



LETTER OF COMMENT NO.

October 15, 2007

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

File Reference: Proposed FSP APB 14-a

Dear Mr. Golden:

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide our perspective on the proposed FASB Staff Position, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement). The organization and operating procedures of the Committee are reflected in Appendix A to this letter. These comments represent the position of the Illinois CPA Society rather than any members of the Committee or of the organizations with which the members are associated.

The Committee disagrees with the conclusion in the proposed FSP. The Committee believes it would result in different accounting treatments for otherwise identical convertible debt instruments where one allows for cash settlement and the other does not. The Committee does not believe that the form of settlement is of significant economic importance and therefore it should not dictate the accounting treatment.

## Form of Settlement Not Important

To illustrate our point that the form of settlement is largely irrelevant to the underlying economics of a convertible debt instrument, consider a convertible bond that does not allow for cash settlement. Upon conversion, the issuing firm would be required to issue common shares in accordance with the conversion terms. The firm could, at its option, simultaneously repurchase on the open market the same number of common shares it just transferred to the convertible debt holders at a cash cost identical to the cash it would have paid out if cash settlement were an option. Thus the firm can effectively create a cash settlement instrument anyway, with the only difference, perhaps, being slightly higher transaction costs. Similarly, a cash settlement can be undone (resulting in the same effect as delivery of common shares) by issuing common shares for cash simultaneous with the conversion. As a result, the Committee sees no substantive

economic difference between convertible bonds that do and do not have cash settlement options.

### **Economically Similar Instruments Should Employ Similar Accounting**

Because our Committee sees no substantive difference between convertible bonds that do and do not allow for cash settlement, it also believes the accounting for such debt instruments should be substantively the same. Therefore, our Committee believes that convertible debt instruments that may be settled in cash should be accounted for according to the same principles as other convertible bonds.

That said, the Committee agrees with much of the logic in the Basis for Conclusions. In particular, our Committee agrees that convertible debt instruments, including instruments within the scope of the proposed FSP, consist of a liability component and an equity component and that separation of those components is conceptually preferable. However, the very same argument may be made about convertible debt instruments that may not be settled in cash, and separation into debt and equity components is not permitted for such instruments. What this FSP highlights to the Committee is a conceptual flaw in the accounting for convertible debt. The Committee believes this flaw should be addressed by reconsidering the accounting for all convertible debt instruments, not by addressing the issue only for a subset of such instruments, especially when the subset is determined by a distinction lacking economic substance.

There are now numerous different sources of authoritative guidance on accounting for convertible debt instruments each with its own accounting model, including: APB Opinion No. 14, SFAS No. 133 and EITF Issues 98-5 and 00-19. This suggests to our Committee a need to readdress accounting for convertible debt instruments as a whole. In doing so, our Committee believes the Board should apply a unifying principle that would lead to similar accounting for substantively similar convertible debt instruments.

The Committee likely would support such reform in accounting for convertible debt instruments. In the meantime, the Committee objects to the proposed FSP because it would further reduce consistency in accounting practices for substantively similar instruments. We prefer consistency with a second-best method over inconsistency.

Although we object to the proposed FSP, we have addressed the specific questions in the exposure document, which presume the FSP is issued. Our responses to those questions are as follows:

Issue 1: 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?

We prefer measuring the liability component at fair value and attributing the remaining proceeds from the issuance to the equity component. We believe in most instances, this approach will be easier to apply.

Issue 2: 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?

We believe references to other applicable U.S. GAAP should be retained in a final FSP.

**Issue 3:** 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?

We believe that an example should be included in the final FSP and that it critical to the understandability of the guidance.

We have one additional comment regarding effective date of the proposed FSP. As noted above, we do not agree with the issuance of the FSP. However, if it issued in final form we recommend that the effective date be delayed for at least one year. We are concerned that the issuance of a final pronouncement so close to its effective date will not allow enough time for implementation.

We appreciate the opportunity to offer our comments.

Sincerely,

John A. Hepp, Chair Accounting Principles Committee

#### APPENDIX A ILLINOIS CPA SOCIETY

# ACCOUNTING PRINCIPLES COMMITTEE ORGANIZATION AND OPERATING PROCEDURES

2007-2008

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint.

Current members of the Committee and their business affiliations are as follows:

#### **Public Accounting Firms:**

Large: (national & regional)

John A. Hepp, CPA Aivin W. Herbert, Jr., CPA Steven C. Johnson, CPA Matthew G. Mitzen, CPA Laura T. Naddy, CPA Reva B. Steinberg, CPA Jeffery P. Watson, CPA

Medium: (more than 40 employees)

Barbara Dennison, CPA Marvin A. Gordon, CPA Ronald R. Knakmuhs, CPA Laurence A. Sophian, CPA Small: (less than 40 employees)

Walter J. Jagiello, CPA Kathleen A. Musial, CPA

Industry:

John M. Becerril, CPA Melinda S. Henbest, CPA James B. Lindsey, CPA Anthony Peters, CPA

**Educators:** 

James L. Fuehrmeyer, Jr. CPA David L. Senteney, CPA Leonard C. Soffer, CPA

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Grant Thornton LLP

Retired/Clifton Gunderson LLP McGladrev & Pullen LLP Virchow Krause & Company, LLP Crowe Chizek and Company LLC

BDO Seidman LLP

Blackman Kallick Bartelstein LLP

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Frost, Ruttenberg & Rothblatt, P.C. Miller, Cooper & Co. Ltd.

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Walter J. Jagiello, CPA Benham, Ichen & Knox LLP

Cabot Microelectronics The Boeing Co.

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