

**FASB Emerging Issues Task Force**

**Issue No.** 06-6

**Title:** Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments

**Document:** Issue Summary No. 1, Supplement No. 1\*

**Date prepared:** October 30, 2006

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**Date previously discussed:** September 7, 2006

**Previously distributed EITF materials:** Issue Summary No. 1, dated August 24, 2006 and Issue 05-7 Issue Summary No. 1, Supplement No. 1, dated June 2, 2006

**References:**

FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (FAS 133)

APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14)

APB Opinion No. 26, *Early Extinguishment of Debt* (APB 26)

EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments" (Issue 96-19)

EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option" (Issue 05-1)

EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues" (Issue 05-7)

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\* **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

## **Background**

1. At the September 7, 2006 EITF meeting, the Task Force reached tentative conclusions on this Issue and directed the staff to pursue the issuance of a draft abstract for public comment. A draft abstract for this Issue and a draft of the amendment to Issue 96-19 to reflect the guidance in this Issue were posted to the website on September 26, 2006, with a comment period that ended on October 13, 2006.

## **Formal Comments Received on the Draft Abstract**

2. No comment letters were received for either (a) the draft abstract for Issue 06-6 or (b) the draft of conforming amendment to Issue 96-19. At the November 16, 2006 EITF meeting, the Task Force will have the opportunity to redeliberate the tentative conclusions in the draft abstract. The Task Force will then be asked to affirm the tentative conclusions as a consensus.

## **Other Comments Received on the Draft Abstract**

3. The staff received one minor editorial comment to clarify the proposed transition requirements in paragraph 9, which is reflected in the marked draft abstract included in Appendix 06-6A. No revisions were made to the draft of the amendment to Issue 96-19 that is included in Appendix 06-6B. The marked changes to Issue 96-19, which reflect the revisions to that Issue that would result from a consensus on Issue 06-6, have not been changed from the draft that was posted for public comment.

## Appendix 06-6A

### *EITF ABSTRACTS (DRAFT<sup>26</sup>)*

**Issue No. 06-6**

**Title:** Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments

**Dates Discussed:** June 15, 2006; September 7, 2006; [November 15–16, 2006]

**References:** FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*  
APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*  
APB Opinion No. 26, *Early Extinguishment of Debt*  
EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments"  
EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option"  
EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"

## ISSUE

1. Issue 05-7 addresses (a) whether a change in the fair value of an embedded conversion option that results from a modification of a convertible debt instrument should be included in the analysis of whether there has been a substantial change in the terms of a debt instrument to determine if a debt extinguishment has occurred pursuant to Issue 96-19, and (b) how an issuer should account for modifications that do not result in a debt extinguishment pursuant to Issue 96-19. At the September 15, 2005 EITF meeting, the Task Force reached the following consensus on Issue 05-7:

Issue 1— An entity should include, upon the modification of a convertible debt instrument, the change in fair value of the related embedded conversion option as a current-period cash flow in the analysis to determine whether a debt instrument has been extinguished pursuant to Issue 96-19.

Issue 2— The modification of a convertible debt instrument should affect subsequent recognition of interest expense for the associated debt instrument for changes in the fair value of the embedded conversion option.

Issue 3— The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of a convertible debt instrument.

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\* ~~This draft abstract is being exposed for a public comment period that will end on October 13, 2006.~~

2. At the March 16, 2006 EITF meeting, the Task Force agreed to clarify the scopes of Issues 05-7 and 96-19 by adding a paragraph to the abstract of each Issue that clarifies that the consensus in Issue 05-7 also applies to a modification of a debt instrument that either adds or eliminates an embedded conversion option that is not bifurcated from its host contract pursuant to Statement 133. The Task Force also agreed that the scope of Issue 05-7 does not include the modification of debt instruments that either adds or eliminates an embedded conversion option that is required to be bifurcated by the issuer from the host contract pursuant to Statement 133 because the Task Force did not discuss those circumstances in its deliberations on Issue 05-7.

