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File Reference: Proposed FSP APB 14-a.



LETTER OF COMMENT NO. 38

**Re Proposed FASB Staff Position APB 14-a- Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement).**

Dear Mr. Golden:

We appreciate the opportunity to comment on the recently proposed FASB Staff Position (FSP) APB 14-a related to the accounting treatment for certain convertible debt instruments that may be settled entirely or partially in cash upon conversion.

ATK is \$4.0 billion Advanced Weapons and Space Systems Company with \$780 million of convertible debt outstanding. Upon conversion, we must satisfy the accreted value of the obligation in cash and the conversion spread (the excess conversion value over the accreted value) in cash or stock. Commonly referred to as an Instrument "C" under EITF 90-19, Convertible Bonds With Issuer Option to Settle for Cash Upon Conversion.

The purpose of this letter is to present our opinions in the following key areas:

**The proposed accounting does not reflect the true economic substance of the transaction**

Currently the accounting for convertible debt, specifically instrument "C" is clear

- Our balance sheet reflects the amount of cash due to note holders.
- Interest expense equals the cash coupon paid to holders.
- As the notes get into the money, we report the dilutive impact in diluted EPS under the requirements of EITF 03-07, Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of No. 90-19).

Under the proposed FSP we would be required to carry the debt balance at an amount less than the amount due the holders. Their claims in bankruptcy are equal to the par value which will be greater than the carrying amount on the balance sheet. Interest expense will be in excess of the coupon rate. If the convertible price is never reached, interest expense will be recorded by the issuer that will never be paid to the holders. Under the proposed FSP we will continue to have the dilutive impact in EPS (consistent with the delivery of shares upon conversion) in addition to the additional interest expense. The FASB states that one of the reasons for the new FSP is the benefit companies receive in the early years before dilution due to a low coupon rate. We disagree that the additional expense and EPS dilution in later years is any more comparative or reflective of the economics of the transaction.

**The proposed separation would likely lead to a lot of confusion among the investing community.**

Given that proposed FSP accounting produces misleading economic effects, issuers will attempt to present non-GAAP reconciliations to provide their investors information about the true financial health of the company. Many ratios and metrics that are commonly used by investors (EPS, Leverage ratios, Price/Earnings ratio, Return on Equity) will be impacted significantly. For example, the return on equity will be worse once the financial statements are restated for the retrospective adoption but will improve each year even though the underlying business has not changed. This distortion of key metrics would be misleading to investors.

**The substance of convertible debt (specifically instrument “C”) is not separable into debt plus warrants.**

Instrument “C” is not separable into debt plus warrants for the following reasons:

- Unlike a warrant, the conversion option cannot be separately traded.
- The exercise of the conversion options does forgo any future interest payments. Once the conversion option is exercised, the debt must be repaid.
- The creditors claims in bankruptcy is that of a convertible bond, not a discounted debt instrument.

In the basis for conclusions included in the FSP, the Board concluded that EITF Issue 90-19, as revised, expanded the application of the guidance in paragraph 12 of APB Opinion 14 because the Opinion contains no discussion of convertible debt instruments that may be settled in cash upon conversion. We believe that paragraph 3 referred to in paragraph 12 of APB 14 does clearly define features of convertible debt. Instrument “C” contains all the features described in paragraph 3. Paragraph 7 of APB 14 notes that “the most important reason given for the accounting for convertible debt solely as debt is the inseparability of the debt and conversion option.” The holder of an Instrument “C” note cannot sell one right and maintain the other.

We do not believe additional guidance is necessary. Since APB 14, accounting literature such as EITF’s 00-19, 90-19, 03-07, 04-08 and FASB Statements 133 and 150 have analyzed these features and provided an accounting model that is widely accepted and followed. There is a consistent model to account for these transactions.

The FSP states that the bifurcation calculations are already being performed for tax purposes as convertible instruments typically contain contingent interest provisions that entitle the issuer to deductions at a higher nonconvertible debt rate. Unlike the calculations required by the FSP, the tax calculations are typically over a longer period (the term of the note, not just to the first redemption period) and the deduction is taken on the full par value of the notes not the discounted debt amount.

