



LETTER OF COMMENT NO. 1

Dear Mr. Smith,

Please allow me to share with my thought about the proposed DIG C21. I will highly appreciate your comments.

Background and Example:

A convertible bond (with face value USD\$1000) is denominated in USD issued by a Taiwanese company and the Taiwanese company's functional currency is Taiwan Dollar (TWD). There is a embedded conversion option which allows a bondholder to convert the USD\$1000 into the Taiwanese company's common shares or depository receipts (GDRs), each representing 5 common shares. The common shares are listed on the Taiwan Stock Exchange and the GDRs are listed on Luxembourg Stock Exchange. The conversion price will be TWD\$17 per common share with a fixed rate of exchange applicable on conversion of the bond of TWD\$34=USD\$1.

Analysis:

Question 1 of the proposed C21

The proposed C21 describes "The consideration received by the issuer (the debt host) is denominated in the issuer's functional currency, so its fair value to the issuer is not affected by currency exchange rates. Thus, the exercise price of the embedded conversion option in this example is deemed to be fixed. Additionally, the number of equity shares that are issuable upon conversion is fixed. Based on the guidance herein, neither the fair value of the consideration received by the issuer (the exercise price) nor the number of shares issuable upon conversion varies based on an underlying; therefore, the embedded conversion option is considered to be indexed only to the issuer's own stock."

Take above example. The exercise price in term of the Taiwanese company's functional currency (TWD in the case) is fixed at the issuance of the bond. The fixed rate of exchange applicable on conversion of the bond makes both the consideration received by the issuer and exercise price denominated in the issuer's functional currency. The effective exercise price of the embedded conversion option is fixed at TWD\$34,000 (USD\$1,000 * fixed FX rate TWD\$34). Upon conversion and at bondholder's choice, the Taiwanese company will issue 2,000 shares (=TWD\$34,000 / conversion price TWD\$17) or 400 units of GDRs (=2000 shares / 5 shares) no matter what current market exchange rates are when converting. The fixed rate of exchange applicable on conversion switches foreign currency risk to bondholders. Thus, the embedded conversion option is considered to be indexed only to the issuer's own stock.

Question 2 of the proposed C21

The proposed C21 describes "an option to acquire a fixed number of an issuer's equity shares with an exercise price that is denominated in the issuer's functional currency (including a conversion option embedded in a functional-currency-denominated convertible debt instrument) shall not be considered indexed to currency exchange rates even though the shares issuable upon exercise or conversion are traded only on an exchange (or other established marketplace) on which trades are not executed in the issuer's functional currency."

Take above example. The conversion option, embedded in the non-functional-currency-denominated convertible bond, whose both exercise price and consideration received by the issuer are denominated in the issuer's functional currency will issue GDRs upon bondholder's conversion choice that are traded on Luxembourg Stock Exchange. The issuer is required to deliver a fixed number of units (400 units) in exchange for the reacquisition of a debt host instrument. Thus, even though the shares issuable upon conversion are traded on an exchange (or other established marketplace) on which trades are not executed in the issuer's functional currency, the conversion option is not considered indexed to currency exchange rates.

Conclusion:

Question 1 of the proposed C21

Each convertible instrument has its own way to define conversion option's exercise price. "Illustrative Convertible Debt Instrument --Question 1" is one of many ways to define exercise price. It may not be appropriate to issue GAAP guidance based on a very unique feature of a convertible bond. Please consider to issue a principle based example to guide a convertible bond issuer how to account for the bond.

Question 2 of the proposed C21

A bond issuer's shares may trade on different exchanges on which trades are executed in her functional currency and/or other than her functional currency. Per the above example, the Taiwanese company's shares are traded on both Taiwan Stock Exchange and the GDRs are listed on Luxembourg Stock Exchange. From the analysis, the conversion option is still indexed only to the issuer's own stock. The language in "Illustrative Convertible Debt Instrument --Question 2", "Those shares are not traded on an exchange (or other established marketplace) on which trades are executed in US\$." may be irrelevant to the accounting treatment. Please consider to omit.

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