to the extent the value that must be conveyed to the holder of the financial instrument upon settlement of the obligation at its maturity changes, the change is attributable to, equal to, and in the same direction as the change in fair value of the issuer’s equity shares.”

There are several factors which make equity instruments different from liabilities, one of which is the permanence of capital. Liabilities are repaid, equity is not. From both the issuers’ and creditors’ perspective this is more important than the economic “relationship” that the holder has to the issuer. If an obligation can be satisfied with the deliverance of an equity instrument in lieu of an asset, then the issuer has the ability to permanently keep the proceeds or assets it received in exchange for the instrument, which should therefore be classified as an equity instrument. Consequently, if the issuer of a financial instrument is required to settle the instrument by the delivery of cash and or other asset, then the capital raised is not permanent and should be classified as a liability or temporary equity (if the instrument does not provide creditor rights in bankruptcy).

This concept was developed in EITF Issue 96-13 and was reiterated in EITF Issues 00-7 and 00-19. In these pronouncements, equity treatment was allowed, provided the issuer had the ability to keep the proceeds without an obligation to repay with the delivery of an asset (net share settlement). The EITF focused on many issues, including the ability of the holder to settle the instrument in the event of bankruptcy. The EITF took a creditor's approach in that if the holder of the financial instrument was treated in bankruptcy in a manner similar to the common shareholders (residual interest), then the instrument could be classified as an equity instrument. This approach would also result in debt that is issued where the issuer has the right to settle in shares equal to the maturity value of debt would be treated as a liability since the holder of the debt has creditor rights during the life of the instrument.

As a result, we recommend the Board not issue new guidance on differentiating between liabilities or equity and instead leave in place EITF Issue 00-19 as the guidance for making such determinations. This “00-19” model identifies the criteria necessary to determine whether an issuer has the ability to keep the proceeds of issuance of “permanent” capital, regardless of ownership relationship. The holders of such instruments would be treated similar to common shareholders in bankruptcy and thus have no creditor rights. We support the conceptual basis of this guidance and believe it is superior to the guidance proposed in the EDs.

## **2. Minority Interest should not be reclassified to the equity section of the balance sheet**

We believe that the current reporting for minority interest between the liability and equity sections of the balance sheet is appropriate and do not see any benefit from the reclassification to a “noncontrolling equity interest.” Rather, we believe there is the potential for misleading users of financial statements due to the reclassification.

Minority interest is unique in that it does not fit the definition of either a liability or equity. Depending on the facts and circumstances, minority interest can economically behave like either a liability or an equity instrument. In bankruptcy, certain minority interests (especially in regulated subsidiaries) may have rights -- from a parent company perspective -- that are more consistent with those of creditors than of equityholders.

We also do not agree that minority interest meets the proposed definition of equity in the ED for Concepts Statement 6. Minority interest does not represent an obligation that can be settled by the conveyance of an asset, nor is it an equity instrument that is a residual of the parent entity. Financial statement users and analysts are accustomed to the current balance sheet classification of minority interest. Its placement between liabilities and equity is appropriate given the complex nature of the instrument. We do not believe that reporting will be improved by reclassifying minority interest to equity. Furthermore, the changes could impact company's debt-to-equity ratios, thereby creating the need to explain such changes to users of financial information. Given these complexities and the lack of practice problems in current reporting, we suggest that the Board leave the accounting for minority interest where it is today, between the liability and equity sections of the balance sheet.

### **3. Financial instruments that contain components of both liabilities and equity should not be bifurcated.**

We strongly disagree with the Board's proposal to bifurcate financial instruments that include both liability and equity components. Under the proposed rules, many commonly understood compound financial instruments, such as convertible debt, will be split into two instruments (or maybe three) and buried in both the liability and equity sections of the balance sheet. We are not convinced this improves the usefulness of financial information.

Bifurcation of compound financial instruments is a complicated task, as noted by the implementation problems encountered with SFAS 133. The difficulty of the task of determining the components of these instruments and valuing them cannot be understated since such components do not typically trade separately in the marketplace and many instruments contain more than two components. We recognize that this approach has been adopted by the IASC, but do not consider their acceptance of bifurcation to be an obligation for adoption by US standard setters.

