

PricewaterhouseCoopers LLP  
400 Campus Dr.  
Florham Park NJ 07932  
Telephone (973) 236 4000  
Facsimile (973) 236 5000  
www.pwc.com

October 15, 2007

Mr. Russell G. Golden  
Director of Technical Application and Implementation Activities  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116



LETTER OF COMMENT NO.

41

**File Reference: Proposed FSP APB 14-a**

Dear Mr. Golden:

PricewaterhouseCoopers LLP appreciates the opportunity to respond to the guidance that the Financial Accounting Standards Board has proposed in FASB Staff Position No. APB 14-a, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*.

The accounting for financial instruments with both liability and equity characteristics is challenging, and we share the concern expressed by others that the current accounting model for convertible debt under APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14), does not result in the recognition and measurement of interest cost that is reflective of the economic borrowing cost of the instrument. However, this issue impacts *all* convertible debt instruments, not just those that may be fully or partially settled in cash upon conversion. We do not believe that the Board should create a new accounting model for a subset of convertible debt instruments when those instruments are not substantively different economically from other instruments that will continue to be within the scope of APB 14. The fact that certain of the instruments within the scope of the new guidance do not have to apply the more dilutive if-converted method for computing earnings per share does not adequately justify the change. Because the proposed FSP does not address the fundamental issue that is common to all convertible debt instruments in a comprehensive fashion, and because it will create additional complexity in financial reporting at a time when efforts are underway to reduce accounting complexity, we do not support the Board's issuance of this guidance.

The Board's agenda currently includes a project to broadly address financial instruments with characteristics of both liabilities and equity. We believe that the best course of action is to address the accounting for all convertible debt instruments at one time through that project. This will enable the Board to not only address the issue in a comprehensive fashion for all convertible instruments, but will also eliminate the need for financial statement preparers, auditors and users to temporarily apply a new accounting model to a subset of these instruments and then adopt another model within a relatively short period of time. The potential for multiple changes in accounting is a very real possibility in this case, as the Board has already expressed its preference for the direct ownership approach in the

liabilities and equity project, which strongly suggests that the ultimate accounting model for convertible debt instruments will not be consistent with the one proposed in the FSP.

In lieu of the proposed guidance, we suggest that the Board consider enhancing the financial statement disclosures surrounding all convertible debt instruments by requiring the disclosure of the estimated effective borrowing rate which would have been incurred absent the conversion option in the instrument. Such a disclosure would provide financial statement users with additional information that is helpful for evaluating the financing costs associated with convertible debt instruments, but would not confuse those users with different accounting models. Requiring enhanced disclosures as an interim step has been effective in the past on projects addressing complex issues. We believe that this approach can serve as an information bridge for users until the Board can finally conclude on the appropriate accounting model for all convertible debt instruments.

If the Board decides to move forward with the proposed guidance, we recommend that it reconsider the transition and effective date requirements. We believe that retrospective application will be of marginal benefit and potentially difficult for preparers. Some have suggested that many issuers of convertible debt will likely avoid issuing instruments that fall within the scope of the proposed FSP in the future, and many issuers with instruments currently outstanding will likely consider amending or refinancing them to eliminate the cash settlement features. Additionally, preparers will need sufficient time to obtain the necessary historical valuations as of each convertible debt instrument's issuance date, as well as any subsequent early conversion dates, and to recast the financial statements for all periods presented in accordance with the proposed model. Accordingly, we believe that extending the effective date and applying the new guidance prospectively is a more practical approach if the Board decides to proceed with issuing the FSP.

### Other Comments

In addition to the comments discussed above, we recommend that the Board further clarify certain aspects of the guidance. We offer the following suggestions and observations for the Board's consideration:

- The proposed FSP requires the initial carrying amount of the liability component to be based on the estimated fair value of a similar debt instrument that is not convertible, and the remaining basis in the convertible debt instrument to be allocated to the equity component. That approach is inconsistent with the methodology for allocating the proceeds received from issuing debt with detachable warrants under APB 14 (i.e., the basis is allocated based on the relative fair values of the two instruments), and debt with an embedded option that is bifurcated pursuant to FAS 133, *Accounting for Derivative Instruments and Hedge Accounting Activities*, (i.e., the embedded derivative is recognized at its fair value and the residual balance is allocated to the debt host contract). Additionally, estimating the fair value of a similar nonconvertible debt instrument may be challenging, especially for those entities with credit ratings that are non-investment grade. Rather than increasing complexity by prescribing a single method that is inconsistent with other accounting practices, we suggest that the Board consider allowing the use of other reasonable methods to allocate an instrument's basis between the liability and equity components. Allowing alternative approaches will also help preparers, such as those with non-investment grade credit ratings, which may find estimating the fair value of the equity component less difficult and more accurate than estimating the fair value of the liability component.

- The proposed FSP requires that the debt discount created by allocating a portion of the instrument's basis to the equity component be amortized to interest cost, using the interest method over the expected life of a similar non-convertible instrument. Many preparers amortize the discount or premium related to a debt instrument over the contractual life of the instrument, or the period from the issuance date to the first put date if it is redeemable by the holder prior to maturity. We believe that requiring a different amortization period for instruments subject to this FSP creates unnecessary complexity. For this reason, we recommend that the Board allow entities to apply an amortization policy that is consistent with their other debt instruments. Additionally, it may be helpful if the Board considers addressing the treatment of issuance costs in the proposed FSP. We have received numerous inquiries as to whether it is also appropriate to allocate the issuance costs associated with a convertible debt instrument between the liability and equity components. We believe such an approach is reasonable and consistent with the overall accounting model proposed. However, it is unclear whether it was the Board's intention to extend the scope of the proposed FSP to include issuance costs.
- The proposed FSP requires that the entire value of the incremental consideration given to the holder of a convertible debt instrument to induce conversion be recognized in earnings as a loss. However, that accounting appears to be inconsistent with the proposed FSP's overall accounting model, which accounts for the issuance of both debt and equity instruments. We believe that the accounting for inducements should be consistent with the accounting for a conversion that was not induced and thus incremental consideration issued should be allocated to the liability and equity components.
- The Basis for Conclusions for the proposed FSP cites the inconsistency between accounting for convertible debt instruments with the characteristics of Instrument C as convertible debt under APB 14, but not as convertible debt for purposes of computing earnings per share, as justification for addressing this accounting issue. However, we note that the scope of the proposed guidance is broader than just Instrument C and also includes Instrument B. Because convertible debt instruments with the characteristics of Instrument B must apply the more onerous if-converted method for computing earnings per share, we question the appropriateness of including them within the scope of the guidance.
- The proposed FSP requires the retrospective application of its guidance to all periods presented and provides a simple example to illustrate the new accounting model. While the example is very helpful, we recommend that the Board consider informing preparers that they may also need to make other less obvious adjustments, as the proposed accounting model may prove far more complex in some cases. For example, a retrospective application for entities with significant capital expenditures may also impact the amount of interest cost capitalized on the constructed assets, which will in turn cause an adjustment to the accounting basis of property, plant, and equipment, depreciation expense, and the related deferred tax balances for these items.

Please contact John Lawton (973-236-7449) or John Althoff (973-236-7288) if you have any questions regarding our comments.

Sincerely,

PricewaterhouseCoopers LLP