June 17, 2008

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to comment on the IASB Preliminary Views Document, *Financial Instruments with Characteristics of Equity*.

We have attached a copy of our comment letter to the FASB Preliminary Views Document, *Financial Instruments with Characteristics of Equity*, to provide the IASB with our responses to the more significant questions asked by the FASB that might also be helpful during IASB deliberations.

AcSEC appreciates the both the IASB's and FASB's efforts to simplify the maze of literature that currently must be navigated to determine whether an instrument should be accounted for as equity or a liability/asset. As illustrated by the attached AICPA flowcharts in Appendix B (AICPA Technical Practice Aid, *Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments*), the current U.S. model does not work well in practice today, as evidenced by the significant number of restatements required by the Securities and Exchange Commission.

AcSEC does not believe that the basic ownership approach as discussed in the FASB Preliminary Views Document would represent an improvement in financial reporting sought by the financial community. AcSEC is concerned that the FASB's preference for the basic ownership approach was focused too heavily on both its perceived simplicity and the amount of abuse it may stop.

Representatives of AcSEC are available to discuss our comments with the Board members and staff.

Yours truly,

Ben Neuhausen, Chair
Accounting Standards Executive Committee

David Morris, Chair
Preliminary Views Task Force

May 30, 2008

Technical Director – File Reference No. 1550-100
Financial Accounting Standards Board
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The Accounting Standards Executive Committee (AcSEC) of the American Institute of Certified Public Accountants (AICPA) appreciates the opportunity to comment on the FASB Preliminary Views Document, *Financial Instruments with Characteristics of Equity*.

AcSEC appreciates the FASB's efforts to simplify the maze of literature that currently must be navigated to determine whether an instrument should be accounted for as equity or a liability/asset. As illustrated by the attached AICPA flowcharts in Appendix B (AICPA Technical Practice Aid, *Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments*), the current model does not work well in practice today, as evidenced by the significant number of restatements required by the Securities and Exchange Commission. However, AcSEC does not believe that the basic ownership approach would represent an improvement in financial reporting sought by the financial community. AcSEC is concerned that the FASB's preference for the basic ownership approach was focused too heavily on both its perceived simplicity and the amount of abuse it may stop. AcSEC believes that what is considered equity under the basic ownership approach is too narrow, and the grouping of dissimilar instruments as liabilities would not be useful to users of financial statements. AcSEC is also concerned that applying an overly simplistic model to complex instruments may ultimately provide financial reporting that is not more representationally faithful to the underlying economics of the transaction, as compared to other approaches.

AcSEC believes that the FASB should first develop a set of principles for differentiating between liabilities and equity that considers its conceptual framework and international convergence projects. In contrast to the basic ownership approach, the majority of AcSEC believe that the principles developed should include a definition of what is to be considered a liability, with the residual being considered equity. A significant minority of AcSEC would prefer the model to include definitions of both equity and liabilities, with the emphasis on the judgments needed in interpreting a list of criteria to consider when classifying instruments. AcSEC recognizes that further work will need to be done to develop a comprehensive approach, including development of the principles needed to address the many open issues (i.e., Day 2 accounting, income recognition, subsequent reassessment issues, and transition), before a standard can be finalized and applied.

Accordingly, AcSEC does not support any of the approaches described in the Preliminary Views. AcSEC believes that the FASB should use the ownership-settlement approach as a starting point for developing a framework to determine whether an instrument should be accounted for as equity or a liability. We note the basic ownership

approach seemingly draws an arbitrary line to determine what is considered an equity instrument on the basis of the simplicity of application. However, AcSEC believes that although the ownership-settlement approach appears to be more complex, application of the ownership-settlement approach would likely result in more representationally faithful financial statements as compared to results of the basic ownership approach. AcSEC also believes that improving financial reporting should be a predominant goal of new guidance, rather than an approach that focuses more on the ease of implementation but results in financial reporting that fails to meet the needs of financial statement users.

