



Deloitte & Touche LLP
695 East Main Street
Stamford, CT 06901-2141

Tel: + 1 203 708 4000
Fax: + 1 203 708 4797

www.deloitte.com

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Mr. Shayne Kuhaneck
Acting Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2019-730

Re: Proposed Accounting Standards Update, *Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*

Dear Mr. Kuhaneck:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*.

Though we strongly support the Board's efforts to reduce unnecessary complexity in the application of generally accepted accounting principles (GAAP), we have reservations about the proposed accounting approaches that are being contemplated for convertible instruments and contracts in an entity's own equity. Accordingly, we do not support the finalization of the proposal in its current form.

Accounting for Convertible Instruments

Establishing a set of internally consistent principles for the development of relevant and representationally faithful financial information and reducing unnecessary complexity for financial instruments with characteristics of both liabilities and equity should be a high priority for the Board. The existing accounting literature in this area is unnecessarily complicated. The existence of multiple models for economically similar instruments adds cost and complexity for preparers and makes it difficult for users to interpret the financial statements.

We encourage the Board to not lose sight of the objective of general-purpose financial reporting and related conceptual issues in its pursuit of simplification. Accounting standards should lead to financial reporting that is representationally faithful of the underlying economic activity. Disclosures are not a substitute for good accounting. If an entity's balance sheet and income statement do not faithfully depict the real-world economic phenomena that they purport to represent, their usefulness is diminished, and the economic reality of transactions may be masked.

The proposal to recognize and measure convertible instruments in a manner that ignores the economic cost of the embedded equity conversion feature raises foundational questions about the meaning and purpose of an entity's balance sheet and income statement. Historically, the existing accounting requirements for convertible instruments were developed in response to concerns about opportunities for accounting structuring, arbitrage, and abuse under accounting models that do not reflect the cost of embedding an equity conversion feature in a

below-market interest rate debt instrument. Under the proposed approach, such opportunities will reemerge. For example, an entity could artificially boost reported net income by embedding an equity conversion feature in a zero-coupon debt instrument issued at a significant premium to par. Over the life of the debt instrument, the debt premium would be amortized as negative interest expense, thereby improving net income. However, this accounting would be misleading. Economically, the entity has not earned this income and its financial position has not improved. Instead, the amount represents a component of the consideration the entity received at inception for the economic cost of embedding an equity conversion feature.

The nonrecognition of the economic cost of providing an investor with an equity conversion feature has the potential to mislead users of financial statements about an entity's financial situation. Effectively, equity financing can be achieved through issuance of convertible debt, resulting in the recognition of income. While sophisticated users might deem the proposed approach adequate for their purposes as long as it is coupled with sufficient supplemental disclosures that permit them to make their own analyses and adjustments to reported amounts, not all users are sophisticated. Further, the fact that sophisticated users tend to make their own adjustments to reported amounts does not imply that the amounts reported in the entity's balance sheet and income statement do not matter. If the Board were to accept the premise that supplemental disclosures are an adequate substitute for representationally faithful accounting in a company's balance sheet and income statement, it would appear that much of the existing recognition and measurement requirements in GAAP could be eliminated (e.g., the amortization of debt discounts and premiums under the interest method, the presentation of leases on the balance sheet, and the estimation of credit losses and other asset impairments). However, such an approach would make the primary financial statements less meaningful. In practice, preparers tend to pay close attention to how transactions are recognized and measured on the balance sheet and the income statement because they perceive that potential investors, lenders, and other users of financial statements consider such information.

We also have serious concerns about the consequences of the proposed accounting for other arrangements that involve an entity's issuance of its own stock to third parties. The proposed accounting raises a question about why a discount is recognized on debt issued with detachable warrants, which is a transaction that is substantially similar to the economics of convertible debt. Further, if there is no recognition of the economic cost incurred by embedding an equity feature in a convertible instrument, this raises questions about the need for recognition and measurement of compensation that is provided by granting share-based payment arrangements.

As discussed in more detail in our response to Question 1 in Appendix A, we recommend that the Board not proceed with its proposed approach for convertible instruments and instead simplify GAAP for such instruments by a single method under which the economic cost of the embedded equity conversion feature is captured. For example, the Board could extend the scope of the application of the Cash Conversion subsections in ASC 470-20 to all convertible instruments for which the embedded equity conversion feature is not bifurcated as a derivative under ASC 815-15. In our experience, that approach is straightforward to apply and is well established in practice. It also has the benefit of resulting in greater convergence with International Financial Reporting Standards. Alternatively, if the Board finds that users do not want a discount associated with the instrument (e.g., a discount on a convertible debt instrument that is created by allocating a portion of the proceeds to equity) because they want the balance sheet to reflect the convertible instrument at the amount currently due, there is still a way to recognize the economic cost of the conversion feature. The amount of the additional interest (dividends) on the convertible instrument could be calculated in a manner similar to the cash conversion model in ASC 470-20 and recognized over the life of the

instrument as an expense (or dividend) and addition to paid-in capital. As a result of this approach, the income statement and EPS would more closely reflect the true economic cost of the instrument without causing the balance sheet to deviate from the principal (par) amount of the convertible instrument.

Accounting for Contracts in an Entity's Own Equity

The proposal to add a remote likelihood threshold to both the indexation and settlement criteria within the equity classification guidance in ASC 815-40 would add complexity to an already complex accounting model. Further, it does not resolve common practice issues and has the potential to result in misleading financial statements. As discussed in our response to Question 3 in Appendix A, we recommend that the Board not proceed with this proposal.

This letter includes four appendixes. In Appendix A, we respond to each of the questions posed by the FASB in the proposed ASU. Appendix B contains other substantive comments related to the proposed amendments. Appendix C contains our additional comments and editorial suggestions. Appendix D contains illustrative examples.

We would be happy to share additional perspectives and suggestions with the Board and FASB staff on the matters discussed in our comment letter.

We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Ashley Carpenter at (203) 761-3197 or Jon Howard at (203) 761-3235.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Ashley Carpenter

Jonathan Howard

Appendix A
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents

Convertible Instruments

Question 1: Should convertible instruments be accounted for as a single unit of account, except in circumstances in which the conversion features are required to be bifurcated by guidance in Topic 815? Please explain why or why not. Under this simplification, would any specific information about convertible instruments be missing in order to understand an entity's financial position and financial performance? If so, please explain what information would be missing and how that information is used.

We do not support the Board's proposed approach because it would result in financial statements that do not faithfully depict the economic cost of the embedded equity conversion feature. Thus, it has the potential to mislead users of financial statements and creates opportunities for accounting structuring, arbitrage, and abuse.

