



File Reference: Proposed Statement 133 Implementation Issue C21, “Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity’s Own Stock and Currency Exchange Rates.”

Dear Mr. Smith,

We believe that the overall guidance in the proposed implementation issue is clear, namely that “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.” However, the proposed implementation issue does not provide further guidance on identifying “the issuer,” which may be relevant in structures where a financing or operating subsidiary issues debt that is convertible into the equity shares of the parent. We believe the Implementation Issue should clarify whether the “issuer” refers to the issuer of the convertible notes of the issuer of the equity shares.

For example, consider a variation on the Illustrative Convertible Debt Instrument – Question 2. A subsidiary with the U.S. dollar (US\$) as its functional currency issues debt denominated in US\$ that is convertible into the equity shares of its parent. The parent has the Euro (EUR) as its functional currency and reporting currency. The parent’s equity shares are only traded on an exchange on which trades are executed in US\$.

Applying the guidance in the response to Question 2, the equity shares are not inherently denominated in a particular currency, so the fact that the EUR functional parent’s equity shares are traded on a US\$ exchange does not affect the analysis of whether the embedded conversion option qualifies for the scope exception in paragraph 11(a) of Statement 133.

However, the guidance focuses on the “issuer’s” functional currency and the exchange on which the “issuer’s” shares are traded. In the example above, the “issuer” of the convertible notes and the “issuer” of the shares are two different entities, and the fact that these have (or could have) different functional currencies could impact the conclusion as to whether the scope exception in paragraph 11(a) of Statement 133.

For purposes of consolidated financial statements, it seems that at least the following variations of the “issuer” could be possible: (a) the group of companies (such as the “registrant”, or as paragraph 11(a) of Statement 133 states, the “reporting entity”), (b) the entity issuing the debt, or (c) the entity issuing the shares (the parent company).

In EITF Issue No. 99-1, *Accounting for Debt Convertible into the Stock of a Consolidated Subsidiary*, the Task Force reached a consensus that in consolidated financial statements, debt issued by either the parent or the subsidiary that is convertible into the stock of a consolidated subsidiary should be accounted for in accordance with Opinion 14, since a separate instrument with the same terms as the embedded instrument meets the exception

in paragraph 11(a) of Statement 133. Also, paragraph 5 of Statement 150 states: "For financial instruments issued by members of a consolidated group of entities, 'issuer's equity shares' includes the equity shares of any entity whose financial statements are included in the consolidated financial statements."

Based on the guidance above, it would appear reasonable to conclude that, in consolidated financial statements, the analysis of whether the embedded conversion option meets the exception in paragraph 11(a) of Statement 133 is not affected by whether the equity shares to be issued upon conversion are equity shares of the parent, equity shares of the subsidiary issuing the convertible debt, or equity shares of another subsidiary in the consolidated group.

We believe it would be useful for the proposed implementation issue to clarify the definition of "issuer" as being the entity that issues the convertible notes and clarify "issuer's equity shares". Without this clarification, it is possible that preparers and auditors would focus narrowly on the debt issuer's equity shares, which could raise further questions if the equity shares issued upon conversion are equity shares of another entity in a consolidated group. To prevent such confusion, we propose that the implementation issue define "issuer's equity shares" consistent with the definition in Statement 150.

Best regards / mit freundlichen Grüßen

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