3. Subsequent to the consensus in Issue 05-7, a number of practice issues were raised that were not specifically discussed by the Task Force in its original deliberations of that Issue. As a result, the Task Force was asked to consider the redeliberation of Issue 05-7.

4. The issues are:

Issue 1— How a modification of a debt instrument (or an exchange of debt instruments) that affects the terms of an embedded conversion option should be considered in the issuer's analysis of whether debt extinguishment accounting should be applied

Issue 2— Accounting for a modification of a debt instrument (or an exchange of debt instruments) that affects the terms of an embedded conversion option when extinguishment accounting is not applied.

### **Scope**

5. This Issue applies to modifications and exchanges of debt instruments that (a) either add or eliminate an embedded conversion option or (b) affect the fair value of an existing embedded conversion option. The scope of this Issue does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Statement 133 prior to the modification, subsequent to the modification, or both prior to and subsequent to the modification.

### **EITF DISCUSSION**

6. The Task Force reached a [consensus] on Issue 1 that the change in the fair value of an embedded conversion option resulting from an exchange of debt instruments or a modification in the terms of an existing debt instrument should not be included in the cash flow test of whether the terms of the new debt instrument are *substantially different* from the terms of the original debt instrument under Issue 96-19. However, a separate analysis must be performed if the cash flow test under Issue 96-19 does not result in a conclusion that a substantial modification or an exchange has occurred. Under that separate analysis, a substantial modification or an exchange has occurred and the issuer should apply extinguishment accounting if the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying value of the original debt instrument immediately prior to the modification or exchange. Additionally, a modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange would always be considered *substantial*, and debt extinguishment accounting would be required in those circumstances. The Task Force decided that for purposes of evaluating whether an embedded conversion option was substantive on the

date it was added to or eliminated from a debt instrument, the factors described in paragraphs 7–9 of Issue 05-1 should be considered.

7. The Task Force reached a [consensus] on Issue 2 that when a convertible debt instrument is modified or exchanged in a transaction that is not accounted for as an extinguishment, an *increase* in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) should reduce the carrying amount of the debt instrument (increasing a debt discount or reducing a debt premium) with a corresponding increase in additional paid-in capital. However, a *decrease* in the fair value of an embedded conversion option resulting from a modification or an exchange should not be recognized. The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon a modification or exchange of convertible debt instruments in a transaction that is not accounted for as an extinguishment.

8. The guidance in Issue 05-7 is [superseded] by the consensus in this Issue. The Task Force agreed to amend Issue 96-19 to replace the guidance from Issue 05-7 with the guidance from this Issue.

### **Transition**

9. The [consensus] in this Issue should be applied to modifications or exchanges of debt instruments ~~occurring~~beginning in the first interim or annual reporting period beginning after Board ratification [(November ~~29XX~~, 2006)]. Earlier application of this Issue is permitted for modifications or exchanges of debt instruments in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.

### **Board Ratification**

10. At its [November ~~29XX~~, 2006] meeting, the Board ratified the [consensus] reached by the Task Force on this Issue.

### **STATUS**

11. No further EITF discussion is planned.

## Appendix 06-6B

### *EITF ABSTRACTS (DRAFT<sup>26</sup>)*

Issue No. 96-19

**Title:** Debtor's Accounting for a Modification or Exchange of Debt Instruments

**Dates Discussed:** September 18–19, 1996; November 14, 1996; January 23, 1997; March 13, 1997; May 21–22, 1997; July 23–24, 1997; July 23, 1998; September 15, 2005, March 16, 2006; September 7, 2006; [November 16+5–26, 2006]

**References:** FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*  
FASB Statement No 76, *Extinguishment of Debt*  
FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*  
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*  
FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*  
FASB Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*  
APB Opinion No. 26, *Early Extinguishment of Debt*  
APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*  
SEC Staff Accounting Bulletin No. 94, *Recognition of a Gain or Loss on Early Extinguishment of Debt*