The proposed approach would enable entities to artificially boost reported net income or EPS by issuing convertible instruments. For example, an entity could issue zero coupon debt with a deep-in-the-money equity conversion feature at a significant premium to par. Economically, the investor paid an amount in excess of the fair value of the debt component in exchange for the equity conversion feature. Because the debt premium would be amortized as a reduction to interest expense under ASC 835-30, the entity would report negative interest expense for the convertible debt over its life. From an economic standpoint, however, the amount reported as negative interest is neither interest nor income. Instead it represents the consideration paid by the investor for an equity conversion feature. Effectively, the issuer is recognizing income that it has not earned. Accordingly, the accounting under the proposed approach would be misleading. This concept is illustrated in Appendix D.

Further, the proposed approach is inconsistent with other GAAP for economically similar or comparable transactions and events. A key factor contributing to the complexity of existing accounting rules for convertible instruments and the limited usefulness of the resulting information is inconsistent conceptual objectives and inconsistent recognition and measurement guidance for different fact patterns. The proposed ASU does not adequately address these conceptual issues and accounting inconsistencies.

Under the proposed amendments, an entity would not recognize in the income statement the economic cost of embedding an equity conversion option in a below-market interest rate (dividend rate) security (unless the option is required to be bifurcated as an embedded derivative under ASC 815). Implicit in this approach is the notion that it does not cost the entity anything to issue an option on its own stock. Such accounting is inconsistent with that for other, economically similar or comparable transactions and events involving noncash consideration in the form of equity instruments. For example:

- If an equity conversion option embedded in debt is bifurcated under ASC 815-15, the cost of the conversion option is expensed through the recognition of a debt discount that is amortized as interest expense over the life of the debt.
- If an equity conversion feature was bifurcated under ASC 815-15 but subsequently no longer meets the bifurcation criteria, ASC 815-15-35-4 (and proposed ASC 815-40-35-10) requires the issuer to reclassify the previously

bifurcated conversion option into equity. Any debt discount associated with the initial cost of the conversion option continues to be amortized.

- If a convertible debt instrument is modified or exchanged and the modification or exchange is not accounted for as an extinguishment, the cost associated with any increase in the fair value of the equity conversion feature is recognized in equity with an offset to the debt and amortized over the remaining life of the debt under ASC 470-50-40-14.
- If an entity enters into an own-share lending arrangement in conjunction with a convertible debt issuance, ASC 470-20 requires the entity to recognize a discount on the debt equal to the fair value of the share-lending arrangement.
- If debt is issued with detachable warrants, generally there is an allocation of the value of the warrant that results in the recognition of a debt discount that is amortized as interest expense over the life of the debt under ASC 470-20. In substance, this represents an "expensing" of the cost of the warrant over the life of the related debt.
- If an entity grants or issues stock consideration to a customer in conjunction with a revenue or leasing transaction, the fair value of such consideration is recognized as a reduction of the transaction price or lease incentive.
- If an entity issues freestanding stock options in exchange for goods or services received from employees or nonemployees, the cost of the stock option is expensed under ASC 718.

In addition, the nonrecognition of the initial cost of an equity conversion feature is inconsistent with (1) the recognition of an expense when the strike price or conversion price of a financial instrument is adjusted under a down-round feature (see ASU 2017-11) and (2) the recognition of an expense when an entity induces the conversion of a convertible debt instrument (see ASC 470-20).

Moreover, we note that the Board's proposed approach is not convergent with International Financial Reporting Standards (IFRS[®] Standards), under which separation of convertible debt into liability and equity components is required unless the embedded equity conversion feature must be separated as a derivative. Feedback we have received has not indicated that the accounting model for convertible instruments in IAS 32, *Financial Instruments: Presentation*, is considered unnecessarily complex, and it appears to be well understood in the international financial statement user community.

We do not believe that supplemental note disclosure is a valid substitute for recognition and measurement standards that result in financial statements that faithfully depict the underlying economic transactions and events that they purport to represent. Historically, for example, the SEC staff has objected to accounting that fails to reflect the cost of a conversion feature that is in-the-money at issuance. Emerging Issues Task Force (EITF) Topic D-60, "Accounting for the Issuance of Convertible Preferred Stock and Debt Securities with a Nondetachable Conversion Feature," provided the SEC staff's position on the accounting for the issuance of convertible preferred stock and debt securities with a nondetachable conversion feature that is in-the-money on at the date of issue, as follows:

The SEC staff believes that a beneficial conversion feature should be recognized and measured by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital. . . . The SEC staff has objected to accounting that fails to account for a beneficial conversion feature as discussed herein and has concluded

that the affected financial statements should be restated in those circumstances. [Emphasis added]

Furthermore, paragraph 9 of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, states:

Since recognition means depiction of an item in both words and numbers, with the amount included in the totals of the financial statements, disclosure by other means is not recognition. **Disclosure of information about the items in financial statements and their measures that may be provided by notes or parenthetically on the face of financial statements, by supplementary information, or by other means of financial reporting is not a substitute for recognition in financial statements for items that meet recognition criteria.** Generally, the most useful information about assets, liabilities, revenues, expenses, and other items of financial statements and their measures (that with the best combination of relevance and reliability) should be recognized in the financial statements. [Emphasis added]

Because of the above reasons, we do not support the Board's proposed convertible instrument model. We recommend that the Board simplify GAAP for convertible instruments by pursuing an approach that takes into account the economic cost of the embedded equity conversion feature. For example, the Board could (1) extend the scope of the application of the Cash Conversion subsections in ASC 470-20 to all convertible debt instruments for which the embedded equity conversion feature is not bifurcated as a derivative under ASC 815-15¹ or (2) require entities to reflect the cost of the equity conversion feature through an adjustment to interest expense (or dividends) and paid-in capital over the life of the convertible instrument.² Under either approach, the Board could eliminate the guidance in ASC 470-20 related to traditional convertible debt, convertible debt issued at a substantial premium, and convertible debt with a beneficial conversion feature.

If the FASB does choose to retain the proposed single-unit of account model for convertible instruments that do not require separation of the embedded conversion option under ASC 815, we believe that the Board should (1) prohibit the recognition of negative interest or dividends (i.e., income) and (2) require entities to reflect an accounting loss when they pay cash consideration on settlement (conversion) that exceeds the carrying amount of the instrument (i.e., to reflect the cash returns paid at maturity of the instrument).

Question 2: Do the disclosure amendments in this proposed Update for convertible debt instruments in paragraphs 470-20-50-1A through 50-1I and for convertible preferred stock in paragraphs 505-10-50-12 through 50-18 provide decision-useful information? Should any of these disclosures be required for every annual and interim period for which a statement of financial position and a statement of financial performance are presented? Should any other disclosures for convertible instruments be required? Please explain why or why not.