While AcSEC favors a model developed along the lines of the ownership-settlement approach, AcSEC has the following comments on the ownership-settlement approach as it is currently written:

- Instruments with identical economic profiles could have different classifications simply due to the form of settlement. AcSEC does not believe this should always be the answer as this obviously provides an opportunity for structuring instruments for an advantageous outcome.
- Under the Preliminary Views, if two substantive settlement features are identified (cash and shares), the issuer should assume equity settlement and classify the instrument as equity. Based on the numerous issues arising in practice today with theses settlement provisions, AcSEC believes that there are many issues relating to the classification resulting from settlement in cash or equity that should be thoroughly reviewed within the next steps of this project.
- AcSEC does not understand why prepaid forward purchase contracts would be classified as assets, when under current guidance they would be considered contra-equity.
- AcSEC questions if the wording in paragraph A5 in the Preliminary Views stating that "an indirect ownership instrument is a derivative instrument or a hybrid instrument with a basic ownership instrument as its predominant underlying", would result in a conflict with the guidance in paragraph 11(a) of FASB Statement No. 133, for scoping out contracts that are indexed to a company's own stock.

Finally, AcSEC believes that the resulting classification for stock options under the basic ownership approach is completely inconsistent with the current accounting as equity awards, and is a good example of why the results of applying the basic ownership approach do not make sense. It is clear under existing literature that transactions involving stock options and other stock-based compensation are considered equity transactions.

AcSEC also does not believe that the reassessed expected outcomes (REO) approach would represent an improvement in financial reporting, and agrees with the FASB that its complexity and the costs associated with implementation outweigh any perceived benefits.

A more complete response to the Board's specific questions is included in Appendix A.

Representatives of AcSEC are available to discuss our comments with the Board members and staff.

Yours truly,

Ben Neuhausen, Chair
Accounting Standards Executive Committee

David Morris, Chair
Preliminary Views Task Force

Appendix A

Response to Questions:
FASB Preliminary Views, Financial Instruments with Characteristics of Equity

Question on the Basic Ownership Approach

1. **Do you believe that the basic ownership approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you agree that the approach would significantly simplify the accounting for instruments within the scope of this Preliminary Views and provide minimal structuring opportunities?**

AcSEC does not believe that the basic ownership approach represents an improvement in financial reporting. AcSEC is concerned that the FASB's preference for the basic ownership approach is focused too heavily on both its perceived simplicity and the amount of abuse it may stop. Instead, AcSEC believes that the focus should be on the development of a principles-based model that produces financial reporting that is more representationally faithful to the underlying economics of the transactions and instruments. We are concerned that applying an overly simple model to complex instruments may ultimately provide an answer that does not meet this goal, and therefore fails to improve financial reporting.

AcSEC believes that what is considered equity under the basic ownership approach is too narrow, and it would not be useful to users of financial statements to lump dissimilar instruments together as liabilities. AcSEC believes that the FASB should first develop a set of principles for differentiating between liabilities and equity that also considers its conceptual framework and international convergence projects. In contrast to the basic ownership approach, the majority of AcSEC believe that the principles developed should include a definition of what is to be considered a liability, with the residual being considered equity. A significant minority of AcSEC would prefer the model to include definitions of both equity and liabilities, with the emphasis on the judgments needed in interpreting a list of criteria to consider when classifying instruments as either equity or liabilities.

AcSEC believes that the resulting classification for stock options under the basic ownership approach is completely inconsistent with the current accounting as equity awards, and is a good example of why the results of applying the basic ownership approach do not make sense. It is clear under existing literature that transactions involving stock options and other stock-based compensation are considered equity transactions.

AcSEC does not support any of the approaches described in the Preliminary Views, but recommends that the FASB use the ownership-settlement approach as a starting point for developing a comprehensive framework to determine whether an instrument should be classified as equity or a liability.

Question on the Ownership-Settlement Approach

1. **Do you believe that the ownership-settlement approach would represent an improvement in financial reporting? Are the underlying principles clear and appropriate? Do you prefer this approach over the basic ownership approach? If so, please explain why you believe the benefits of the approach justify its complexity?**

Appendix A

Response to Questions:
FASB Preliminary Views, Financial Instruments with Characteristics of Equity

AcSEC does not believe that the ownership-settlement approach as currently drafted would represent an improvement in financial reporting, but believes that the FASB should use the ownership-settlement approach as a starting point for developing a framework to determine whether an instrument should be classified as equity or a liability. AcSEC believes that although the ownership-settlement approach appears to be more complex than the basic ownership approach, application of a modified ownership-settlement approach may result in more representationally faithful financial statements as compared with results from application of the basic ownership approach.

