Interpretation of the Emerging Accounting Issues Working Group

INT 02-05: Accounting for Zero Coupon Convertible Bonds

ISSUE NULLIFIED BY SSAP NO. 26

At 1/1/X1:

Purchase Price	$900,000
Bond Fair Value	$750,000
Yield	8.87%
Warrant Fair Value	$150,000

At 12/31/X1:

Bond Fair Value	$780,000
Warrant Fair Value	$200,000

Entries 1/1/X1:

Bonds-AFS	$750,000
Warrants-Trading	$150,000
Cash	($900,000)

Entries 12/31/X1:

Cash (coupon rate)	$50,000
Bonds-AFS (amortization)	$16,554
Investment income	($66,554)

Record discount accretion and cash from coupon rate

Bonds-AFS	13,446
Warrants-Trading	50,000
Unrealized gains-OCI	(13,446)
Realized gains	(50,000)

Mark AFS and Trading to fair value

Statutory Accounting Practice (SAP)

5. Under statutory accounting (SSAP No. 26), a convertible bond is accounted for as a

scientific method. Thus, if the bond does reach the end of the ten years without conversion, this technique was correct because the value of the warrant was zero at the end of the 10-year term. If the value of the warrant was near zero any time prior to the end of the ten-year term, the Company in essence was able to defer the loss on the warrant and amortize it slowly into the income statement.

12. The working group reached a consensus that the full amount of the premium should be recorded as amortization within investment income on the date of purchase.

INT 02-05 Status

13. No further discussion is planned.