## ISSUE

Issue No. 86-18, "Debtor's Accounting for a Modification of Debt Terms," addresses circumstances under which existing debt should be considered extinguished, resulting in recognition by the debtor of an extraordinary gain or loss. [Note: See STATUS section.] In that Issue, the Task Force reached a consensus that an exchange of a new noncallable debt instrument for an older callable debt instrument should be accounted for as an extinguishment by the debtor. Many Task Force members agreed that substantive modifications of debt (that is, modifications

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\* ~~This draft abstract is being exposed for a public comment period that will end on October 13, 2006.~~

to principal, interest rate, maturity, or call provisions) should be accounted for as the extinguishment of that debt and the creation of new debt, although no consensus was reached on that issue. Other Task Force members said that extinguishment accounting should be applied only to those debt instruments meeting the conditions for extinguishment under Statement 76.

Statement 125, which superseded Statement 76 on January 1, 1997, limits derecognition of a liability to extinguishments. It limits extinguishments to situations in which the debtor pays the creditor and is relieved of its obligation or is legally released as the primary obligor either judicially or by the creditor.

The issues are:

1. How a debtor should account for an exchange of debt instruments with substantially different terms
2. How a debtor should account for a substantial modification in the terms of an existing debt agreement (other than a troubled debt restructuring)
3. If a gain or loss is recognized from an exchange or modification, whether the gain or loss should be classified as extraordinary.

## EITF DISCUSSION

The Task Force reached a consensus that an exchange of debt instruments with substantially different terms is a debt extinguishment and should be accounted for in accordance with paragraph 16 of Statement 125. The Task Force observed that a debtor could achieve the same economic effect by making a substantial modification of terms of an existing debt instrument. Accordingly, the Task Force reached a consensus that a substantial modification of terms should be accounted for like, and reported in the same manner as, an extinguishment.

The Task Force also reached the following consensuses regarding (1) when an exchange or modification is considered *substantial*, (2) how to account for fees paid or received by a debtor and costs incurred by a debtor with third parties as part of an exchange or modification, and (3) the impact of the consensuses reached in this Issue on other related EITF Issues.

From the debtor's perspective, an exchange of debt instruments between or a modification of a debt instrument by a debtor and a creditor in a nontroubled debt situation is deemed to have been accomplished with debt instruments that are *substantially different* if any of the following three conditions are met:

1. ~~The present value of the cash flows (including changes in the fair value of an embedded conversion option<sup>1</sup> upon modification of a convertible debt instrument) under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument.~~

For purposes of determining the change in the present value of cash flows, the Task Force observed that cCash flows can be affected by changes in principal amounts, interest rates, or maturity. They can also be affected by fees exchanged between the debtor and creditor to effect changes in:

- Recourse or nonrecourse features

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~~<sup>1</sup>The change in the fair value of an embedded conversion option is calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification. [Note: See STATUS section.]~~

- Priority of the obligation
- Collateralized (including changes in collateral) or noncollateralized features
- Debt covenants and/or waivers
- The guarantor (or elimination of the guarantor)
- Option features.

If the terms of a debt instrument are changed or modified in any of the ways described above and the cash flow effect on a present value basis is less than 10 percent, the debt instruments are *not* considered to be substantially different, except as discussed in the following paragraphs.

2. A modification or an exchange that affects the terms of an embedded conversion option, where the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying value of the original debt instrument immediately prior to the modification or exchange.

3. A modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange.<sup>1</sup>

With respect to the second and third condition, this guidance does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Statement 133 prior to the modification, subsequent to the modification, or both prior and subsequent to the modification. [Note: See STATUS Section]

The following guidance is to be used to calculate the present value of the cash flows for purposes of applying the 10 percent cash flow test.

