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Summary of the September Meeting of the Emerging Issues Task Force

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This *EITF Snapshot* summarizes the September 14, 2023, meeting of the Emerging Issues Task Force (“EITF” or “Task Force”). Initial Task Force consensus (consensus-for-exposure) are exposed for public comment upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting to reach a final consensus. Those final consensus are then provided to the FASB for final ratification and, ultimately, issuance as an Accounting Standards Update (ASU).

The official EITF minutes will be posted to the [Deloitte Accounting Research Tool \(DART\)](#) and to the [FASB’s Web site](#) (note that the official EITF minutes may contain details that differ from those in this publication). EITF [meeting materials](#) (released before the meeting and used to frame the discussion) are also available on those sites.

Issue 23-A, “Induced Conversions of Convertible Debt Instruments”

Status: Consensus-for-exposure.

Affects: Entities that enter into arrangements involving convertible debt instruments settled in accordance with conversion terms that differ from the originally stated contractual conversion provisions.

Background: Convertible debt instruments are legal-form debt securities that have features allowing conversion of the instruments into shares of the issuer or affiliate entity at the option of the holder. The types of convertible debt instruments, as well as the features included in these instruments, can vary. For example, there are convertible debt instruments that can be (1) settled with a combination of shares and cash or (2) fully settled in cash. Historically, different types of convertible debt instruments have been summarized, for example, in SEC speeches and EITF Issue 90-19.¹ The [meeting memo](#) describes these different types of instruments as follows:

- (a) **Traditional Convertible Debt:** Upon conversion, the issuer *must* satisfy the obligation entirely in shares based on a fixed number of shares into which the debt instrument is convertible.
- (b) **Instrument C:** Upon conversion, the issuer *must* satisfy the accreted value of the obligation in cash and *may* satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock.
- (c) **Instrument X:** Upon conversion, the issuer *may* settle the conversion value of the debt in shares, cash, or any combination of shares and cash.

In August 2020, the FASB issued [ASU 2020-06](#).² Before the issuance of this ASU,³ entities that settled convertible debt instruments with cash conversion features (CCFs) were required to (1) calculate an extinguishment gain or loss equal to the difference between the carrying amount of the liability component and the fair value of similar debt without a conversion feature and (2) recognize the settlement of the conversion feature in equity.

ASU 2020-06 amends ASC 470-20⁴ to allow entities to apply conversion accounting to settlements of convertible debt instruments in accordance with their original contractual conversion terms. However, entities would apply extinguishment accounting to any convertible debt instruments settled whose terms differ (or are modified) from the original contractual conversion terms. Under ASU 2020-06, entities are required to (1) calculate an extinguishment gain or loss equal to the difference between the carrying amount of the convertible debt instrument and the fair value of the consideration issued on settlement and (2) recognize that difference in gain or loss. As a result of the amendments made by ASU 2020-06, entities can apply conversion accounting to convertible debt instruments settled in either form (i.e., cash, shares, or a combination of both) as long as the instrument is converted in accordance with its original contractual conversion terms.

ASC 470-20 also includes a model for induced conversions, specifically for “conversions of convertible debt to equity securities pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance.”⁵ Entities may, from time to time, offer a “sweetener” to entice convertible debt instrument holders to settle their note before the end of the instrument’s term. The inducements conversion model requires entities to recognize an expense for the sweetener provided to induce the holder to convert. However, the entity will not recognize a gain or loss for the shares issuable in accordance with the original conversion terms of the convertible debt instruments, since conversion accounting will apply.

¹ EITF Issue No. 90-19, “Convertible Bonds With Issuer Option to Settle for Cash Upon Conversion.”

² FASB Accounting Standards Update No. 2020-06, *Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*.

³ For public business entities that are not smaller reporting companies, ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. The guidance may be early adopted for fiscal years beginning after December 15, 2020, and interim periods within those fiscal years. For convertible instruments that include a down-round feature, entities may early adopt the amendments that apply to down-round features if they have not yet adopted the amendments in ASU 2017-11, *Earnings per Share (Topic 260)*; *Distinguishing Liabilities From Equity (Topic 480)*; *Derivatives and Hedging (Topic 815)*; (Part I) *Accounting for Certain Financial Instruments With Down Round Features*, (Part II) *Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception*.

