

June 2, 2005

Letter of Comment No: 2
File Reference: FSPFAS150E
Date Received:

Mr. Lawrence Smith
Director of Technical Application and Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, Connecticut 06856-5116

RE: File Reference No. FSP FAS 150-e, *Issuer's Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable*

Dear Mr. Smith:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the Financial Accounting Standards Board (FASB or the "Board") on its proposed FASB staff position (FSP) noted above.

We agree that it is necessary to clarify how paragraph 11 of FASB Statement 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity* (FAS 150), applies to warrants and other similar instruments in which the underlying shares are puttable at the option of the holder. Confusion has arisen in practice over the application of FAS 150 to such instruments in part because the put feature is embedded in the underlying shares instead of the warrant, the put option may not be exercisable for an extended period after the exercise of the warrant, and the strike prices for the warrant and the put feature are often the same amount. An FSP that clarifies the applicability of FAS 150 to these instruments should help to eliminate the diversity in practice.

We do not, however, agree with the conclusion reached in the proposed FSP. We believe that a warrant to acquire shares that are puttable should be outside the scope of FAS 150, provided the warrant itself does not contain a put feature. In determining the applicability of FAS 150, warrants to acquire puttable shares and puttable shares should be treated the same way. With respect to puttable shares, the Board decided to exclude them from the scope of FAS 150 and instead address them in the project's second phase. As explained in the basis for conclusions, the scope of the project's first phase was limited because the Board was still redeliberating several major issues, one of which is whether and how certain compound instruments with characteristics of both liabilities and equity should be separated into discrete components. We believe that warrants to acquire puttable shares are also compound instruments that have characteristics of both liability and equity, and are just as complex of an instrument as the underlying puttable shares which are outside the scope of FAS 150.

If the Board nonetheless decides to proceed with the proposed FSP as currently drafted, we recommend that the Board clarify the proposed FSP in the following ways:

- The FSP should acknowledge that even though the warrant on puttable shares would be initially classified as a liability, upon exercise of the warrant, public entities would recognize the underlying puttable shares as mezzanine equity as required by Accounting Series Release (ASR) 268, *Presentation in Financial Statements of "Redeemable Preferred Stock."* Nonpublic entities would present the puttable shares as either "permanent" equity or mezzanine equity. Further, it would also be helpful if the FSP provided guidance on accounting for the extinguishment of the

warrant liability and the initial measurement of the puttable shares issued when the holder exercises the warrant.

- The FSP's title refers to "redeemable" shares. Paragraph 1 clarifies that the term "redeemable" refers both to shares that are "puttable" and to shares that are "mandatorily redeemable." As a result, shares that are redeemable at the issuer's option are excluded from the FSP's scope. For the sake of clarity and greater specificity, all instances of the term "redeemable" could be replaced with the phrase "shares that are either puttable or mandatorily redeemable" (e.g., in the title; in paragraphs 1, 5, and 8).
- Footnote 3 states that instruments that are subject to FASB Statement 123(R), *Share-Based Payment* (FAS 123(R)), may need to be reclassified when such instruments are no longer subject to FAS 123(R). We understand, however, that at its May 18, 2005 meeting, the Board directed the staff to issue a proposed FSP that would amend FAS 123(R) so that the initial classification of instruments subject to FAS 123(R) would not change even after they are no longer subject to FAS 123(R) unless the terms of the instruments are modified subsequent to their issuance. Accordingly, the guidance in paragraph 8 of this FSP may need to be revised if and when the expected proposed FSP related to FAS 123(R) is issued as a final FSP.
- In paragraph 9, the reference to various dates could confuse readers (e.g., the date that the FSP is finalized, the date that the final FSP is posted to the FASB's website, and the date of FAS 150's transition provisions). We suggest that the Board revise paragraph 9 as follows:

The guidance in this FSP shall be applied in the first reporting period that begins after [the date that the final FSP is posted to the FASB's website]. If the guidance in this FSP makes it necessary for an entity to change previously reported information, the entity shall transition to the FSP by reporting the cumulative effect of a change in an accounting principle for freestanding warrants and other similar instruments that fall within this FSP's scope and remain in existence on the FSP's effective date. The guidance in this FSP should not be applied to freestanding warrants or similar instruments that expired, matured, or were reacquired prior to the FSP's effective date.

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If you have questions regarding our comments, please contact John Althoff (973) 236-7288 or Marie Kling (973) 236-4460.

Sincerely,

PricewaterhouseCoopers LLP