1. The cash flows of the new debt instrument include all cash flows specified by the terms of the new debt instrument plus any amounts paid by the debtor to the creditor less any amounts received by the debtor from the creditor as part of the exchange or modification.
2. If the original debt instrument and/or the new debt instrument has a floating interest rate, then the variable rate in effect at the date of the exchange or modification is to be used to calculate the cash flows of the variable-rate instrument.
3. If either the new debt instrument or the original debt instrument is callable or puttable, then separate cash flow analyses are to be performed assuming exercise and nonexercise of the call or put. The cash flow assumptions that generate the smaller change would be the basis for determining whether the 10 percent threshold is met.
4. If the debt instruments contain contingent payment terms or unusual interest rate terms, judgment should be used to determine the appropriate cash flows.
- ~~5. If the debt instrument contains an embedded conversion option, the change in the fair value of the embedded conversion option that results from a modification of the debt instrument, should be included in a manner that is similar to the manner in which a current period cash flow would be included. [Note: See STATUS section.]~~

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<sup>1</sup> For purposes of evaluating whether an embedded conversion option was substantive on the date it was added to or eliminated from a debt instrument, the factors described in paragraphs 7-9 of Issue No. 05-1 "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option," should be considered.

56. The discount rate to be used to calculate the present value of the cash flows is the effective interest rate, for accounting purposes, of the original debt instrument.

67. If within a year of the current transaction the debt has been exchanged or modified without being deemed to be substantially different, then the debt terms that existed a year ago should be used to determine whether the current exchange or modification is substantially different.

If it is determined that the original and new debt instruments are *substantially different*, then the calculation of the cash flows related to the new debt instrument at the effective interest rate of the original debt instrument is *not* used to determine the initial amount recorded for the new debt instrument or to determine the debt extinguishment gain or loss to be recognized. The new debt instrument should be initially recorded at fair value, and that amount should be used to determine the debt extinguishment gain or loss to be recognized and the effective rate of the new instrument.

If it is determined that the original and new debt instruments are *not* substantially different, then a new effective interest rate is to be determined based on the carrying amount of the original debt instrument, adjusted for an increase (but not a decrease) in the fair value of an embedded conversion option resulting from the modification, and the revised cash flows ~~including any change in the fair value of an embedded conversion option~~.

Fees paid by the debtor to the creditor or received by the debtor from the creditor (fees may be received by the debtor from the creditor to cancel a call option held by the debtor or to extend a no-call period) as part of the exchange or modification are to be accounted for as follows:

- If the exchange or modification is to be accounted for in the same manner as a debt extinguishment [Note: See STATUS section.] and the new debt instrument is initially recorded at fair value, then the fees paid or received are to be associated with the extinguishment of the old debt instrument and included in determining the debt extinguishment gain or loss to be recognized.
- If the exchange or modification is not to be accounted for in the same manner as a debt extinguishment, then the fees are to be associated with the replacement or modified debt instrument and, along with any existing unamortized premium or discount, amortized as an adjustment of interest expense over the remaining term of the replacement or modified debt instrument using the interest method.

Costs incurred with third parties directly related to the exchange or modification (such as legal fees) are to be accounted for as follows:

- If the exchange or modification is to be accounted for in the same manner as a debt extinguishment [Note: See STATUS section.] and the new debt instrument is initially recorded at fair value, then the costs are to be associated with the new debt instrument and amortized over the term of the new debt instrument using the interest method in a manner similar to debt issue costs.
- If the exchange or modification is not to be accounted for in the same manner as a debt extinguishment, then the costs should be expensed as incurred.

The consensus in Issue No. 95-15, "Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount," is superseded by the consensus in this Issue. The transaction described in Issue 95-15 deals with when a debtor enters into a binding contract with a holder of its debt obligation to redeem the

debt security at a future date for a specified amount greater than (or less than) the debtor's carrying amount of the debt for financial reporting purposes. The future date of the exchange specified in the contract will occur within one year of the date that the contract becomes binding to the parties. The debtor's accounting for this transaction is to be accounted for based on the consensus in this Issue.

