

LETTER OF COMMENT NO. /L

14



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October 12, 2007

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

Re: Proposed FSP APB 14-a

Dear Mr. Golden:

SanDisk Corporation ("SanDisk" or "We") appreciates the opportunity to provide our views on the Proposed FASB Staff Position APB No. 14-a, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), (the "Proposed FSP"). We first provide general comments on the Board's proposed solution to the accounting for convertible debt instruments that require or permit partial cash settlement upon conversion. We then provide comments on the three specific points highlighted in the Notice to Recipients in an Appendix to this letter.

We understand the Board's objective is to provide investors with a better representation of interest costs for convertible debt instruments that require or permit partial cash settlement upon conversion. However, we do not believe that the fundamental changes from existing GAAP the Proposed FSP is advocating, primarily the separation of the liability and equity components in these types of instruments, achieves that objective. We believe the Proposed FSP contributes to unnecessary incremental accounting complexity, reduced relevance of financial reporting, and further compromises the presentation and accuracy of certain financial statement line items under current GAAP.

First, we believe the separation of the debt from the conversion option does not reflect the reality or the economic substance of such convertible debt instruments. Second, we believe this type of convertible instrument is included within the scope of Accounting Principles Board No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants ("APB 14"). Third, we believe the method of separation as prescribed in the Proposed FSP results in the understatement of liabilities and creates a "hypothetical interest" model that could be misleading to users of the financial statements.

1. The Board's view that the issuer of a convertible debt instrument that requires or permits partial cash settlement upon conversion should recognize the same interest cost they

would have incurred had they issued a comparable debt instrument without the embedded conversion option is the basis for the separation of the debt and equity components. However, the economics of such instrument do not support the separation of the debt from the conversion option. Investors accept a lower coupon in exchange for an embedded option, as they would for other convertible instruments which provide for delivery of shares upon conversion. The holders of such convertible debt instruments will receive the same conversion value regardless of how the convertible debt instrument is settled, whether 100% in shares or for cash for the principal amount and shares for the conversion spread. Therefore, we believe the settlement option does not change the economic substance of the transaction, and the accounting for this type of instrument should follow the current accounting for other convertible debt instruments.

- 2. The Proposed FSP maintains that debt instruments that require or permit partial cash settlement are not addressed in APB 14. We disagree with this conclusion and believe that the debt and conversion option of such instruments meet the non-separability criteria of APB 14 paragraph 7, regardless of how the security, as a whole, is settled. These types of convertible debt instruments are structured such that the equity component cannot be separately traded from the debt component. In addition, the exercise of the conversion option and the repayment of the debt are mutually exclusive. The holder of the instrument cannot exercise the option to convert unless they forego the right to redemption. This is most easily illustrated in the case of a conversion (however unlikely) while the conversion option is "out-of-the-money." In this case, the holder would be redeemed for less than the debt claim. Therefore, we believe APB 14 has already addressed the issue of separability, and this type of convertible instruments should be treated as convertible debt in accordance with APB 14.
- 3. We believe the method of separation as currently prescribed in the Proposed FSP would result in the recording of a liability that does not reflect the issuer's true obligation to its investors. The issuer has an obligation to repay the full face value of the debt at all times, not merely as of the "expected life," and the balance sheet would reflect a much lower liability under the proposed separation of debt and equity components in the Proposed FSP. Furthermore, the resulting accounting for interest costs would not reflect the true interest costs for the issuer, thereby creating "hypothetical interest" which would distort the net earnings presentation of the issuer as well as create a deferred tax liability which would have no economic substance.

We agree with the Board that an inconsistency exists regarding the diluted earnings-pershare treatment of convertible debt instruments that require or permit partial cash settlement. However, we believe a better alternative to the Proposed FSP would be to treat these types of convertible debt instruments under the "if-converted" method. This would be preferential to recognizing additional interest cost because it would be consistent with existing GAAP as opposed to establishing new rules for a subset of convertible debt instruments, and no estimation would be required. Whereas with the current Proposed FSP, we believe estimation and significant management judgment would be required to fair value the notes upon conversion, which introduces another level of variability in the financial statements.