Furthermore, the issuers of these securities will be required to report a significant increase in debt costs if the securities are not converted due to the accretion of the debt discount created from bifurcating the conversion option. This distortion is further magnified by the fact that there will not be a corresponding increase in income for the premium of the conversion option if it is classified as an equity instrument. This presentation does not indicate the true cost of these funds in the income statement. The EPS computation explains the potential dilution.

ISDA believes SFAS 133 and the related DIG guidance provide a sufficient accounting model for bifurcation of compound instruments and further requirements for bifurcation are not needed. Through the DIG, FASB is currently in the process of defining more clearly when a debt host exists and when an equity host is present (Open DIG issue 15-5, *When should an Embedded*

*Derivative in a Preferred stock Hybrid Instrument Be Split out and Accounted for Separately?*). For investors, this guidance will help clarify when bifurcation of a not-clearly and closely related derivative is required. From the issuer's perspective, the SFAS 133 guidance coupled with EITF Issues 96-13, 00-7 and 00-19 provide adequate guidance on bifurcation. Specifically, if a debt host exists and the embedded derivative is linked to the issuer's own stock, bifurcation is typically not required. We think this model makes sense and that new guidance on bifurcation is not needed. Rather, we strongly recommend that the Board quickly codify the emerging DIG guidance so it may be applied in practice.

If the Board goes forward with bifurcation of products such as convertible debt, we believe it is important that SFAS 133 be amended so that, from the issuer's perspective, the equity derivative component may be bifurcated from other SFAS 133 embedded derivatives and recorded in equity (thus, any other SFAS 133 derivatives will not "taint" the equity treatment of the equity derivative component of a hybrid instrument).

*Summary*

ISDA strongly recommends that the Board reconsider the changes it is proposing in these two EDs. We do not believe there is sufficient benefit to these changes to outweigh the disruption in financial statement reporting that will be created. This coupled with the significant costs of implementation and ongoing compliance on already overburdened users and preparers of financial statements should give the Board pause as to whether this proposed standard should move forward. Rather, we urge the Board to rely on current practice to guide the accounting for liability and equity instruments.

ISDA would be pleased to discuss these views further with the Board at your convenience.

Very truly yours,

Robin A. Doyle  
Chair, North American Accounting Committee

Robert G. Pickel  
Executive Director, Chief Executive Officer

**Appendix I****Scope**

***Issue 1: Certain financial instruments that have characteristics of liabilities, equity, or both also contain components that, if freestanding, would be assets. The Board decided not to address separation of asset components in this proposed Statement. Separate recognition of those components might be required by other authoritative pronouncements. Is the Board’s decision not to address separation of asset components appropriate? If so, why? If not, why not?***

**Paragraphs 219–221 discuss the basis for the Board’s conclusion.**

Since we do not agree with the bifurcation of compound liability and equity instruments (as noted in item 3 in our cover letter), we also do not support the bifurcation of the asset component from these instruments. Further decomposition of compound instruments would only serve to confuse the financial statement reader into believing that these “assets” are separately recognizable when they are an integral part of a compound liability or equity instrument.

**Initial Classification**

***Issue 2: This proposed Statement would require that the issuer of a compound financial instrument separate that instrument into its liability components and its equity components if certain conditions are met. (That requirement would supersede APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants.*)***

- a. Is the requirement to separate a compound financial instrument into its liability components and its equity components appropriate? If so, why? If not, why not?**
- b. Does this proposed Statement provide enough guidance for determining when and how a compound financial instrument should be separated into components? If not, what additional guidance would be helpful?**
- c. What implementation issues can be expected to arise as a result of the requirement to separate a compound financial instrument into its components?**

**Paragraphs 149–161 discuss the basis for the Board’s conclusion.**

As noted in item 3 in our cover letter, we do not support the ED’s proposal to bifurcate compound liability and equity instruments into separate components since we do not believe it improves financial reporting. Rather, we support the current accounting and reporting model for these instruments. Change should be used judiciously to address areas of accounting where there are no rules or the rules generate misleading financial reporting. Financial statement users understand what a convertible debt instrument is, what it means in terms of funding costs, the potential dilution and the fact that it is a unitary instrument whose parts can not be separately traded. A presentation that shows the debt component separate from the equity option misleads the reader into believing that the debt can be extinguished apart from the equity option or vice versa which is not true.