**Limited deliberation and review associated with the FSP may create unanticipated interpretational results.**

The FASB is able to issue an FSP quickly as they are not subjected to the extensive review and examination endured by Financial Accounting Standards. However, when a FSP touches upon a broad based issue (such as potential de facto amendments of APB 14, SFAS No. 133 and SFAS No. 128) the accelerated process may fail to fully address and resolve issues leading to further confusion, diversity in practice and need for guidance. (The two FINs and approximately 15 FSP’s addressing the accounting for variable interest entities (i.e. FIN 46) are examples of the potential for issues associated with “quick” accounting guidance issues with broad impacts.)

**The term “Expected life” requires additional clarification.**

Our convertible debt contains a contingent put feature that allows our debt holders to accelerate the redemption date and put the debt to us, at their sole discretion, once a certain share price is reached. We believe that the current accounting literature requires the debt be reclassified from long-term to short-term debt. Given this classification of debt as current, we expect that once the contingent put feature is triggered, all remaining debt discount should be written off so that the carrying amount of debt equals the amount owed to the note holders on that date. This seems to be consistent with SEC Staff Accounting Bulletin, Topic 3-C, Redeemable Preferred Stock (SAB Topic 3-C), which states, in part that the carrying amount shall be increased by periodic accretions, using the interest method, so that the carrying amount will equal the mandatory redemption amount at the mandatory redemption date. This treatment would result in the redemption amount on the balance sheet on the earliest redemption date (i.e. once the contingent put option share price is met). In addition, it would seem inconsistent to reclassify the debt to current and not adjust the liability to an amount owed to the holders. We request the Board clarify that once the redemption date is accelerated and the debt may be put back to the Company, at the sole discretion of the note holder, we would immediately write-off of any unamortized debt discount.

We believe that any other approach introduces subjectivity, may result in unintentional interpretational results, and adds confusion among the investing community.

**Given the FASB's current liabilities and equity project, the effort to implement the new FSP may be repeated in a relatively short time frame.**

The Board has stated that its liabilities and equity "project is one part of the Board's broader initiative to improve the accounting for financial instruments. The project's objective is to develop a comprehensive standard of accounting and reporting for financial instruments with characteristics of equity, liabilities, or both, and assets." They also state "Consistent with the FASB's broader convergence goals, the Board will use this project to further converge with accounting standards developed by the IASB. Presently, the FASB and the IASB plan to conduct this project under a modified joint approach." Given the Proposed FSP does not achieve convergence and new accounting guidance is forthcoming, we believe new guidance should be part of the broader project in order to limit confusion and prevent the duplication of effort.

**Given the quick timeframe of implementation, companies will not be able to properly include the impact in their normal planning and budgeting used to responsibly manage their business.**

Given the earliest the final FSP could be issued is November or December, with an implementation date for years beginning after December 31, 2007 many companies planning process will be significantly impacted. Many companies will need to scramble to reallocate funds to achieve the targets most likely already approved by the Board of Directors. The compressed timeframe will make it difficult to adequately explain the change to investors and the investor community and thus add confusion. If valuation assistance is necessary to fair value the debt component, the timeframe will be even more compressed

### **Suggested Resolution**

For the reasons explained above, we believe the current accounting represents the true economic impacts of the transaction and therefore no change is warranted. If the Board insists a change is warranted, we suggest the Board wait to issue any guidance until they complete the liabilities and equity project. This project will allow the Board to achieve its broader goals.

If the Board is unwilling to wait for the completion of the liabilities and equity project, we ask they handle the proposed accounting as disclosure only or delay the effective date for years beginning after December 15, 2008 and clarify the meaning of "expected life". This one year delay provides companies adequate time to understand the impact on both past and future periods. This also gives companies time to adequately disclose the impact to the users of the financial statements.

**Wayde Heirigs**  
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**John Shroyer**  
Senior Vice President and Chief Financial Officer