We have no significant concerns about the proposed disclosure amendments for convertible debt instruments in ASC 470-20-50-1A through 50-1I and for

¹ We believe that in doing so, there is an opportunity to eliminate some of the complexities that arise under this model. For example, the current settlement accounting model under the cash conversion guidance in ASC 470-20 could be simplified.

² This approach is intended to meet the primary objective of the cash conversion model (e.g., that interest expense on the debt reflects the issuer's nonconvertible borrowing rate). However, it differs from the cash conversion model because the cost of the equity option is not fully recognized at initial recognition of the convertible instrument. Rather, that cost is recognized over the life of the instrument. One potential benefit of this approach is that the convertible instrument itself is recognized on the balance sheet at an amount that equals or approximates the current principal (par) amount.

convertible preferred stock in ASC 505-10-50-12 through 50-18. We encourage the Board to consider stakeholder feedback regarding the benefits of providing the disclosures in both interim and annual periods. See Appendix C for additional comments and suggested editorial changes to the proposed amendments.

Derivatives Scope Exception for Contracts in an Entity's Own Equity

Question 3: Should remote settlement features be disregarded for purposes of determining the classification of a contract in an entity's own equity (for both indexation and settlement)? Is remote an operable threshold? Please explain why or why not.

We do not support the proposal to disregard remote settlement features because we believe that it adds complexity to an already complex accounting model and raises broader issues about the role of probability in the identification of financial liabilities.

We share the concerns expressed in paragraph BC55 related to the potential audit risk of evaluating a remote threshold. The remote threshold will also create complexity for preparers. For example, we expect that this threshold may be challenging to apply to convertible instruments and warrants issued by start-up and other private companies. In our experience, private companies often issue convertible instruments and contracts in their own equity that contain multiple complex settlement features and adjustments (e.g., adjustments or cash settlement features that are contingent on a qualified financing, a business milestone, a qualified IPO, a change of control, or a business combination). Adding a remote threshold to the guidance will further complicate the required accounting analysis and, as a result, is likely to increase the risk of potential accounting errors. If the proposed amendments are finalized, we encourage the FASB to work with the PCAOB, the SEC, and the AICPA to determine whether entities may need additional audit or accounting guidance to apply the proposed approach.

The proposed remote threshold in the determination of whether a contract with net cash settlement features should be recognized as a liability also raises a broader question about the role of probability in the identification of liabilities. If the same remote threshold were to be applied to other conditional contractual obligations to pay cash (e.g., issued financial guarantee contracts, insurance contracts, and written options for which the issuer receives a premium up front), in some situations those contracts would not qualify as liabilities because the likelihood of a cash settlement is remote at inception. We would not support such an approach, because the entity has a contractual obligation under which it could be forced to transfer cash and it would be misleading to users of financial statements to immediately recognize any premium received as income. Further, the nonrecognition of a liability has the potential to mislead users of financial statements if a cash settlement is no longer remote.

In addition, the proposal to disregard remote settlement features is inconsistent with the SEC's guidance on temporary equity, which does not take into account probability (ASC 480-10-S99-3A(5)). Accordingly, contracts with remote cash settlement features that would qualify as equity under the proposed amendments might have to be classified, recognized, and measured as temporary equity by SEC registrants.

Moreover, we do not believe that the addition of a remote threshold to the indexation requirements in ASC 815-40 sufficiently addresses the practice issues that are currently associated with this overly complex guidance. Certain form-over-substance accounting outcomes that currently result from the application of the indexation guidance in ASC 815-40 will continue to exist. For example, all of the following contracts would continue to be classified as liabilities:

- Warrants for which the number of shares depends on the amount of debt draws that an entity decides to make. Even though the entity has no obligation to make any debt draws and the contract does not meet the conceptual definition of a liability, such a contract would be classified as a liability under ASC 815-40 because the amount of debt draws is not an input into a fixed-for-fixed option or forward on an entity's stock.
- Contracts that involve the issuance of a variable number of shares based on the number of outstanding shares of the issuing entity (e.g., a warrant to sell 5 percent of the entity's total outstanding common stock). In practice, such contracts are classified as liabilities because the number of outstanding shares is not an input into a fixed-for-fixed option or forward on an entity's stock.
- Warrants for which the number of shares issuable depends on an entity's net income or earnings before interest, taxes, depreciation and amortization (EBITDA). In practice, such contracts are classified as liabilities because the amount of earnings is not an input into a fixed-for-fixed option or forward on an entity's stock.

In our view, none of the three types of contracts above should be precluded from equity classification. In fact, we believe that these contracts contain more equity-like characteristics than, for example, contracts under which adjustments would be required to the settlement amount upon the occurrence of an extraneous event whose likelihood of occurring may be considered remote. If the Board decides to retain an indexation assessment as part of distinguishing liabilities from equity, we support its efforts to provide more faithfully representational and less complex guidance related to the indexation requirements; however, we believe that the proposed approach does not meet this objective and increases complexity. It is incumbent upon entities that enter into equity-linked contracts to understand and evaluate all the relevant features in those contracts, and it is difficult to understand why certain features that are obviously important to the counterparties to these arrangements would be treated as essentially nonsubstantive for accounting purposes (i.e., by asserting that they have a remote likelihood of occurring).

If, however, the proposed amendments are finalized, we recommend that the Board consider making the following additional changes:

- **Apply the remote threshold assessment consistently to both step 1 and step 2 of the indexation guidance in ASC 815-40 or eliminate step 1 of the indexation guidance.** It is difficult to understand why a remote evaluation would be relevant under step 2 of the indexation guidance but irrelevant under step 1. We believe that the Board should not retain this inconsistency. Given that the step 1 evaluation under the indexation requirements of ASC 815-40 is inconsistent with the evaluation of exercise contingencies related to contingently exercisable calls and puts in debt instruments,³ we would support eliminating the exercise contingency requirements in step 1 of ASC 815-40 in lieu of making the evaluation of steps 1 and 2 consistent.
- **Eliminate the requirement that entities evaluate adjustments to the settlement terms of an equity-linked contract that are solely within their control.** ASC 815-40 can result in liability classification of a freestanding equity-linked contract solely as a result of a potential adjustment feature that is within the control of the issuing entity.⁴ We do not believe that it is appropriate to recognize a liability (i.e., an obligation) as a result of an adjustment feature that is entirely dependent on an action that

³ Under ASC 815-15-25-41 through 25-43, the nature of the contingency underlying an embedded call or put option has no bearing on whether such option is required to be separately accounted for at fair value.

⁴ See the first example in the bullet list above for an illustration.

an entity could but is not obligated to take. In addition, the recognition of a liability in these circumstances is inconsistent with the underlying principle in ASC 480 that a liability exists only because of an entity's unavoidable obligation. The addition of the remote threshold, as proposed, would not address this issue.

