

EITF ABSTRACTS

Issue No. 85-18

Title: Earnings-per-Share Effect of Equity Commitment Notes

Dates Discussed: June 27, 1985; August 8, 1985

References: FASB Statement No. 55, *Determining whether a Convertible Security Is a Common Stock Equivalent*
FASB Statement No. 85, *Yield Test for Determining whether a Convertible Security Is a Common Stock Equivalent*
FASB Statement No. 128, *Earnings per Share*
FASB Interpretation No. 31, *Treatment of Stock Compensation Plans in EPS Computations*
APB Opinion No. 15, *Earnings per Share*
AICPA Accounting Interpretation 28, *Classification and Computation Not Always the Same, of APB Opinion No. 15*
AICPA Accounting Interpretation 45, *Securities Convertible into Other Convertible Securities, of APB Opinion No. 15*

ISSUE

Debt instruments known as equity commitment notes and equity contract notes have been issued by enterprises that agree to repay the debt from the issuance of, at their discretion, either common stock or perpetual preferred stock. Equity commitment notes are repaid with cash proceeds from the sale of either common or preferred stock, whereas equity contract notes obligate the holder to take either common or preferred stock in lieu of cash.

The issue is whether those securities should be included in the issuer's earnings-per-share computations and whether distinction should be made between equity commitment notes and equity contract notes.

EITF DISCUSSION

The Task Force reached a consensus that shares contingently issuable under equity commitment notes and equity contract notes should not be included in either primary or fully diluted earnings-per-share computations. The Task Force agreed that no substantive differences between equity

commitment notes and equity contract notes would appear to affect that consensus. [Note: This consensus has been nullified by Statement 128. See STATUS section.]

A further consensus was reached that equity notes that specifically require the issuance of common stock to repay debt, rather than those that allow the choice of issuing other types of equity securities, should be included in earnings-per-share computations in accordance with the general provisions of Opinion 15. [Note: See STATUS section.]

The SEC Observer indicated, and the Task Force agreed, that supplemental earnings-per-share disclosure was appropriate in certain circumstances and that related shares should be determined based on the market price of common stock for each reporting period.

STATUS

In February 1997, the FASB issued Statement 128, which supersedes Opinion 15 and its interpretations, including FASB Interpretation 31, and Statement 85. Statement 128 is effective for financial statements for both interim and annual periods ending after December 15, 1997, and earlier application is not permitted.

Statement 128 nullifies the first consensus in Issue 85-18 by stating that contracts that may be settled in stock or cash should be presumed to be settled in stock and reflected in the computation of diluted EPS unless past experience or a stated policy provides a reasonable basis to believe otherwise. Statement 128 supports the second consensus reached; equity contracts that require payment in stock should be considered potentially dilutive securities (convertible debt).

No further EITF discussion is planned.