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Dear Ms. Bielstein:

The Accounting Standards Executive Committee (AcSEC) and Financial Instruments Task Force (FITF) of the American Institute of Certified Public Accountants appreciate the opportunity to comment on the May 1, 2002 Proposed Statement of Financial Accounting Standards *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*. AcSEC supports the proposed statement. However, AcSEC believes there are important issues that should be addressed prior to issuance of this amendment.

**Embedded derivatives in beneficial interests**

The new embedded rules for beneficial interests are complex and will result in potential implementation issues. We recommend that the FASB staff provide implementation guidance and specific examples to help clarify the application of the embedded derivatives rules to beneficial interests. The FITF understands that constituents have provided such examples that may serve as useful illustrations and further, offers to provide additional examples, at your or your staff's request.

**Warrants on common stock**

AcSEC recommends that the Board address that the broader issue of restrictions for business purposes as opposed to restrictions imposed to avoid derivative accounting prior to issuance of this amendment. Originally, DIG A14 concluded that shares to be received upon the exercise of a warrant are not readily convertible to cash if the buyer is precluded from selling the shares for 31 days. The FASB staff modified the conclusion in DIG A14 to limit the 31-day restriction to an issuer's own stock. Considering the investor's accounting, AcSEC believes that whether an entity issues warrants on its own stock, versus another entity, is not relevant to the investor. AcSEC recommends adding an explanation for the Board's decision to limit only to warrants on an issuer's own stock. If the Boards finds no practical reason to limit the guidance to those warrants of an issuer's own stock, AcSEC recommends that the Board explore whether the limitation should be extended to include all equities and other transactions such as commodities. AcSEC believes it would be desirable to have symmetry in accounting and reporting for both the investors and the issuers. Notwithstanding its recommendations, AcSEC supports the continuation of the 31-day restriction for warrants on an issuer's own stock.

## **Definition of a derivative**

The proposed amendment to paragraph 6(b) of Statement 133, as AcSEC interprets, suggests that many instruments may now be considered option-based contracts. AcSEC believes that examples would clarify this change. For example, how would a deep-in-the-money option be evaluated under paragraph 6(b)?

## **Application of short-cut treatment**

The exposure draft changes the application of the short-cut method for swaps that hedge pre-payable assets or liabilities. The change appears to require an up-front cash payment equal to the value of the embedded put or call. AcSEC recommends that the Board explore whether the proposed change is operational and whether it mirrors the hedged item. AcSEC interprets paragraph 68(b) to require an up-front cash payment equal to the value of the embedded put or call. In practice, AcSEC envisions that the short-cut treatment will not be available for many swaps on puttable or callable debt because there is generally not an upfront cash payment on the swap. A possible clarification might be to replace “is equal to the time value” with “is not greater than the time value.” Lastly, AcSEC suggests that the transition be clarified to address whether this applies to instruments acquired prospectively or for existing instruments.

## **Other**

AcSEC recommends issuance of a brand-new statement for Statement 133, Statement 137, Statement 138, technical corrections and this proposed amendment. AcSEC acknowledges the ‘green book’ is comprehensive to include all category *a* generally accepted accounting principles (GAAP) and DIG conclusions. However, AcSEC believes that the category *a* GAAP for derivative instruments and hedging activities should reside in one statement, particularly with the complexity of the subject matter. AcSEC notes precedence for this approach by the Board with the replacement of Statement 125 with Statement 140 and the rescission of Statement 121 with Statement 144. AcSEC appreciates the challenges involved with consolidating the basis for conclusions; however, we believe the enhanced usefulness to users, preparers, and auditors outweighs those challenges.

Representatives of AcSEC will be pleased to discuss these comments with you as necessary.

Sincerely,

Mark V. Sever, Chair  
Accounting Standards Executive Committee

Thomas Omberg, Chair  
Financial Instruments Task Force