- **Make a consequential amendment to ASC 480-10-25-8 to allow entities to ignore features that have a remote likelihood of occurring.** Under ASC 480-10-25-8, a warrant or other instrument that embodies an obligation "to purchase the issuer's equity shares, or is indexed to such an obligation" must be classified as an asset or liability if it "requires or may require the issuer to settle the obligation by transferring assets." For instance, a warrant on preferred stock is classified as a liability under ASC 480-10-25-8 if the preferred stock is contingently redeemable for cash upon an event that is outside the entity's control (e.g., change of control or other deemed liquidation event). We believe that the classification should not differ depending on whether a remote cash settlement provision is incorporated into the warrant or the underlying share. It would be inconsistent and counterintuitive to classify a warrant that involves the delivery of equity-classified preferred stock as a liability under ASC 480-10-25-8 only because the preferred stock includes a remote cash settlement provision if the inclusion of the same remote cash settlement feature in the warrant itself would not have precluded equity classification.
- **Allow entities to apply the remote threshold to the evaluation of their ability to deliver shares (i.e., whether there will be sufficient authorized and unissued shares to settle the contract).** The proposal would require liability classification if at any point during the life of a contract an entity does not currently have sufficient authorized and unissued shares to settle the contract. Conceptually, if an entity can evaluate the likelihood of the occurrence of events outside its control to determine the classification of an equity-linked contract, it should be able to apply that approach to all potential net cash settlement features. Thus, even if an entity does not currently have shares available to settle a contract, we believe that the entity should be able to evaluate the likelihood of its having those shares on the date on which the shares would be required to be delivered. In making this evaluation, an entity would need to ensure that the counterparty cannot require settlement currently (i.e., the contract can only be settled at the counterparty's option at a future date). We find the current proposal a bit perplexing in the sense that an entity must have sufficient unissued shares at each balance sheet date to classify a contract in equity but can ignore whether securities laws would actually prevent the entity from issuing those shares as required by the contract.

Furthermore, if the proposed amendments are finalized, the Board should specifically address how to evaluate an instrument that has multiple features that do not satisfy the requirements related to indexation or settlement in ASC 815-40. Should an entity evaluate the likelihood of each feature individually or should it evaluate the likelihood that any of the features in the instrument will be triggered (i.e., by performing an aggregate assessment)? If each feature must be evaluated individually, should similar features be grouped together (e.g., an instrument that contains multiple similar settlement features that are contingent on qualified financings of different sizes)? If each feature is evaluated individually, an entity could divide a single contingent feature that is expected to be triggered into an unlimited number of features, each of which is remote. For example, assume that a start-up entity issues warrants that are net cash settled upon a change of control. The entity will either (1) go out of business, (2) undergo an IPO, or (3) be sold. The entity is unable to conclude that a change of control is remote. Therefore, it issues a warrant that has numerous different change-in-control provisions that it evaluates

individually as remote.

Question 4: Should a requirement to settle a contract in registered shares not affect the classification of a contract in the entity's own equity? Please explain why or why not.

We disagree that a contractual requirement to settle a contract in registered shares should not affect the classification of that contract. If an entity is not legally able to deliver registered shares to settle a contract under U.S. securities laws (and the entity would be forced to settle the contract in cash), it would be misleading to classify the contract in equity. We understand that the securities laws can be challenging to evaluate; however, we believe that in issuing complex instruments, entities must inevitably make accounting determinations that may require significant judgment.

For this reason, we also disagree with the amendments to ASC 815-40-25-22, which suggest that requirements in federal securities law that transactions involving offerings of shares be registered "do not, by themselves, imply that an entity does not have the ability to deliver shares and thus do not preclude equity classification." If, however, the Board retains this language, we believe that the paragraph should be further amended because it does not appear to provide an explicit scope exception related to the potential requirement to settle a contract in registered shares.

In addition, we believe that the proposed amendments, as drafted, raise other questions about the practical implication of removing certain requirements from ASC 815-40. The language in ASC 815-40-25-4, after the proposed amendments, suggests that any feature that could result in net cash settlement upon the occurrence of an event outside the control of the issuer, if not remote, results in liability classification. Such general requirement is inconsistent with specific "scope exceptions" that would be applied to specific types of settlement features. Furthermore, the deletion of certain current conditions would be misunderstood in practice because the general requirement in ASC 815-40-25-4 would continue to apply to those conditions.

Question 5: Should a requirement to post collateral not affect the classification of a contract in an entity's own equity? Please explain why or why not.

Yes, we agree that a requirement to post collateral should not affect the classification of a contract in an entity's own equity. This condition is unrelated to whether the contract will be cash settled or share settled.

Question 6: Should the hierarchy of a counterparty's rights or shareholder rights not affect the classification of a contract in an entity's own equity? Please explain why or why not.

Yes, we agree that the hierarchy of a counterparty's rights or shareholder rights should not affect the classification of a contract in an entity's own equity. This condition is unrelated to whether the contract will be cash settled or share settled. However, to the extent that such right substantively represents the ability of the counterparty to force net cash settlement in a bankruptcy or insolvency of the issuer, we believe that it should be evaluated in the same manner as any other net cash settlement feature.

Question 7: Are the proposed amendments about reassessment of the derivatives scope exception operable? Should reassessment of the derivatives scope exception occur only upon a reassessment event (as defined in paragraph 815-40-35-8)? If not, should the reassessment be performed more frequently even if a reassessment event has not occurred, for example, on an annual basis? If performed annually,

should the likelihood threshold be remote or should a different threshold be applied? Please explain your rationale for each of the answers provided.

We do not support the proposed amendments related to reassessment under ASC 815-40. We believe that a reassessment should be performed in each reporting period. We do not believe that such an approach is overly onerous because entities will have to incorporate the appropriate internal controls to perform the initial assessment. On an ongoing basis, entities may be able to prepare more limited documentation that merely describes that they have validated that the likelihood assessment made at inception has not changed.

The proposed amendments require that an entity ignore subsequent changes in the likelihood of a settlement adjustment unless a reassessment event occurs. We believe that such an approach does not produce representationally faithful accounting and may be confusing to users of the financial statements. Two examples highlight our concern. First, under the proposed approach, a contract will remain in equity even if the event that contractually requires the contract to be cash settled has occurred.⁵ Second, as part of their capital raising efforts throughout their life cycle, entities often issue the same instruments at different points; under the proposed approach, an entity that issues two identical contracts at different points in time may have one contract classified in equity and the other classified as a liability, which would be confusing to investors. Therefore, the absence of an ongoing reassessment requirement could cause the financial statements to be confusing and potentially misleading.

Furthermore, the proposed amendments to ASC 815-40-35-8A imply that there are no accounting ramifications if a contract is ultimately cash settled. If the Board intended such an outcome, we recommend that it indicate that in the Basis for Conclusions.