⁴ FASB Accounting Standards Codification (ASC) Subtopic 470-20, *Debt: Debt With Conversion and Other Options*.

⁵ Quoted text is from ASC 470-20-40-13.

Stakeholders have expressed concerns that when convertible debt instruments are cash-settled in accordance with conversion terms that differ from the original contractual conversion terms, it is difficult for stakeholders to determine whether to apply induced conversion accounting or extinguishment accounting after the adoption of ASU 2020-06. Although the definition of conversion accounting, as amended by ASU 2020-06, remains indifferent regarding the form of settlement, the induced conversion model still only applies to the conversion of convertible debt instruments to “equity securities.” Accordingly, given the amendments made by ASU 2020-06, stakeholders have asked the Board to provide guidance on when either induced conversion accounting or extinguishment accounting applies to settlements of convertible debt instruments whose terms differ from the original contractual conversion terms.

At its April 26, 2023, [meeting](#), the FASB decided to add a project on induced conversions of convertible debt instruments to its technical agenda and directed the EITF to address that project. Further, on June 15, 2023, the EITF held an educational session to discuss preliminary approaches related to this Issue. No formal votes were taken, and no decisions were made. For further details about this meeting, see Deloitte’s June 2023 [EITF Snapshot](#).

One of the questions the FASB staff asked the EITF to deliberate at its September 14, 2023, meeting was whether the preexisting contract approach or the incremental fair value approach was preferable in the determination of whether induced conversion accounting applies. Under the preexisting contract approach, an inducement offer would need to preserve the form and amount of the consideration under the original conversion terms for the entity to apply the induced conversion accounting model. Under the incremental fair value approach, the entity would assess the fair value of the inducement offer (regardless of form), including any sweeteners offered, and compare it with the fair value under the original conversion terms. If the fair value of the inducement offer is greater, the entity would apply the induced conversion accounting model.

The FASB staff also asked the EITF to deliberate whether induced conversion accounting should apply to convertible debt that is not currently convertible. Convertible debt instruments may not be convertible because they have not satisfied certain market contingencies (e.g., share price triggers) or nonmarket contingencies (e.g., time-based restrictions).

Summary: At its September 14, 2023, meeting, the Task Force decided to pursue amendments aligned with the preexisting contract approach, with the following two clarifications:

- *Clarification 1* — When evaluating the inducement offer, issuers should determine, as of the offer acceptance date,⁶ whether the inducement offer would at least provide the cash, shares, or both, issuable under the original conversion terms.
- *Clarification 2* — If a modification (that did not result in extinguishment accounting) has occurred in the year (12 months) before the offer acceptance date, the form and amount specified in the “original conversion privileges” would refer to the terms that existed one year before the offer acceptance date.

⁶ The Task Force voted to select the offer acceptance date as of which the assessment is performed, in accordance with Issue 2, “Assessment Date.”

To demonstrate the application of the preexisting contract approach, the following examples have been reprinted from the meeting memo for the September meeting:

All examples assume the fair value of an entity's share of common stock is \$60 as of the [offer acceptance date⁷] and assume a par value of \$1,000 for the convertible debt.