AcSEC believes that the FASB should first develop a set of principles for differentiating between liabilities and equity that considers its conceptual framework and international convergence projects. In contrast to the basic ownership approach, the majority of AcSEC believe that the principles developed should include a definition of what is to be considered a liability, with the residual being considered equity. A significant minority of AcSEC would prefer the model to include definitions of both equity and liabilities, with the emphasis on the judgments needed in interpreting a list of criteria to consider when classifying instruments as either equity or liabilities.

Question on the REO Approach

1. **Do you believe that the REO approach would represent an improvement in financial reporting? What would be the conceptual basis for distinguishing between assets, liabilities, and equity? Would the cost incurred to implement this approach exceed the benefits? Please explain.**

AcSEC does not believe that the REO approach would represent an improvement in financial reporting, and agrees with FASB that its complexity and costs associated with implementing the REO approach outweigh any perceived benefits.

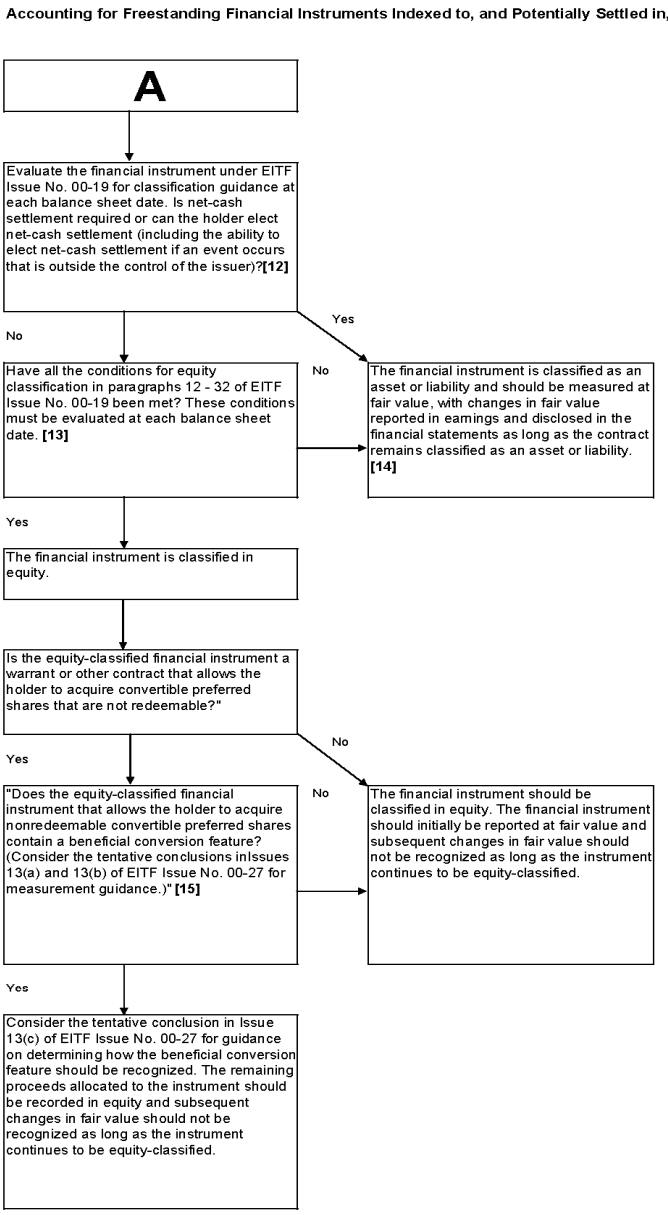
Appendix B

AICPA Technical Practice Aid, *Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments*

Accounting for Freestanding Financial Instruments Indexed to and Potentially Settled in a Company's Own Stock

Appendix B

AICPA Technical Practice Aid, *Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments*



Appendix B

AICPA Technical Practice Aid, *Convertible Debt, Convertible Preferred Shares, Warrants, and Other Equity-Related Financial Instruments*