Goldman Sachs

Mr. Russel G. Golden Director of Technical Application & Implementation Activities Financial Accounting Standards Board

Via Email

October 15, 2007

Dear Mr. Golden:



LETTER OF COMMENT NO. 24

Thank you for the opportunity to comment on the tentative conclusion reached by the FASB Staff in FSP APB 14-a, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement) (the "Proposed FSP"). We have numerous clients who have issued convertible bonds that will be impacted by the guidance in the Proposed FSP. We disagree with the FASB's decision to change the accounting for the subset of convertible bonds within the scope of the Proposed FSP for several reasons.

The guidance in the Proposed FSP is based on the Staff and the Board's conclusion that convertible bonds within its scope are not addressed by paragraph 12 of Opinion 14. We believe that there are many compelling reasons not to change the accounting for convertible bonds even if one agrees with this conclusion.

### Piecemeal Approach to Changing GAAP

We believe a change to the accounting for convertible bonds should be decided by the Board in the context of its Liabilities & Equity Project. The accounting for convertible bonds (and most equity instruments) has evolved in a piecemeal fashion that has introduced an enormous amount of complexity and uncertainty to the accounting for convertible bonds. There are at least 2 accounting standards, 15 EITF Issues as well as a significant amount of accounting firm practice guidance that an issuer must consider when issuing a convertible bond. Certain guidance applies only to a subset of convertible bonds. For example, Issue 05-1 applies only to convertible bonds with a conversion price struck high enough to be considered non-substantive for accounting purposes. The Proposed FSP will add further complexity and rules-based guidance without making any progress on a comprehensive, principles-based framework for instruments with components of both liabilities and equity. These piecemeal changes also introduce significant uncertainty in the capital markets which impedes the ability of US corporations to raise efficient capital and remain competitive in the global economy.

Admittedly, the Board is working on the Liabilities & Equity Project in a deliberate manner so it may be some time before a final Standard is in effect. This however, is the appropriate way to resolve the complex issues, including separation, that exist in looking at the accounting treatment for convertible bonds. In addition, from observing the Board's deliberations on this project we believe the pace has been due, in large part, to the complexity of the issues and decisions to be made. We would observe that a majority of the issues the Staff and the Board have been struggling with regard to the measurement of instruments under a separation approach will have to be solved in the context of the Proposed FSP.

### Financial Statement Complexity

The Proposed FSP will introduce complexity that could make GAAP financial statements less relevant to users. Under the Proposed FSP issuers will show some fraction of the debt liability. For some convertible bonds the debt component could be as low as 50% of the par amount. However, if the issuer becomes insolvent the claim of the holder is par value. This differs from a zero-coupon bond, which is also recorded on an issuer's books at a discount, but has a claim in bankruptcy similar to the accreted value. Thus, separation can become very misleading from creditors' perspective by understating the real amount of an issuer's debt obligations.

In addition, judgments made when performing the separation calculation required by the Proposed FSP may decrease financial statement comparability. Issuers will have to make judgments on, among other things, identifying the terms of the hypothetical straight debt instrument to be valued and what to do if the issuer does not have any extant non-convertible debt.

Determining the terms of the appropriate hypothetical straight-debt will be challenging and subject to interpretation. An issuer of a fixed maturity bullet convertible bond may be able to determine its straight-debt rate for a bullet bond with an equivalent term (provided the issuer has straight-debt outstanding). However once the more complex features that exist in most convertible bonds are added, the determination of the straight-debt rate will get significantly more complicated.

For example, what is the appropriate debt instrument to use to calculate the debt component of a 30 year convertible bond, which the issuer can call in 5 years (30NC5)? A non-convertible 30NC5 bond is <u>not</u> equivalent to the debt component of the convertible 30NC5 bond. The basis for the decision to call each bond is entirely different; the non-convertible call decision is based on interest rates and credit spreads, whereas the convertible call decision is based somewhat on interest rates and credit spreads, but predominantly on the issuer's equity price.