If the Board decides to retain a reassessment trigger approach, we propose the following for the Board's consideration:

- **Eliminate or modify condition (a).** Proposed ASC 815-40-35-8(a) requires reassessment at any time there is an "[a]djustment to the instrument's strike price or the number of shares used to calculate the settlement amount as described in paragraph 815-40-15-7D." We struggle with this reassessment trigger for several reasons. First, why would an entity need to reassess the classification of a contract if an adjustment to the terms of the contract occurs in accordance with a provision that did not preclude equity classification? For example, assume that a contract includes an adjustment that applies in the event of a stock split by the issuing entity. Why would the entity need to reassess other conditions that required an assessment of their likelihood at inception of the contract? Second, why should an entity reclassify contracts from equity if certain disqualifying indexation features occur that were ignored at inception under a "remote occurrence assertion" but not reclassify contracts if certain contingent net cash settlement features that were considered remote at inception are subsequently triggered?
- **Eliminate or modify condition (b).** Proposed ASC 815-40-35-8(b)

⁵ In accordance with exchange-listing requirements, an entity is often obligated to obtain shareholder approval to issue its common shares to settle a convertible debt instrument or an equity-linked instrument. In the absence of such approval, the entity may be required to cash settle the contract. Under the proposed ASU, if, for example, a freestanding equity-linked option contract with a 10-year life requires such shareholder approval within six months and the entity is unable to obtain the approval within that timeframe, the entity would continue to report the option in equity for an extended period even though the entity must now net cash settle the contract.

requires reassessment at any time there is an “[e]xpiration of a settlement feature that was evaluated under Section 815-40-15 or Section 815-40-25.” In a manner similar to our comments above on condition (a), we question why an entity would need to reassess the classification of a contract if another feature expires that would not have precluded equity classification regardless of its likelihood of occurrence. That is, why does the expiration of a “qualifying feature” result in reassessment of a “disqualifying feature”? The accounting results of such an approach are not intuitive. For example, an entity may reclassify a contract as a liability as a result of the expiration of a cash dividend adjustment feature (which is consistent with the inputs into the fair value of a fixed-for-fixed contract) because the likelihood that there will be another adjustment that is not consistent with such valuation premise changes from remote to reasonably possible. However, if that same arrangement required adjustments to the exercise price for cash dividends throughout the entire term of the contract and included a contingent net cash settlement feature instead of the nonqualifying settlement adjustment feature, the entity would retain equity classification of the contract even if the contingent net-cash-settlement feature was triggered, thus requiring the contract to be settled in cash. This odd outcome results from the fact that in the latter example, there is no reassessment trigger.

- **Eliminate condition (c).** We do not understand why all contingent cash settlement features would not be not treated similarly. Thus, we would recommend deleting this condition.
- **Include, as a reassessment condition, any modification of a contract.** Contracts could potentially be modified to change the settlement terms to require net cash settlement. We believe that any modification to a contract should result in a new assessment.
- **Clarify the date on which an entity should make the remote assessments for certain convertible instruments.** An entity may issue a convertible debt instrument when its common stock is not publicly traded. Therefore, at the issuance date, the entity would not apply ASC 815-40 because the embedded conversion option would not meet the ASC 815-10-15-83 characteristic of a derivative. If, however, the entity undergoes an IPO, the characteristic of a derivative is met. The Board should clarify whether the entity should apply the remote assessment at inception of the convertible debt instrument or when the entity undergoes an IPO.

Question 8: Do the proposed disclosure amendments for contracts in an entity's own equity in paragraph 815-40-50-5(f) through (g) provide decision-useful information? Please explain why or why not. Should any other disclosures for contracts in an entity's own equity be required? Please explain which disclosures should be required and why.

We have no significant concerns about the proposed disclosure amendments for contracts in an entity's own equity in ASC 815-40-50-5(f) through (g). We encourage the Board to consider stakeholder feedback on whether any other disclosures for contracts in an entity's own equity should be required.

Question 9: Under current guidance in Topic 825, fair value disclosures are required for financial instruments that are classified as liabilities but are not required for financial instruments that are classified as equity. Should new fair value disclosures be considered for public business entities for all equity-classified instruments, including those outside the scope of the proposed amendments (such as employee stock options)? If yes, how would you use that information? If yes, which equity-classified instruments should the disclosures be required for?

We encourage the Board to consider stakeholder feedback on this question.

Earnings per Share

Question 10: Should diluted EPS for all convertible instruments be calculated using the if-converted method of diluted EPS? Is the revision to the if-converted method in paragraph 260-10-45-40(b) operable? Please explain why or why not.

We do not support the Board's proposal to require entities to apply the if-converted method to all convertible instruments to calculate diluted EPS because the if-converted method, as it is described in the proposed ASU, is applied inconsistently to similar convertible instruments. The example in ASC 260-10-55-84B reflects application of the treasury stock method; it does not reflect how the if-converted method is described in ASC 260-10-45-40. Therefore, the proposed amendments would not result in an alignment of the diluted EPS calculation for convertible instruments that share the same economics. As a result of the proposed amendments, the diluted EPS amount for Instrument C⁶ would be calculated in a manner similar to that under the treasury stock method, whereas the traditional if-converted method would be used for diluted EPS for Instrument X.⁷ We believe that if different types of convertible debt instruments are accounted for in the same manner wholly as debt, diluted EPS should also be computed in a similar manner (e.g., Instrument C vs. Instrument X).

Question 11: For a contract that may be settled in either cash or shares (except for certain share-based payment arrangements that are classified as liabilities), should an entity presume (and not be allowed to overcome the presumption) share settlement when calculating diluted EPS? Please explain why or why not.

Yes, we generally believe that an entity should not be allowed to overcome the presumption of share settlement when calculating diluted EPS for a contract that may be settled in cash or shares. However, we believe that the following additional considerations of the implications of these proposed amendments are necessary:

- **Whether share settlement should be presumed if it would always be uneconomical relative to cash settlement.** For example, an entity may issue debt for which, on maturity, the issuer can pay \$1,000 or deliver shares worth \$1,100. Why would the entity presume that share settlement should be used if it is always uneconomical? Similar issues would apply to interest that is payable in kind or in cash. We recommend that the Board retain the guidance in ASC 815-40-25-18 that clarifies that "the uneconomic settlement alternative shall be disregarded in classifying the contract" and add similar guidance to ASC 260-10.
- **Whether share settlement should be presumed when a contract requires payment in shares only upon the occurrence of a contingent event.** For example, assume that a contract, by its terms, requires settlement in cash but would allow the entity to settle in cash or shares if an event outside the control of the issuer and counterparty were to occur. We recommend that to address such situations, the Board consider the interaction between the guidance on contracts that may be settled in cash or stock and the guidance applicable to contingently issuable shares.

