PROPOSED FASB STAFF POSITION

No. FAS 150-e

Comment Deadline: June 2, 2005

Title: Issuer's Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to address whether freestanding warrants and other similar instruments on shares that are redeemable (either puttable or mandatorily redeemable) would be subject to the requirements of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* regardless of the timing of the redemption feature or the redemption price.

Background and Scope

2. Paragraph 11 of Statement 150 applies to a freestanding financial instrument, other than an outstanding share, that, at inception, embodies an obligation to repurchase the issuer's equity shares and *requires or may require* the issuer to settle the obligation by transferring assets.

3. Example 2 in FSP FAS 150-1, "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*," illustrates a warrant for shares that can be put back by the holder at a fixed price immediately after exercise of the warrant. Such a warrant is a liability under Statement 150 and FSP FAS 150-1. Questions arose whether the timing of the redemption feature or the redemption price affects the application of paragraph 11 of Statement 150 to warrants for shares that are puttable. Specifically, constituents questioned whether paragraph 11 applies only to warrants with underlying shares that are puttable immediately after exercise of the warrants, or also to those that are puttable at some date in the future.

FASB Staff Position

4. FSP FAS 150-1 explains that warrants for shares that are puttable are liabilities under paragraph 11 of Statement 150 because the warrants embody obligations to repurchase the issuer's shares and may require a transfer of assets. Similarly, as stated in FSP FAS 150-1, warrants for mandatorily redeemable shares are classified as liabilities under paragraph 11 of Statement 150 because the warrants embody obligations to repurchase the issuer's shares that, if exercised, will require a transfer of assets.

5. Paragraph 11 of Statement 150 applies to freestanding warrants and other similar instruments on shares that are either puttable or mandatorily redeemable regardless of the timing of the redemption feature or the redemption price because those instruments embody obligations to transfer assets. Therefore, paragraph 11 applies to warrants on shares that are redeemable immediately after exercise of the warrants and also to those that are redeemable at some date in the future.

6. The phrase *requires or may require* in paragraph 11 encompasses instruments that either conditionally or unconditionally obligate the issuer to transfer assets. If the obligation is conditional, the number of conditions leading up to the transfer of assets is irrelevant.[1]

7. A warrant for puttable shares conditionally obligates the issuer to ultimately transfer assets—the obligation is conditioned on the warrant being exercised and the shares obtained by the warrant being put back to the issuer for cash or other assets. Additionally, a warrant for mandatorily redeemable shares conditionally obligates the issuer to ultimately transfer assets—the obligation is conditioned only on the warrant being exercised because the shares will be redeemed.[2] Thus, warrants for both puttable and mandatorily redeemable shares are analyzed the same way and are liabilities under paragraph 11, even though the number of conditions leading up to the possible transfer of assets differs for those warrants.

8. The guidance in this FSP also is applicable to options or similar instruments on redeemable shares that are no longer subject to FASB Statement No. 123(R), *Share-Based Payment*.[3] Paragraphs A230–A232 of Statement 123(R) provide guidance for determining when an instrument ceases to be subject to the requirements of that Statement.

[1] An example of an instrument having multiple conditions leading up to a transfer of assets is described in the answer section of paragraph 1 in FSP FAS 150-1. That paragraph states that an instrument 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.

[2] Footnote 3 in Statement 150 states that "an instrument that requires the issuer to settle its obligation by issuing another instrument (for example, a note payable in cash) ultimately requires settlement by a transfer of assets." In that footnote, it is clear that a warrant for mandatorily redeemable shares would be a liability under Statement 150. In applying paragraph 11 of Statement 150, footnote 3 also would apply for an instrument settled with another instrument that ultimately *may require* settlement by a transfer of assets (warrants for puttable shares).

[3] Paragraphs 30–32 and A227–A229 of Statement 123(R) provide classification guidance for options or similar instruments on puttable and mandatorily redeemable shares as either liabilities or equity. Because Statement 123(R) and Statement 150 have different classification guidance for options or similar instruments on redeemable shares, those instruments may be subject to reclassification at the time Statement 150 becomes applicable.

Effective Date and Transition

9. The guidance in this FSP shall be applied to the first reporting period beginning after [the date that the FSP is finalized]. If the guidance in this FSP results in changes to previously reported information, the cumulative effect shall be reported according to the transition provisions of Statement 150 in the first period beginning after the final FSP is posted to the FASB website.