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March 26, 2004

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Letter of Comment No: 4
File Reference: FSPFAS129A

File Reference No. FAS 129-a
Disclosure Requirements under FASB Statement No. 129, *Disclosure of Information about Capital Structure*, Relating to Contingently Convertible Financial Instruments

Dear Mr. Smith:

We are pleased to comment on the Proposed FASB Staff Position No. FAS 129-a, "Disclosure Requirements under FASB Statement No. 129, *Disclosure of Information about Capital Structure*, Relating to Contingently Convertible Financial Instruments" ("FSP 129-a").

In general, we support FSP 129-a, which clarifies the disclosure requirements applicable to contingently convertible financial instruments and to their potential dilutive effects on earnings per share pursuant to paragraph 4 of FASB Statement No. 129, *Disclosure of Information about Capital Structure* ("FASB 129"). Additionally, we would like to raise the following concerns in relation to FSP 129-a for your consideration:

- The scope of FSP 129-a should be clarified to indicate whether it also applies to financial instruments that are not convertible but involve a contingent issuance of common stock.
- The disclosures required by Paragraph 3(b) of FSP 129-a should be expanded to encompass possible conversion prices and possible number of shares into which the instrument is potentially convertible as well as other significant terms when the conversion price is contingently adjustable.
- The term, "in connection with" in paragraph 5 of FSP 129-a needs further clarification to ensure consistent application.

Each of the concerns noted above is explained in more detail in the Appendix to this letter. The Appendix also includes certain editorial comments in relation to FSP 129-a.

We appreciate your consideration of our comments. Should you have any questions regarding our letter, please contact Bob Uhl at (203) 761-3705.

Yours Truly,

Deloitte & Touche LLP

APPENDIX
DELOITTE & TOUCHE LLP COMMENTS
Proposed FASB Staff Position No. FAS 129-a

1. *The scope of FSP 129-a should be clarified to indicate whether it also applies to financial instruments that are not convertible but involve a contingent issuance of common stock.*

Throughout FSP 129-a, the term, “contingently convertible financial instruments” is used. One view is that the guidance is only applicable to instruments such as contingently convertible debt and contingently convertible preferred stock but does not address disclosure requirements for instruments such as contingently issuable shares and options and forwards on an issuer’s stock that contain contingent features since these instruments are not convertible. Others believe this guidance should include instruments that are not convertible but that contain features involving the issuance of shares based on a contingency as the contingent feature may be similar to those contingent features embedded in convertible instruments. We recommend that the scope of this FASB Staff Position be clarified with respect to non-convertible instruments.

2. *The disclosures required by Paragraph 3(b) of FSP 129-a should be expanded to encompass possible conversion prices and possible number of shares into which the instrument is potentially convertible as well as other significant terms when the conversion price is contingently adjustable.*

Paragraph 3(b) of FSP 129-a states:

The conversion price and the number of shares into which the instrument is potentially convertible.

Some contingently convertible financial instruments have terms that adjust the conversion price and number of shares into which the instrument is convertible based on a contingent event. In a number of these instruments, the adjusted conversion price and adjusted number of shares into which the instrument is convertible will not be known until the contingency is resolved. For example the conversion price may adjust based on the amount of extraordinary dividends paid to common shareholders or adjust to a specified percentage of the share price in a subsequent issuance of common stock. Some of these instruments may be within the scope of Issue 7 of EITF Issue No. 00-27, *Application of Issue 98-5 to Certain Convertible Instruments*. For Instruments within the scope of EITF 00-27, that Issue requires full disclosure of the possible conversion prices and dates as well as other significant terms. We recommend that Paragraph 3(b) of FSP 129-a be expanded to require similar disclosures for instruments that contain features that adjust the conversion price and number of shares into which the instrument is convertible but that are not within the scope of EITF 00-27.

We also recommend the FASB staff consider incorporating the disclosure requirements in paragraph 50 of EITF Issue No. 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock*, to the extent that those disclosures are not redundant with the proposed disclosure requirements under FSP 129-a.

3. *The term, “in connection with” in paragraph 5 of FSP 129-a needs further clarification to ensure consistent application.*

Paragraph 5 of FSP 129-a states, in part:

To the extent that derivative transactions were entered into in connection with the issuance of the contingently convertible financial instrument, the terms of those derivative transactions (including settlement), how those transactions relate to the contingently convertible instrument, and the number of shares underlying the derivatives should also be disclosed. [Emphasis added, footnote omitted]

It is unclear under what circumstances a derivative transaction is considered to be “entered into in connection with” the issuance of the contingently convertible financial instrument, and therefore, is subject to the proposed disclosure requirements under paragraph 5 of FSP. For example, a company may issue to the buyer of contingently convertible debt a number of detached warrants. The detached warrants may have terms that are dissimilar to the debt. Sometime after the issuance of the debt, the company may issue to the holder of the debt additional warrants with terms similar to the debt but with a lower strike price. In addition, the company may issue warrants to parties involved in the issuance of the debt (e.g., lawyers, investment bankers, etc.). Would any or all of these warrants be considered entered into in connection with the issuance of the contingently convertible debt? Some considerations include whether the derivative was entered into simultaneously or contemporaneously with the contingently convertible financial instrument, whether the derivative was entered into with the same counterparty that purchased the contingently convertible instrument, and whether changes in the derivative offset changes in the contingent conversion option embedded in the financial instrument.

In order to ensure consistent application, we recommend that the staff clarify what is meant by entered into in connection with the issuance of the contingently convertible instruments. Providing indicators and examples may be useful tools for clarifying when a derivative transaction is considered to be “in connection” with the issuance of a contingently convertible financial instrument.

4. *Editorial Comments*

- a. Paragraph 3(a) of FSP 129-a states, in part:

The share price or other benchmark(s) that must be achieved for conversion to occur and any significant features necessary to understand conversion rights and the time of those rights [Emphasis added]

We recommend that the term “benchmark” be replaced with “condition” as this is more consistent with the description of contingencies in FASB Statement No. 128, *Earnings per Share*.

- b. Paragraph 4 of FSP 129-a states, in part:

Since contingently convertible shares may or may not be included in the calculation of diluted EPS ... [Emphasis added]

We recommend that the Board replace the term, “contingently convertible shares” with “underlying shares of the contingently convertible financial instruments.”