We also have concerns over the issuer's ability to bifurcate the option from the debt instrument since the equity option in many instruments (such as convertible debt) are not simple instruments like an exchange traded option. Convertible debt is often callable, and in some cases puttable, but only in the context of the unitary instrument, not on its own. The bifurcation proposed in the ED creates a "fictional" derivative in the equity section and a "fictional" plain vanilla debt instrument in the liability section. For these instruments, we believe the reality of the single instrument has more informational content and less ability to mislead. For example, recording a plain vanilla debt instrument in the liabilities is misleading when in reality such an instrument is callable/convertible. In addition, the bifurcation of certain instruments such as puttable preferred or common stock is highly misleading since the base equity instrument is not "permanent" due to the ability of the holder to put the instrument back to the issuer. This is especially true when it can be put for fair value since the lack of permanence of the capital will not be evident on the face of the balance sheet as the value of the put at all times will be minimal. This will make the call on liquidity and the disappearing nature of the capital obscured. We believe a temporary equity or liability presentation (depending on creditor rights) of the compound instrument would make more sense and better portray the potential negative outcome of the instrument.

Valuation issues on the separate items should not be underestimated. Our experience with SFAS 133 indicates that these components will be extremely difficult to value appropriately. However, if bifurcation is adopted, we believe that the issuer should have the ability to choose which method (relative-fair-value or with-and-without) to use to allocate the proceeds of issuance.

***Issue 3: One of the three essential characteristics of a liability discussed in paragraph 36 of FASB Concepts Statement No. 6, Elements of Financial Statements, is that "it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, on occurrence of a specified event, or on demand" (emphasis added). This proposed Statement would require liability classification for certain obligations that require or permit settlement by issuance of a reporting entity's equity shares (and, thus, do not require future transfer or use of the entity's assets).***

**Under the provisions of this proposed Statement, only those financial instrument components that establish an ownership relationship would be classified as equity. A component is deemed to establish an ownership relationship if it (1) is an outstanding equity share not subject to redemption provisions or (2) is an obligation that a reporting entity can or must settle by issuance of the issuer's equity shares and, to the extent the monetary value of the obligation changes, the change is attributable to, equal to, and in the same direction as the change in fair value of the issuer's equity shares.**

- a. Do you agree with the Board's conclusion that certain obligations that permit or require settlement by issuance of the reporting entity's equity shares should be classified as liabilities?**
- b. Do you agree with the Board's conclusion that a financial instrument component that does not establish an ownership relationship should not be classified as equity?**
- c. Do you believe that the Board has made an appropriate distinction between equity-settled obligations that should be classified as equity and equity-settled obligations that should be classified as liabilities?**

**If so, why? If not, why not?**

**Paragraphs 164–194 discuss the basis for the Board’s conclusions.**

As noted in item 1 in our cover letter, we do not support the ED’s proposal that an ownership relationship, as defined by the ED, is required for certain financial instruments to be classified as equity. Rather, it is our view that when an issuer can create permanent equity with a given contract, that contract should be characterized as equity. We believe that the EITF 00-19 model provides appropriate guidance for identifying equity instruments and should be the basis for determining the classification of financial instruments on an issuer’s own stock.

**EXAMPLE**

ABC Company (publicly traded) has issued options to employees that expire in three years. ABC Company desires to avoid shareholder dilution from the employee option plan, so they intend to purchase shares from the market to satisfy the option issuance at expiration. Expecting to achieve its desired effect (an increase in stock price between issuance and expiration), ABC Company decides to lock in the cost of the share repurchase at today’s market value. To accomplish this, they have been presented with two options:

**Structure A:**

Buy the stock today for \$10mm (1mm shares at today’s market price of \$10/share). Acquisition will be structured through XYZ investment bank. XYZ investment bank will also finance the acquisition by using the 1mm shares of ABC as collateral.

**Structure B:**

Enter into a forward buy with XYZ investment bank for 1mm shares of stock. The premium on the forward equates to XYZ investment bank’s cost of funds plus a spread. The forward may be settled by physical delivery of the shares only. Since the forward does not provide the holder with an ownership type relationship, it is not an equity transaction and thus is recorded as a derivative under SFAS 133.