Original Conversion Consideration	Inducement Offer	Potential Induced Conversion Under Preexisting Contact Approach?
<p>Form: Principal in cash and the conversion spread in cash or shares at entity's election (Instrument C)</p> <p>Amount: Total amount equals product of 20 shares multiplied by VWAP calculated over a future 40-day period</p>	<p>Form: Cash</p> <p>Amount: Amount per \$1,000 bond indexed to 20 shares multiplied by VWAP calculated over a future 10-day period + an additional \$50 per \$1,000 par value bond.</p>	<p>Yes. Form and amount of original consideration are preserved in offer.</p> <p>Original: Cash of \$1,000 + (either \$200 in cash or 3.33 shares based on current share price)^(*) per \$1,000 bond</p> <p>Offer: Cash of \$1,250 per bond based on current share price</p>
<p>Form: Principal in cash and the conversion spread in cash or shares at entity's election (Instrument C)</p> <p>Amount: Total amount equals product of 20 shares multiplied by VWAP calculated over a 40-day period</p>	<p>Form: Shares</p> <p>Amount: 22 shares per \$1,000 bond.</p>	<p>No. The offer does not preserve the form of the original consideration (cash) for the principal.</p> <p>Original: Cash of \$1,000 + (either \$200 in cash or 3.33 shares) per \$1,000 bond based on current share price</p> <p>Offer: 22 shares</p>
<p>Form: Any combination of cash and shares (Instrument X)</p> <p>Amount: Total amount equals product of 20 shares multiplied by VWAP calculated over a 40-day period</p>	<p>Form: Cash</p> <p>Amount: \$1,220 per \$1,000 bond</p>	<p>Yes. Form and amount of original consideration are preserved in offer.</p> <p>Original: Combination of cash and shares that equals \$1,200 (based on current share price)</p> <p>Offer: Cash of \$1,220 (based on current share price)</p>
<p>Form: Any combination of cash and shares (Instrument X)</p> <p>Amount: Total amount equals product of 20 shares multiplied by VWAP calculated over a future 40-day period</p>	<p>Form: Cash + Warrants</p> <p>Amount: Cash amount equal to 20 shares multiplied by VWAP calculated over a future 10-day period + 2 warrants per \$1,000 par value bond.</p>	<p>Yes. Form and amount of original consideration are preserved in offer.</p> <p>Original: Combination of cash and shares that equals \$1,200 (based on current share price)</p> <p>Offer: Cash of \$1,200 (based on current share price) + 2 warrants</p>
<p>Form: Any combination of cash and shares (Instrument X)</p> <p>Amount: Total amount equals product of 20 shares multiplied by VWAP calculated over a future 40-day period</p>	<p>Form: Cash payable upon settlement in 30 days</p> <p>Amount: Cash amount will equal the value of 35 shares of a different entity that is a related party of the reporting entity as of the settlement date (fair value of offer is greater than for the original conversion consideration as of the specified point in time)</p>	<p>No. The offer does not preserve the form of the original consideration (cash and/or shares) because the cash payment is indexed to something other than the entity's shares.</p> <p>Original: Combination of cash and shares that equals \$1,200 (based on current share price)</p> <p>Offer: Cash indexed to something other than the entity's shares</p>
<p>^(*) \$200 in cash calculated as (\$60 share price × 20 shares, or \$1,200) – \$1,000 par. The amount of 3.33 shares is calculated as (\$1,200 – \$1,000) / \$60 per share. This equals the conversion spread of \$200 divided by the current share price of \$60 per share. The change in the VWAP period (from 40 days to 10 days) does not affect the assessment of whether the original conversion consideration is preserved because the share price is calculated as of a single, specified point in time.</p>		

⁷ The date at which the assessment is performed was addressed by the Task Force in Issue 2, "Assessment Date," as described in more detail in the meeting memo.

In addition, the Task Force decided that induced conversion accounting may apply to all convertible debt instruments, including conversions of convertible debt instruments that are not currently convertible, that are within the scope of ASC 470-20 and have a substantive conversion feature⁸ as of the time of issuance.

Effective Date and Transition: The Task Force tentatively decided that the guidance in EITF Issue 23-A would be applied prospectively to convertible debt instruments settled after the effective date. An entity would be permitted, but not required, to apply the guidance retrospectively to convertible debt instruments only settled after the adoption of ASU 2020-06. Transition disclosures would be required for the period of adoption, including the nature of and reason for the change in accounting principle.

The Task Force will discuss the effective date at a future meeting after considering stakeholder feedback on the proposed amendments.

Next Steps: The FASB staff expects to draft a proposed ASU related to this Issue and present it to the Board for ratification in October 2023.

Administrative Matters

The next EITF decision-making meeting is tentatively scheduled for November 30, 2023. However, on the basis of the timeline for Issue No. 23-A discussed at the September meeting, it is unlikely that this Issue will be discussed in November. Further details about the timeline, including the comment-letter period for the proposed ASU, should be available at the November meeting. The EITF will most likely reconvene in early 2024 to discuss the comment letters received on the proposal.

⁸ ASC 470-20-40-7 defines a substantive conversion feature as a "conversion feature [that] is at least reasonably possible of being exercised in the future. If the conversion price of an instrument at issuance is extremely high so that conversion of the instrument is not deemed at least reasonably possible as of its issuance date, then the conversion feature would not be considered substantive."

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