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September 26, 2003

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: Proposed FASB Staff Position, "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"

Dear Mr. Smith:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the proposed FASB Staff Position (the "Proposed FSP"), "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". We have the following suggestions to improve the operationality and clarity of the final FSP:

• The response to Question 1 states in part:

As a result the puttable warrant in question is a liability under paragraph 11, because it embodies an obligation indexed to an obligation to repurchase the issuer's shares and may require a transfer of assets. It is a liability even if the repurchase feature is conditional on a defined contingency in addition to the level of the issuer's share price.



For an obligation to be "indexed to" (or "based on variations in the fair value of" – as further clarified in footnote 6 to paragraph 11 of FAS 150) an obligation to repurchase the issuer's equity shares, one might logically conclude that the amount of the obligation should *vary* with the stock price. However, the instrument described in the question, as well as that in Example 1, obligates the company to pay a *fixed* monetary amount (e.g., \$2) in cash regardless of the stock price. Therefore, it would be helpful if the Board clarified how the right to put the warrant, not the shares received upon exercise of the warrant, for a *fixed* price is indexed to an obligation in a forward purchase contract.

Additionally, the concept of "a defined contingency" in the above-quoted paragraph of the proposed FSP is not clear from the facts given in the question. It is already quite clear from paragraph 11 of FAS 150 that the obligation within the scope of that paragraph can be conditional, i.e., can have optionality. Therefore, the additional concept of a "defined contingency" may not be needed to support the answer.

- The response to Question 2 states that the issuer must analyze the instrument at inception and consider all possible outcomes to judge which obligation is *predominant*. However, neither the FSP nor FAS 150 provides specific guidance on whether there is only a single acceptable way to perform the analysis of all possible outcomes of the instrument at its inception. One way to determine if an obligation feature is predominant is through a comparison of the relative fair values of the various features in the instrument. As further discussed in the following bullet, paragraph B47 of FAS 150 implies the use of a "value-based" approach to determine predominance. Another way to assess predominance is to compare the probability of the various features in the instrument being triggered. Although the two approaches are similar, they may not yield the same conclusion in all circumstances. There may be other approaches as well. It would be helpful if the Board would indicate in the final FSP whether there is only one method for making this assessment, or alternatively, acknowledge that there may be different acceptable methods for carrying out the assessment.
- Paragraph B47 of FAS 150 indicates that the concept of "predominance" was added in paragraph 12 because of the Board's concern that instruments would be constructed to avoid FAS 150's scope by embedding "a small amount" of monetary value variation in response to changes in the fair value of the issuer's equity shares even though the overall variation would predominantly respond to something else. Based on the Board's reference to "a small amount" in paragraph B47, we have concluded that a relatively high threshold is required for a feature to be considered predominant. However, we acknowledge that another possible interpretation is that a mere "preponderance" or a simple "majority" is enough for a feature to be considered predominant. While we would not expect the Board to give a bright line test, the Board



should assess whether there is sufficient understanding of its intent regarding the use of the word "predominance" to ensure an acceptable level of consistent application.

- The proposed transition provision states that if this guidance results in changes to previously reported information, the cumulative effect should be reported according to the provisions of Statement 150 in the first period *ending after* the final FSP is posted to the FASB website. We suggest that the transition provision be changed so that entities have to report the cumulative effect in the first period *beginning after* the final FSP is posted to the FASB website. Our suggested change is consistent with the approach followed for the transition of guidance in many Derivatives Implementation Group (DIG) issues and also with paragraph 29 of FAS 150.
- The first sentence in Example 6 states, in part, "Company F's share-settleable puttable
  warrant described in *Example 1...*". The warrant in Example 1 is not share-settleable
  but is payable in cash. The final FSP should eliminate this cross-reference to an earlier
  example in the FSP and instead fully describe the instrument.

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If you should have any questions regarding our comments, please feel free to contact John Althoff at (973) 236-7288, Deidre Schiela at (973) 236-7222, or Bob Bhave at (201) 521-3058.

Sincerely,

PricewaterhouseCoopers LLP