**Analysis:**

Both structures will achieve the desired effect, a purchase of 1mm shares from the market to satisfy the expected exercise of the employee options. Both structures cost the same, XYZ investment bank’s cost of funds plus a spread. Cash flow between ABC Company and XYZ investment bank would be identical.

The accounting for the two structures would be dramatically different. In Structure A, ABC would increase treasury stock for the share repurchase, financed with a payable to XYZ investment bank. ABC would repay the financing at maturity of the contract. There would be no income statement recognition during the life of the transaction. Under Structure B, ABC Company would record the forward initially at zero fair value and then mark to market the derivative through the income statement for the life of the contract. At maturity of the contract, ABC would receive the shares and pay XYZ bank the exercise price. Cash flow under both structures would be identical, but the income statement effect of Structure B is drastically different from Structure A.

Under the current “00-19” model, the forward in Structure B would be considered an equity instrument and would *not* be marked-to-market through the income statement.

**Issue 4:** Under the approach in this proposed Statement, any financial instrument that is issued in the form of shares that are subject to mandatory redemption provisions (that is, subject to redemption upon a specified date or upon the occurrence of an event that is certain to occur) are classified as liabilities. That would include shares issued by some privately held companies that require that the shares be resold to the issuer upon the holder's termination of its ownership position (whether by selling the shares or by death). That conclusion would reduce (and in some cases eliminate) the equity of some privately held entities. (Alternatively, a privately held entity's shares may be puttable to the issuer at the fair value of the shares at the date the put option is exercised. Paragraph 63 addresses stock that is puttable at its fair value.) Are there other factors that the Board should consider regarding the applicability of its conclusion on shares subject to mandatory redemption provisions to privately held entities that issue that type of security?

We agree that financial instruments with mandatory redemption features should not be accounted for as equity instruments. However, we would encourage the Board to consider an exception for certain conditional financial instruments of privately held entities where the equity holder was required to sell the equity instruments back to the issuer in limited circumstances (e.g., death or significant change in the tax code.) This type of instrument illustrates a good example of where a mezzanine or temporary equity classification would provide useful information to financial statement users.

### **Initial Measurement**

**Issue 5:** If a financial instrument has multiple settlement alternatives and the monetary values of those settlement alternatives have the potential to differ, this proposed Statement would require that the settlement alternatives be considered separate components of a compound financial instrument. For purposes of initial measurement of those components, the following general rules would apply:

- a. If a compound financial instrument has no component that is an outstanding share of stock, the obligation that is classified as a liability should be considered an unconditional obligation and the obligation that is classified as equity should be considered a conditional obligation.
- b. If a compound financial instrument has a component that is an outstanding share of stock (other than mandatorily redeemable stock), the instrument should be considered to comprise (1) an outstanding share of stock and (2) a conditional obligation.

Do you agree with the Board's conclusions? Are there circumstances in which those general rules would result in initial measurement of components that you consider inappropriate? If so, what are those circumstances?

**Paragraphs 195–208 discuss the basis for the Board's conclusion.**

As noted in item 3 in our cover letter, we do not support the ED's proposal to bifurcate compound instruments into separate components.

**Issue 6:** This proposed Statement would require that the issuer of a compound financial instrument allocate the proceeds of issuance of that instrument to its separately classified liability components and equity components using the relative-fair-value method. That requirement

would apply in all circumstances except when (a) the instrument contains a component that is a derivative subject to the requirements of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, or (b) application of the relative-fair-value method is impracticable because the fair value of one or more components cannot be reliably determined.

**Is the requirement to use the relative-fair-value method appropriate? If not, why not? Are there other circumstances in which that method should not be required?**

**Paragraphs 209–218 discuss the basis for the Board’s conclusion.**

As noted in item 3 in our cover letter, we do not support the ED’s proposal to bifurcate compound instruments into separate components. However, if bifurcation is adopted, we believe that the issuer should have the ability to choose which method (relative-fair-value or with-and-without) to use to allocate the proceeds of issuance.