⁶ Upon conversion, the issuer must satisfy the accreted value of the debt obligation (the amount accrued to the benefit of the holder, excluding the conversion spread, or the principal amount of the debt) in cash and may satisfy the conversion spread in either common stock or cash.

⁷ Upon conversion, the issuer may satisfy the accreted value of the obligation (the amount accrued to the benefit of the holder, excluding the conversion spread, or the principal amount of the debt) in either cash or common stock and may satisfy the conversion spread in either common stock or cash (i.e., the issuer can pay any combination of cash or common stock to achieve conversion).

Furthermore, there is no conceptual basis or other valid reason for exempting liability-classified share-based payment arrangements as proposed in ASC 260-10-45-45A. Accordingly we recommend that this proposed paragraph be deleted.

Question 12: Should the Board consider a project about the effect of antidilutive instruments on the diluted EPS calculation (for example, the effect of call options used to offset the potential dilution from convertible instruments)? Should any other EPS improvements be considered? If yes, please provide details.

We believe that the Board should not undertake a separate project on the effect of antidilutive instruments on diluted EPS. However, if the Board were to do so, we believe that it should involve a holistic reconsideration of the objective of EPS and its application to different instruments.

Transition and Effective Date

Question 13: Should the proposed amendments that affect classification, recognition, and measurement be applied on a modified retrospective basis, with an option for full retrospective application? Do you agree with the Board's proposed transition expedient? Please explain why or why not.

If the guidance is finalized, we believe that entities should be able to choose one of the following two approaches to apply it:

- **Full retrospective.** All of the proposed amendments would be applied retrospectively. The determination of whether a contract's classification changes would be made on the basis of likelihood assessments (as they pertain to the new remote threshold) as of the date of adoption as suggested by the proposed ASU. This approach promotes comparability.
- **Modified retrospective/prospective.** The accounting for changes in the classification of contracts as equity versus liability and the changes to the accounting for convertible instruments would be reflected on a modified retrospective basis through a cumulative change in accounting principle under which retained earnings are adjusted. The amendments affecting the income statement and EPS would be applied prospectively from the date of adoption. Supplemental disclosure of the impact on the current period's income statement and EPS would be required.

As discussed in our response to Question 3, we do not support the introduction of a remote threshold in the application of the indexation and settlement guidance in ASC 815-40.

Question 14: Should the proposed amendments to EPS be applied as of the initial date of adoption for the transition from treasury stock method to if-converted method and applied retrospectively for instruments that may be settled in cash or shares? Please explain why or why not.

If the guidance is finalized, we believe that the transition provisions for the proposed amendments to EPS should be the same as those for the transition from the treasury stock method to the if-converted method and for instruments that may be settled in cash or shares. See further discussion in our response to Question 13.

Overall

Question 17: The proposed amendments would supersede various areas of guidance (such as the guidance on certain accounting models for convertible instruments). Do you expect that superseding that guidance will result in any unintended

consequences? For example, is there guidance that is currently analogized in practice to account for transactions for which there is no explicit guidance under current GAAP? Please explain what those unintended consequences are and potential solutions, if applicable.

Yes. We have summarized potential unintended consequences of superseding various areas of guidance below. For each of the areas below, we recommend that the Board consider retaining the original guidance, appropriately adapted, in the final amendments to avoid such unintended consequences.

Superseded Guidance	Use
ASC 470-20-30-9 through 12	In practice, this guidance is applied by analogy to determine the appropriate initial measurement date for issuances of any type of debt or equity securities.
ASC 470-20-30-13	In practice, this guidance is applied by analogy to distinguish between issuance costs and reductions in proceeds.
ASC 470-20-30-16 through 18	In practice, this guidance is applied by analogy to determine the appropriate measurement date for paid-in-kind interest or dividends.
ASC 470-20-35-7	In practice, this guidance is applied by analogy to determine the appropriate amortization period for discounts associated with any type of debt or equity securities.
ASC 470-20-40-1 through 40-3	In practice, this guidance is applied by analogy to determine the treatment of any unamortized discount originated by an equity component recognized under ASC 470-50-40-14 or ASC 815-15-35-4.
ASC 815-40-25-18	This guidance is used to disregard uneconomical settlement alternatives for classifying a contract.
ASC 815-40-25-31	This guidance is used to disregard contractual provisions related to normal contractual remedies for classifying a contract or, by analogy, when identifying embedded features that should be bifurcated as a derivative under ASC 815-15.

In addition, the current guidance in ASC 260-10-55-11 clarifies that convertible securities that permit or require the payment of cash by the holder of the security at conversion are considered the equivalent of warrants. The proposed amendments supersede such guidance. We recommend that the Board retain the current guidance unless it was the Board's intent to change the current practice of considering convertible securities that permit or require the payment of cash by the holder of the security at conversion as the equivalent of warrants. If it was the Board's intent, we recommend the Board include an amendment regarding how to calculate diluted EPS for such arrangements. Although these instruments are not common in practice, it is unclear why the diluted EPS accounting would change for them.

Lastly, we believe that the guidance in ASC 470-20-25-18 should be retained and

included in ASC 718-10 unless the Board believes that it is no longer relevant. If the Board believes that it is no longer relevant, it would be helpful if the Board provided its rationale in the Basis for Conclusions.

Appendix B
Deloitte & Touche LLP
Other Substantive Comments

Earnings per Share

Proposed ASC 260-10-25-1

We do not support the inconsistent treatment of down-round features in convertible debt versus freestanding equity-linked contracts and convertible preferred stock. The requirement to recognize the effect of a down-round feature, when triggered, in convertible preferred stock but not in convertible debt, will result in EPS calculations that are not comparable.

The proposed ASU's Basis for Conclusions states the Board's rationale for this as follows:

The Board decided not to extend the scope of the Topic 260 recognition and measurement guidance to convertible debt instruments. **The Board decided not to include convertible debt instruments in the requirements because Topic 825 requires that an entity disclose fair value information for convertible debt.** Therefore, the Board decided that financial statement users would be provided with sufficient information for these instruments because changes in the down round feature (such as a trigger) would be captured within the fair value calculation. [Emphasis added]

This rationale is inconsistent with the guidance in paragraph 9 of FASB Concepts Statement No. 5 (excerpted previously).

There is no conceptual basis for treating down-round features differently for EPS depending on the extent of an entity's disclosures. Furthermore, the fair value disclosures do not need to be comparable to those provided about the recognition of a down-round feature that is triggered in convertible preferred stock. In addition, we note that the requirements related to fair value disclosures and EPS presentation differ in scope.