A second example illustrates further complexity. What is the appropriate debt instrument to use to calculate the debt component of a 30 year convertible bond, which the issuer can call or the investor can put in 5 years (30NC5P5) that contains a contingent interest feature? A non-convertible 30NC5P5 bond is economically a 5 year bond as it will be advantageous to either the issuer to call or the investor to put the bond at year 5. However, the issuer of a convertible 30NC5P5 contingent interest bond may not call the

bond at year 5 as it would have to forgo future tax benefits of the contingent interest feature even when it may also not be advantageous to the investor to put. Thus, a non-convertible 30NC5P5 is <u>not</u> equivalent to a convertible 30NC5P5 contingent interest bond. So, should the issuer use a 5 year debt rate, a 30 year debt rate or something else? For tax purposes, issuers generally use the 30-year straight debt rate to calculate periodic interest for the above instrument, but if the debt component of this instrument was derived by treating this as a 30-year discount bond it would dramatically overstate the value of the conversion option.

Furthermore, many convertible bond issuers do not have any straight debt to benchmark against. Approximately 30% - 40% of issuers of convertible bonds do not have any straight debt and do not have a rating from a third party credit rating agency. In fact many convertible bond issuers cannot issue straight debt. This has become exacerbated by the recent turmoil in the high-yield market. It is not clear how such issuers should determine the terms of the "debt host".

There are also issuers that could issue straight debt but choose not to do so because they would have more restrictive covenants on straight debt then they do in a convertible bond given the different investor demands. Issuers will need guidance on whether the impact of these restrictive covenants should be taken into account to compute a non-convertible straight debt rate and if so, how.

The issues described above are just a sample of the types of decisions issuers may face as convertible bonds can have other more complex features that make it even more difficult to isolate the debt component. For example, some bonds have provisional call rights which can only be exercise if the bond is significantly "in the money." Convertibles can have step-up or remarketing features as well as pay-in-kind features that make the straight debt component even more difficult to isolate.

### Fair Value Option

We do not believe there should be a prohibition from applying the Fair Value Option within the Proposed FSP. Paragraph 8(f) of Statement 159 prohibits an entity from measuring financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity. However, once a convertible bond is separated, it should be accounted for as a separate debt and equity instrument. Thus, an issuer should be able to apply the Fair Value Option to the debt component. We do not believe an issuer of separable debt + warrants would currently be prohibited from applying Statement 159 to the debt component and do not believe an issuer of a convertible bond within the scope of the Proposed FSP should be prohibited from doing so. This is consistent with the FASB's conclusion in the Proposed FSP that convertible bonds within the scope should be accounted for like debt + warrants.

# Earnings per Share

Some issuers of convertible bonds within the scope of the Proposed FSP will still be required to use the if-converted method of calculating diluted EPS. Such issuers have "Instrument X" bonds outstanding and have not overcome the presumption of share settlement. It would be helpful for the FASB to provide guidance regarding how the diluted EPS calculation should be performed for those issuers with bonds within the scope of the Proposed FSP who must apply the if-converted method of calculating diluted EPS.

# Effective Date

It is our understanding that the FASB plans to issue a final FSP sometime late in the fourth quarter of 2007 effective for fiscal years beginning after December 15, 2007. We believe this is much too short a transition period for such a significant accounting change. In particular, as highlighted above we believe there are a number of issues that will need to be addressed by issuers and their auditors regarding how the separation calculation should be performed. In addition, it will take some time for issuers to obtain the necessary information to effect such separation since they will often need to recreate history. We would recommend the Proposed FSP have an effective date at least six months following issuance, but preferably a year after it is issued.

# Grandfathering

The accounting for convertible bonds within the scope of the Proposed FSP was clearly prescribed by the EITF in Issue 90-19 and was not an area with diversity in practice. Numerous issuers followed this guidance and based their decision to issue a specific security, in part, on the settled accounting treatment. Given this, it seems punitive to require issuers who had reason to believe that this guidance would remain in effect until the Liabilities and Equity Project is completed, to apply the guidance in the Proposed FSP. We would recommend the FASB consider grandfathering bonds issued prior to March 15, 2007 – the date the EITF first discussed a proposed change to the accounting for convertible bonds within the scope of EITF Issue 90-19.

If you would like to discuss our comments or any other issues further you can contact me at 212-902-7052 or Nora Joyce at 212-357-8391.

Sincerely,

Timothy J. Bridges Managing Director