### **Classification and Presentation of the Noncontrolling Interest in a Consolidated Subsidiary**

**Issue 7: This proposed Statement would require that an equity instrument that is issued by a consolidated subsidiary of the reporting entity and that represents the noncontrolling interest in that subsidiary be reported in the consolidated financial statements as a separate component of equity. Do you agree with the Board’s conclusion that the noncontrolling interest is part of the equity of the consolidated entity? If not, why not? What implementation issues can be expected to arise as a result of that decision?**

**Paragraphs 226–233 discuss the basis for the Board’s conclusion.**

As noted in item 2 in our cover letter, we do not support the ED’s proposal to reclassify minority interest to the equity section of the balance sheet. We do not see a compelling reason to change the current accounting that allows for minority interest to be classified between the liability and equity sections of the balance sheet.

Furthermore, there are other instruments that should be classified between the liability and equity sections of the balance sheet. Many instruments have debt-like features (stated maturity or redemption amount) yet in liquidation do not have creditor rights, making them more akin to equity holders. Since these types of instruments (e.g. mandatorily redeemable trust preferred securities) do not readily fit in either a liability or equity category, it seems beneficial to categorize these securities into a section of the balance sheet between debt and equity. This type of information on liquidation preference is extremely important for investors in entities that have lower credit ratings.

**Issue 8: In accordance with the Board’s conclusion that shares of a consolidated subsidiary that represent the noncontrolling interest are equity of the consolidated entity, sales of those shares to entities outside the consolidated group would be considered equity transactions. Accordingly, no gain or loss would be recognized on those sales as long as the subsidiary remains consolidated. Do you agree with the Board’s conclusion related to recognition of gain or loss on sales of subsidiary shares? If so, why? If not, why not?**

**Paragraphs 234–236 discuss the basis for the Board’s conclusion.**

As noted in item 2 in our cover letter, we do not support the ED’s proposal to reclassify minority interest to the equity section of the balance sheet. Consistent with that approach, we do not believe that the gains and losses on a secondary offering of subsidiary shares should be classified as equity transactions.

**Issue 9: For an entity with one or more less-than-wholly-owned subsidiaries, this proposed Statement would require that amounts displayed as line items in the income statement and amounts displayed as components of other comprehensive income include amounts attributable to both the controlling interest and the noncontrolling interest. An entity with one or more less-than-wholly-owned subsidiaries would be required to disclose the amounts attributable to the controlling interest for the following items if they appear in the financial statements:**

- **Income from continuing operations**
- **Discontinued operations**
- **Extraordinary items**
- **Cumulative effect of changes in accounting principle**
- **Net income or net loss**
- **Total comprehensive income**
- **Each component of other comprehensive income.**

**An entity with one or more less-than-wholly-owned subsidiaries that displays comprehensive income and its components in a statement of changes in equity would be required to display aggregate amounts and amounts attributable to the controlling interest and the noncontrolling interest for each component of comprehensive income. Do you agree with the Board’s conclusions related to presentation and disclosure requirements for an entity with one or more less-than-wholly-owned subsidiaries?**

**Paragraphs 237–239 discuss the basis for the Board’s conclusions.**

As noted in item 2 in our cover letter, we do not support the ED’s proposal to reclassify minority interest to the equity section of the balance sheet. We do not see a compelling reason to change the current accounting and believe that the ED is unnecessarily complicating the accounting for minority interest where there are no practice problems.

**Issue 10: This proposed Statement would require that an entity that presents earnings-per-share information in accordance with FASB Statement No. 128, *Earnings per Share*, present on the face of the income statement a total for adjustments to net income (or net loss) or to net income (or net loss) attributable to the controlling interest to arrive at the numerator for the calculation of basic earnings per share. Do you agree with the requirement to present that total on the face of the income statement?**

**Paragraphs 240 and 241 discuss the basis for the Board's conclusion.**

Again, we do not support the ED's proposal to reclassify minority interest to the equity section of the balance sheet. Therefore, we do not see a need to change the presentation of EPS on the income statement. EPS for non-controlling shareholders has no relevance to the minority interest shareholders it represents. It does not serve any purpose other than as an artificial measure needed to reconcile to the EPS measures that are currently disclosed. This convoluted reconciliation process highlights the fact that this new guidance is flawed.

**Disclosures**

***Issue 11:* The disclosure requirements of this proposed Statement are included in paragraph 45. Do you agree with those requirements? If not, what disclosure requirements would you omit or add?**

**Paragraphs 242–247 discuss the basis for the Board's conclusion.**

Since we generally believe that the accounting for the instruments covered by these two EDs is adequately addressed by existing guidance and does not present any discernible practice issues, we do not agree that additional disclosure is warranted.