Proposed ASC 260-10-45-21A

We support the Board's efforts to clarify how entities should consider instruments with variable exercise prices or numbers of shares when the variability arises from the entity's share price. However, we believe that the amendments should more comprehensively address instruments with variable exercise prices or numbers of shares regardless of the underlying responsible for such variability. For example, the forward price in a forward sale of common stock typically varies on the basis of interest rates.

In addition, we encourage the Board to further explore the relationship between the proposed amendments in ASC 260-10-45-21A and the existing diluted EPS guidance applicable to contingently issuable share arrangements. If an entity has issued contingent consideration in the form of an instrument that may require the entity to issue additional common shares solely on the basis of future stock prices, which guidance applies? Furthermore, proposed ASC 260-10-55-89 further complicates the issue as it seems to imply shares contingently issuable based on share prices follows the new guidance.

The proposed amendments to ASC 260-10-45-21A refer to "paragraphs 260-10-55-4 through 55-5 for implementation guidance about determining an average market price." The guidance referenced is only applicable to the treasury stock method;

however, ASC 260-10-45-21A provides guidance for both the treasury stock method and the if-converted method. We recommend that the Board consider clarifying whether the referenced guidance is only applicable to the treasury stock method.

Proposed ASC 260-10-55-34

We believe that in the calculation of year-to-date (YTD) diluted EPS, the numerator and denominator adjustments should be performed on the basis of internally consistent assumptions. The use of inconsistent assumptions would cause the resulting EPS information to be potentially misleading. Therefore, we do not support the proposed deletion of the last sentence in ASC 260-10-55-34. We recommend the Board retain the current guidance in ASC 260-10-55-34 related to the alignment of numerator and denominator adjustments in the calculation of YTD diluted EPS.

Convertible Instruments

Proposed ASC 470-20-15-2C

Proposed ASC 470-20-15-2C specifies that ASC 470-20 applies to stock-settled debt with substantive conversion features. Further, ASC 470-20-25-14 and 55-19 specify that certain instruments with a continuously resetting conversion option "shall be considered stock-settled debt." It is unclear how this proposed guidance is meant to be interpreted and applied, because the proposed ASU provides no definition of "stock-settled debt." For example, does "stock-settled debt" refer to instruments in the legal form of debt that provide for mandatory conversion into a variable number of shares worth a fixed monetary amount? Or, does it refer to instruments in the legal form of equity shares that include a mandatory conversion feature into a variable number of shares worth a fixed monetary amount if those instruments are exempt from the scope of ASC 480 because it also includes a "true" substantive equity conversion feature (i.e., does the Board effectively intend to broaden the scope of the liability classification requirements in ASC 480-10 through the proposed amendments)? Further, is the guidance intended to imply that stock-settled debt (whether in the legal form of debt or shares) should be evaluated as a host debt contract with an embedded redemption feature under ASC 815-15? These proposed amendments will cause confusion in practice unless they are clarified. We suggest that to resolve these potential issues, the Board amend the proposed language to simply indicate that a feature that would result in payment of a variable number of shares equal to a fixed monetary amount should be evaluated as a redemption option (or, if such feature is operable only at maturity, a mandatory settlement feature as opposed to a conversion feature).

Derivatives Scope Exception for Contracts in an Entity's Own Equity

Proposed ASC 815-40-25-10

The proposed amendments to ASC 815-40-25-10(d) imply that a penalty payment if the entity fails to timely file does not preclude equity classification unless the payment represents a net cash settlement. However, it is unclear whether other penalty or cash payments (e.g., a cash payment to compensate the holder for the difference in value between registered and unregistered shares) would preclude equity classification if they do not represent a net cash settlement. We recommend that the Board clarify its intention. We suggest that in doing so, the Board also address whether other periodic cash payments that are not contingent in nature would preclude equity classification of the related contract. For example, assume that an entity issues an equity-linked contract that requires it to make periodic "interest" payments to the counterparty. Would the entity ignore such payments in evaluating the classification of the contract? If the contract instead required the counterparty to make periodic "interest" payments to the issuing entity, would the entity classify the contract within equity and recognize the payments received as income?

Appendix C
Deloitte & Touche LLP
Minor and Editorial Comments

This appendix contains minor comments on, and suggested editorial changes to, the proposed ASU. (Added text is underlined and deleted text is ~~struck-out~~.)

ASC Master Glossary

Convertible Security

We recommend that the Board adjust the definition of "Convertible Security" as follows:

A security that is convertible into another security based on a contractually specified conversion rate. For example, convertible preferred stock that is convertible into common stock on a two-for-one basis (two shares of common for each share of preferred).

Effective Interest Rate

The proposed definition of "Effective Interest Rate" is not appropriate because it is designed for assets, not liabilities. We recommend that the Board adjust the definition to make it appropriate for liabilities.

Freestanding Contract

We recommend that the Board delete the definition of "Freestanding Contract" because it duplicates the definition of "Freestanding Financial Instrument" in the ASC master glossary. We believe that one definition would be sufficient.

ASC 260-10-25-1

The wording of the proposed amendments to ASC 260-10-25-1 appears to imply that a convertible preferred stock is not a freestanding financial instrument. This may cause confusion about how to interpret and apply the definition of a freestanding financial instrument and that of a financial instrument in other areas of GAAP. Accordingly, we propose that the Board revise the paragraph to avoid creating the impression that convertible preferred stock is not a freestanding financial instrument.

ASC 260-10-45-40

We recommend that the Board clarify whether the guidance applies when an embedded conversion option has been separated as a derivative under ASC 815.

ASC 260-10-45-45

We recommend that the Board adjust ASC 260-10-45-45 as follows:

Share settlement shall be presumed for the diluted EPS calculation (if the effect is dilutive) for an otherwise ~~cash-settled~~ cash-settleable instrument that contains a provision that requires or permits share settlement (regardless of whether the election is at the option of the entity or the holder, or the company has a history or policy of cash settlement).

Example 3, Disclosure of Long-Term Obligations (ASC 470-10-55-10 through 55-12)

Example 3, Disclosure of Long-Term Obligations, illustrates convertible debt with annual cumulative sinking fund payments. In our experience, convertible debt instruments with sinking fund payments are not prevalent in the marketplace. We recommend that the Board adjust Example 3 to remove the reference to sinking fund payments. Furthermore, in the illustrative example in ASC 470-10-55-12, the maturities and sinking fund requirements for mandatorily redeemable preferred stock are separate from the guidance on long-term borrowings. Since the mandatorily preferred stock would be classified as debt under ASC 480, why is it not just referred to as "Debt?"

ASC 470-20-05-4

The guidance that has been carried forward in ASC 470-20-05-4 is not accurate for certain cash convertibles. There is not a mutually exclusive choice between redemption and conversion for convertible debt with the characteristics of Instrument C (as noted in paragraph B3 of FSP APB 14-1) or Instrument X.

