

Accountants and
Management Consultants
The US Member Firm of
Grant Thornton International
National Office
175 West Jackson Blvd.
Chicago, IL 60604-2615
Tel: 312 856-0001
Fax: 312 861-1340

October 2, 2003

Director, Technical Application and
Implementation Activities
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856

Re: Proposed FASB Staff Position (FSP)

We are pleased to respond to Proposed FSP FAS 150-a, "Issuer's Accounting for Freestanding Financial Instruments Composed of More Than One Option or Forward Contract Embodying Obligations under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*" (the "Proposed FSP").

We generally agree with the Proposed FSP's conclusions. However, we believe the response to the first question in the final FSP should clarify the accounting for stock purchase warrants providing the holder with the right to acquire shares of the issuer that are:

- mandatorily redeemable at a specified or determinable date or upon an event certain to occur, or
- puttable at any time after exercise for a specified period of time.

Although Example 2 in the Proposed FSP appears to address the financial instrument described in the second bullet above, the arrangement described in Example 2 is substantively the same as the put warrant in Example 1. In both examples, the holder is required to decide on the settlement (exercise) date whether to receive a net cash settlement (in Example 1, the settlement is net; in Example 2, the parties exchange checks at the same time, resulting in the same economics as net cash settlement). If the holder does not elect to exercise its put right on the exercise date, in both examples it would acquire shares of the issuer that the issuer would classify in equity. As the financial instrument in Example 2 is, in substance, a put warrant, the conclusion to Example 2 would not necessarily apply to the accounting for the financial instrument described in the second bullet.

We have previously discussed the accounting for the two freestanding financial instruments with members of the FASB staff, who concluded that both would be classified as a liability. We

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understand that the staff reached its conclusions (at least in part) based on the discussion in paragraph 11 of Statement 150.

In determining the classification of a freestanding financial instrument, we believe paragraph 11 would only require liability classification if (a) the issuer could be obligated to settle the freestanding financial instrument by transferring assets (e.g., a written put option requiring net cash settlement) or (b) the freestanding financial instrument requires, or could require, the issuer to repurchase its own shares (e.g., a written put option or forward contract requiring physical settlement). A stock purchase warrant that entitles the holder to acquire shares that are mandatorily redeemable or puttable (other than only at the time of exercise of the warrant which, as noted above, would result in viewing the warrant as, in substance, a put warrant) does not appear to meet either condition. We think it would be helpful if the staff included the two examples above in the FSP and, if the staff concludes that both instruments should be classified as liabilities, the analysis that led to that conclusion.

Where the warrant does not appear to meet the conditions in paragraph 11 to be classified as a liability, we believe it would be appropriate to determine its classification by considering how the underlying financial instrument would be classified if the warrant were exercised. Under this approach, the first freestanding financial instrument described above should be classified as a liability because the shares to be issued on exercise of the stock purchase warrant would be classified as a liability under paragraph 9 of Statement 150, while the second would not be classified as a liability because the shares to be issued on exercise would not be classified as a liability under Statement 150. This approach would result in consistent accounting for economically similar arrangements. For example, under the FASB staff's conclusions, a penny warrant that provides the holder with the right to acquire the issuer's puttable shares would be classified as a liability (although presumably the shares underlying the warrant would continue to be included in the computation of basic earnings per share under FASB Statement No. 128, *Earnings per Share*, necessitating an adjustment of earnings available for common shareholders). However, if the issuer decided to forego the penny per share exercise price, it could issue the shares (instead of a penny warrant) and classify the puttable shares within equity (or in the mezzanine, if a public company).

Other Comments

We believe the response to Question 2 should clarify what the Board intended by the term "predominantly" in paragraph 12 of Statement 150. Would the fair value of a freestanding financial instrument be based "predominantly" on one of the three conditions in paragraph 12 only if the fair value of any embedded contractual obligations meeting one of the three conditions is more than one-half of the fair value of the entire freestanding financial instrument? Or did the Board have some other test or threshold in mind? In order to properly apply the guidance in paragraph 12, we believe it is necessary to understand how the Board intended "predominantly" to be interpreted.

We also believe paragraph 12 would be clearer if it were modified as follows:

A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that

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the issuer must or may settle by issuing a variable number of its equity shares shall be classified as a liability (or an asset in some circumstances) if, at inception, the monetary value of the financial instrument ~~obligation~~ is based solely or predominantly on any one of the following:

We believe the use of “financial instrument” is more appropriate than “obligation” as the classification of the financial instrument is based on a comparison of the fair value of any embedded contractual obligations that fall within the scope of paragraph 12 to the financial instruments’ total fair value to determine whether those embedded obligations represent the “predominant” value.

Lastly, Example 6 refers to a “share-settleable puttable warrant” in Example 1. It is not clear whether that reference is to Example 1 in the Proposed FSP or some other document. Example 1 in the Proposed FSP provides an example of a cash-settled puttable warrant, so we do not believe Example 1 is a correct reference. Example 3 in the Proposed FSP does provide an example of warrant with a share-settleable put. We believe Example 6 should be revised so either it stands on its own or refers to the correct example for the base facts.

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We would be pleased to discuss any of our comments with the Board or the FASB staff. Please direct your questions or comments to Joe Graziano at (732) 516-5560 or Jeff Ellis at (312) 602-8991.

Very truly yours,

Grant Thornton LLP