In fact, the disclosure requirements for non-controlling interest to be completely unnecessary. The amounts disclosed as non-controlling interest do not provide useful information to either the shareholder of the parent company or to the minority shareholders of the consolidated subsidiary. We see no reason for this disclosure other than as a "reconciliation" for income and equity. With no apparent benefit, the significant costs to produce the reconciling items are unjustifiable.

**Effective Date and Transition**

***Issue 12:* This proposed Statement would require that in the initial year of adoption an entity restate all financial statements for earlier years presented for the effects of financial instruments within the scope of this Statement that were outstanding at any time during the initial year of adoption. An entity would be permitted, but not required, to restate all financial statements presented for the effects of financial instruments that were not outstanding at any time during the initial year of adoption. An entity that elects to restate for those financial instruments would be required to restate all financial statements presented for the effects of all financial instruments within the scope of this Statement that were outstanding in any period presented, beginning with the earliest year presented. The cumulative effect of adopting this proposed Statement would be required to be included in the earliest year restated.**

This proposed Statement also would require that an entity whose consolidated financial statements include one or more less-than-wholly-owned subsidiaries at any time during the initial year of adoption restate all financial statements presented for earlier years that include those subsidiaries to classify the noncontrolling interest as equity. The entity also would be required to restate all financial statements presented for the effects of any gains or losses on any sales of a

subsidiary's shares that were not accounted for in accordance with paragraphs 37 and 38 of this Statement. An entity would be permitted but not required to restate all financial statements presented for the classification of the noncontrolling interest and any gains or losses recognized on sales of a subsidiary's shares for the noncontrolling interest that did not exist at any time during the initial year of adoption. An entity that elects to restate for those noncontrolling interests and associated gains and losses would be required to restate all financial statements presented for the effects of all noncontrolling interests that existed and all those gains and losses that were recognized in any period presented, beginning with the earliest year presented. This proposed Statement would not require that an entity recognize a cumulative effect for gains or losses on sales of a subsidiary's shares in periods that are not restated.

**Would another transition method be more appropriate? If so, what method and why?**

**Paragraphs 248–255 discuss the basis for the Board's conclusion.**

We strongly disagree with this approach. We feel that existing instruments should be grandfathered, as was done by EITF Issue 00-19 for publicly issued derivatives and SFAS 133 for hybrid instruments. The approach in EITF Issue 00-19 was taken to accommodate long-term equity contracts that could not be amended. Additionally, the adoption of this guidance should be prospective. The costs involved could be significant in trying to determine the value of certain esoteric embedded options in debt instruments at a date many years prior to the current reporting period. Also, the difficulty involved in researching and reclassifying prior gains and or losses on sales of minority interest outweigh any benefit from a restatement of financial statements.

Regarding the timing, if the Board proceeds with the current EDs, given the significance of the proposed changes, the transition date should be deferred to provide entities ample opportunity to digest the changes, evaluate the impact and adopt the new accounting model. If our recommendations are accepted, one year from issuance date should be adequate time for transition. If the EDs are issued substantial as is, greater than one year will be necessary to adopt and implement the new standards.

## **Public Hearings**

**Issue 13: The Board has not yet determined whether there is a need for a public hearing or other forum. The Board will assess that need based on comment letters received. Any respondent that wishes to participate in such a meeting, if one is held, should indicate a desire to do so.**

Due to the significant changes in the accounting for many financial instruments, we urge the Board to hold public hearings on these changes before finalizing the EDs.

**Issue (CONS 6): The Board has concluded that certain obligations that require (or permit at the issuer's discretion) settlement by issuance of the issuer's equity shares should be classified as liabilities. That conclusion necessitates an amendment to the definition of liabilities in Concepts Statement 6. Do you agree with the proposed changes to the definition of liabilities?**

As noted in item 1 in our cover letter, we do not support the ED's proposal that will change the definition of a liability, nor do we agree with the proposed definition of ownership relationship. We

believe that the EITF Issue 00-19 accounting model provides guidance for identifying equity instruments and should be the basis for determining the classification of financial instruments on an issuer's own stock.