ASC 470-20-05-7

We recommend that the Board clearly state that the "fixed discount feature" referred to in ASC 470-20-05-7 should be evaluated for bifurcation as an embedded put option under ASC 815-15.

ASC 470-20-05-8

The proposed ASU would, in part, amend ASC 470-20-05-8(b) as follows:

Certain convertible debt instruments may have a contingently adjustable conversion ratio; that is, a conversion price that is variable based on future events such as any of the following:

- a. A liquidation or a change in control of an entity
- b. A subsequent round of financing at a price lower than the convertible ~~security's instrument's~~ original conversion price
- c. An initial public offering at a share price lower than an agreed-upon amount.

We recommend that the Board retain the existing guidance because the reference to "convertible instrument's" is more consistent with the other proposed amendments made to this section of the Codification.

ASC 470-20-15-2C

We believe that the Board should further amend ASC 470-20-15-2C as follows:

The guidance in this Subtopic does not apply to a convertible debt instrument award issued to a grantee in exchange for goods or services received (or to be received) that is subject to the guidance in Topic 718 on stock compensation unless the instrument is ~~modified in accordance with and~~ no longer subject to the guidance in that Topic.

As currently worded, the proposed guidance is confusing since an instrument cannot be modified in accordance with GAAP.

ASC 470-20-30-1

We recommend that to avoid potential confusion, the Board revise the wording of this paragraph to conform to the guidance that is generally applied in practice. That is, a relative-fair-value allocation is not appropriate if one (but not both) of the units of account is required to be measured at fair value with changes in fair value recognized in earnings.

ASC 470-20-50-1B

The proposed amendments to ASC 470-20-50-1B state that entities should disclose “[p]ertinent dates, such as conversion date and maturity date.” This sentence seems to imply that an entity would only disclose one date — that is, the date it was converted, and not the dates it may be converted. We recommend that the Board consider expanding the language to clarify the requirement and the Board's intent.

ASC 470-20-50-11

The proposed amendments to ASC 470-20-50-11 specify that an entity should disclose information about “derivative transactions entered into in connection with the issuance of convertible debt instruments within the scope of this Subtopic regardless of whether such derivative transactions are accounted for as assets, liabilities, or equity instruments.” It is unclear whether this would include, for example, an interest rate swap entered into in connection with a convertible debt instrument issuance. We encourage the Board to consider clarifying the noted disclosure guidance to include derivatives related to the conversion option entered into in connection with the issuance of convertible debt instruments.

ASC 470-20-55-1B

Proposed ASC 470-20-55-1B states:

Examples of events or changes in circumstances that occur during the reporting period that significantly affect the conversion conditions under paragraph 470-20-50-1E(b) include those that indicate that, in the following reporting period, the conversion contingencies may be met **or the conversion terms may be changed** and, therefore, significantly affect the assessment of financial statement users on the cash flow prospects of a reporting entity. [Emphasis added]

We recommend that the Board further amend the guidance in ASC 470-20-55-1B to clarify that the conversion terms may have already changed as a result of events as of the balance sheet date.

ASC 470-20-55-19

We believe that the Board should further clarify Example 4, Stock Settled Debt, to avoid unnecessary confusion since, if this instrument is issued in the form of a share, it would not be classified as a liability under ASC 480. In particular, we recommend that the Board clarify in Example 4 that the embedded conversion feature should be evaluated as an embedded put option under ASC 815-15.

ASC 505-10-50-13

The proposed amendments to ASC 505-10-50-13 state that entities should disclose “[p]ertinent dates, such as conversion date and maturity date.” This sentence seems to imply that an entity would only disclose one date — that is, the date it was converted and not the dates it may be converted. We recommend that the Board consider expanding the language to clarify the requirement and the Board's intent.

ASC 815-15-25-15

We recommend that the Board consider deleting the guidance in ASC 815-15-25-15 since we have observed that it is rarely applied in practice. Furthermore, we note that since this guidance is not well understood in practice, there is diversity related to when it applies.

ASC 815-40-15-4

The proposed paragraph states, in part:

The guidance in this Subtopic **only** applies to derivatives embedded in contracts in analyzing the embedded feature under paragraphs 815-15-25-1(c) and 815-15-25-14 as though it were a freestanding instrument (as further discussed in paragraphs 815-40-25-39 through 25-40). [Emphasis added]

We recommend that the Board remove “only” from the proposed amendments because we believe that a person could reasonably conclude that the guidance in ASC 815-40-15-4 does not apply to freestanding instruments.

ASC 815-40-50-5

We believe that ASC 815-40-50-5(d) should be further amended as follows:

For each settlement alternative, the amount that would be paid, or the number of shares that would be issued and their fair value, determined under the condition~~s~~ specified in the contract if the settlement were to occur at the reporting date and how changes in the fair value.

ASC 815-40-55-25A

The language should be further amended to state:

The Examples in paragraphs 815-40-55-26 through 55-48 illustrate the application of the guidance beginning in paragraph 815-40-15-5. Those Examples do not address whether the likelihood of an adjustment occurring is remote, which should ~~not~~ be considered in the evaluation of Step 2 (as described in paragraphs 815-40-15-7C through 15-7D). An entity may need to make specific judgments when determining whether the likelihood that an adjustment will occur is remote. The Examples in paragraphs 815-40-55-49 through 55-50B illustrate the application of the guidance beginning in paragraph 815-40-35-8.

ASC 815-40-55-49A and 55-50A

Example 22, Reassessment of a Contract with a Single Reassessment Event, should be further amended to clarify that the warrants “~~will~~ **must** settle in shares” for equity classification to not be precluded. Furthermore, we recommend the Board clarify that for equity classification to be met, all other conditions in ASC 815-40 must be satisfied.

Appendix D
Deloitte & Touche LLP
Illustrative Examples

As noted in our response to Question 1, the proposed amendments will enable entities to artificially boost reported net income by issuing convertible instruments. The two examples below illustrate this concern.

Example 1 — Company A issues \$100 million of debt that is mandatorily convertible in three years, with a conversion price that is equal to the lesser of (1) 100 percent of the stock price on the conversion date or (2) \$20. The coupon rate is 2 percent per annum. Company A's stock price on the date of issuance is \$30. The convertible debt is issued for \$130 million. Company A will report negative interest expense of \$24 million over the three-year period.

Example 2 — Company B issues \$100 million of debt that is due in 10 years. The holder can convert the debt at any time after year 3 at a conversion price of \$20 per share. At any point at which B's stock price is below \$20, the holder can put the debt for par. The coupon rate is 2 percent per annum. Company B's stock price on the issuance date is \$35 per share. The convertible debt is issued for \$130 million. Company B will report negative interest expense because the amortization of the debt premium exceeds the coupon rate.