

**MEMO# 9279**

September 26, 1997

## **DRAFT COMMENT LETTER ON PROPOSED FASB DERIVATIVES STANDARD**

[9279] September 26, 1997 TO: ACCOUNTING/TREASURERS COMMITTEE No. 34-97  
INDEPENDENT ACCOUNTANTS ADVISORY COMMITTEE No. 5-97 RE: DRAFT COMMENT  
LETTER ON PROPOSED FASB DERIVATIVES STANDARD

---

The Financial Accounting Standards Board issued an exposure draft Accounting for Derivatives and Similar Financial Instruments and for Hedging Activities (the "Exposure Draft") on June 20, 1996. The Exposure Draft related primarily to historical cost based entities that defer gains and losses on derivatives through "hedge" accounting. While the Exposure Draft required investment companies to provide additional financial statement footnote disclosure regarding derivatives activities, it did not modify funds basic financial statements. The FASB recently issued a "revised draft standard" to interested parties for their views on the clarity and operationality of the draft. The revised draft standard has been changed from the Exposure Draft to require that "embedded derivatives" be separated from their "host contract" and accounted for as a separate derivative instrument. The revised draft standard indicates that convertible bonds, inverse floaters, inflation indexed securities, and structured notes are securities which include embedded derivatives. In addition, forward, when-issued, and "to be announced" transactions are also cited as securities with embedded derivatives. While it is unclear, the revised draft standard may be read to require separate reporting of gains/losses attributable to derivatives on the statement of operations. Further, the revised draft standard may be read to require separate reporting of embedded derivatives in the schedule of investments (e.g., separate reporting of the fixed-income component and the call option component attributable to a convertible bond). A copy of the revised draft standard may be obtained by visiting the FASB web site at [www.fasb.org](http://www.fasb.org). The attached draft comment letter argues that separate reporting of embedded derivatives is unnecessary for investment companies and other entities which use market value based accounting. The draft comment letter notes that separate reporting of embedded derivatives may: a) lead to shareholder confusion, b) conflict with SEC rules requiring disclosure of portfolio holdings, and c) create difficulties in valuing the individual components of securities with embedded derivatives. The attached letter seeks clarification that separate reporting of embedded derivatives in the statement of operations and the schedule of investments would not be required for investment companies and other entities that use market value based accounting. Comments on the revised draft standard are due to the FASB by October 14. If you have any comments on the attached draft comment letter please call or e- mail the undersigned at 202/326-5851 or [smith@ici.org](mailto:smith@ici.org) by October 8.

Gregory M. Smith Director - Operations/ Compliance & Fund Accounting Attachment (in .pdf format)

---

Copyright © by the Investment Company Institute. All rights reserved. Information may be abridged and therefore incomplete. Communications from the Institute do not constitute, and should not be considered a substitute for, legal advice.