While one can argue that using the if-converted method creates the issuance of hypothetical shares under Statement of Financial Accounting Standards No. 128, *Earnings Per Share*, the Proposed FSP, as currently drafted, creates hypothetical interest. We believe there is no current GAAP literature that supports a basis for a preference of hypothetical shares or

hypothetical interest. From a preparer's standpoint, retroactively restating earnings-pershare would be less disruptive to the investors, capital markets and users of financial information than retroactively restating net income, and is preferable since there is already an existing GAAP framework for the if-converted method with no estimation required. Additionally, we believe the Proposed FSP should be drafted based upon a technical solution without initial concern for convergence with IFRS.

In summary, we believe that the Proposed FSP does not represent an improvement in financial reporting due to its interpretation of only a subset of convertible instruments, nor a more appropriate interpretation of existing GAAP. Issuing this type of piecemeal guidance that contradicts existing GAAP diminishes financial reporting relevancy to all users of the financial statements and pushes companies to focus on non-GAAP measures of income as a more accurate and consistent view of financial results. We believe our proposal to use the if-converted method would limit the use of non-GAAP measures, provide consistent accounting and presentation under an existing GAAP framework rather than create new GAAP, and be easier to implement as it would require no estimation.

The Proposed FSP increases complexity, has significant accounting and tax implications which have no economic substance, and could prove to be problematic should the Board supersede the Proposed FSP when they finalize their joint liabilities and equity project. We believe that users of financial information would benefit more from a comprehensive accounting model that addresses this issue, rather than from separate piecemeal guidance. Until the Board finalizes its liabilities and equity project, we believe that the Board and preparers should continue to apply existing GAAP.

We thank you for providing us with the opportunity to provide our comments on the Proposed FSP and are available to meet with you in person or telephonically to discuss these issues further.

Sincerely.

Donald F. Robertson, Jr.

Vice President and Corporate Controller

SanDisk Corporation

CC: Judy Bruner, Executive Vice President, Administration and Chief Financial Officer

APPENDIX

Issue 1- Method and Application of Separation

This proposed FSP requires that instruments within its scope be separated into their liability and equity components at initial recognition by (a) recording the liability component at the fair value of a similar liability that does not have an associated equity component and (b) attributing the remaining proceeds from issuance to the equity component. The rationale for the Board's decision to require this separation methodology for convertible debt instruments within the scope of this proposed FSP is described in Appendix B. Do you agree with this method of separation? Would this proposed FSP be easier to apply if separation were achieved by (a) recording the embedded conversion feature (equity component) at its fair value and (b) attributing the remaining proceeds from issuance to the liability component?

Response: As discussed above, we do not agree that separation is required at all, and do not believe that the Proposed FSP would be easier to apply if separation were achieved by recording the embedded conversion feature at its fair value and attributing the remaining proceeds from issuance to the liability component.

Issue 2- References to U.S. GAAP

This proposed FSP provides guidance on the attribution of proceeds at initial recognition and at settlement for convertible debt instruments within its scope. It also requires that discounts on the liability component of instruments within its scope be amortized using the interest method over the expected life of a similar liability that does not have an associated equity component (considering the effects of prepayment features other than the conversion option). The remaining guidance in this proposed FSP, including much of the guidance on subsequent measurement and accounting for modifications, primarily consists of references to other applicable U.S. generally accepted accounting principles (GAAP). Does the inclusion of those references to other applicable U.S. GAAP improve the understandability of this proposed FSP, or should those references be eliminated from a final FSP?

Response: Yes. The inclusion of those references to other applicable U.S. GAAP improves the understandability of the proposed FSP and should not be eliminated.

Issue 3- Illustrative Example

Does the inclusion of the illustrative example in Appendix A improve the understandability of the guidance in this proposed FSP, or should that example be eliminated from a final FSP?

Response: Yes. The inclusion of the illustrative example in Appendix A improves the understandability of the guidance in this Proposed FSP and should be included in the final FSP.

However, we believe additional guidance needs to be provided, specifically related to disclosures and the discount rate used in the fair value calculation of the liability component

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upon conversion as shown in Paragraph A7. The Board suggests in Paragraph B8, that the inputs required to estimate the fair value of the nonconvertible debt instrument will be available with limited effort on the part of the issuer. Generally, we agree with this concept at the time of issuance of the debt but disagree that the information is available at the time of conversion. We believe the method used in the fair value calculation at conversion is subject to divergent use of management judgment due to the lack of readily available market information and set terms as provided in the original debt issuance agreement, which could lead to very different answers in practice. For these reasons, we believe our proposal to use the if-converted method is preferable.