The guidance in Issue 86-18 for the transaction described below is not affected by the consensus reached in this Issue. In the context of its deliberations on Issue 86-18, the Task Force discussed a specific transaction in which a borrower, instead of acquiring debt securities directly, loans funds to a third party, who in turn acquires the borrower's original debt securities. The borrower and third party agree that they may settle their respective receivables and obligations by right of setoff as payments become due, contingent upon the third party's continued retention of the borrower's original debt. The Task Force reached a consensus in Issue 86-18 that the borrower should not account for the original debt securities as extinguished and that those securities should not be offset against the receivable from the third party in the borrower's financial statements.

### **Implementation Guidelines**

The Task Force reached a consensus that:

1. The exchange of cash by the debtor or the debtor's agent to acquire or settle debt is an extinguishment of debt under paragraph 16 of Statement 125. Therefore, such transactions involving the exchange of cash between a debtor and a creditor or creditors are not covered by the scope of this Issue. However, transactions involving contemporaneous exchanges of cash between the same debtor and creditor in connection with the issuance of a new debt obligation and satisfaction of an existing debt obligation by the debtor would only be accounted for as debt extinguishments if the debt instruments have substantially different terms, as defined in this Issue.
2. In transactions involving a third-party intermediary acting as agent on behalf of a debtor, the actions of the intermediary should be viewed as those of the debtor in order to determine whether there has been an exchange of debt instruments or a modification of terms between a debtor and a creditor. Stated another way, when a third-party intermediary acts as agent, the analysis should "look through" the intermediary.
3. In transactions involving a third-party intermediary acting as principal, the intermediary should be viewed as a third-party creditor similar to any other creditor in order to determine whether there has been an exchange of debt instruments or a modification of terms between a debtor and a creditor. Stated another way, when a third-party intermediary acts as principal, the analysis should not "look through" the intermediary.
4. Transactions among debt holders do not result in a modification of the original debt's terms or an exchange of debt instruments between the debtor and the debt holders and do not impact the accounting by the debtor.
5. Transactions between a debtor and a third-party creditor should be analyzed based on the guidance in paragraph 16 of Statement 125 and the consensus in this Issue to determine whether gain or loss recognition is appropriate. Transactions entered into between a debtor or a debtor's agent and a third party that is not the creditor are not included in the scope of this Issue.

The Task Force noted that application of those guidelines may require determination of whether a third-party intermediary is an agent or a principal and that consideration of legal definitions may be helpful in making that determination. The Task Force noted that, generally, an agent acts for and on behalf of another party. Therefore, a third-party intermediary is an agent of a debtor if it acts on behalf of the debtor. In addition, the Task Force noted that an evaluation of the facts and circumstances surrounding the involvement of the third-party intermediary should be performed. The Task Force observed that the following indicators should be considered in that evaluation:

1. If the intermediary's role is restricted to placing or reacquiring debt for the debtor without placing its own funds at risk, that would indicate that the intermediary is an agent. For example, that may be the case if the intermediary's own funds are committed and those funds are not truly at risk because the intermediary is made whole by the debtor (and therefore is indemnified against loss by the debtor). If the intermediary places and reacquires debt for the debtor by committing its funds and is subject to the risk of loss of those funds, that would indicate that the intermediary is acting as principal.
2. In an arrangement where an intermediary places notes issued by the debtor, if the placement is done under a best-efforts agreement, that would indicate that the intermediary is acting as agent. Under a best-efforts agreement, an agent agrees to buy only those securities that it is able to sell to others; if the agent is unable to remarket the debt, the issuer is obligated to pay off the debt. The intermediary may be acting as principal if the placement is done on a firmly committed basis, which requires the intermediary to hold any debt that it is unable to sell to others.
3. If the debtor directs the intermediary and the intermediary cannot independently initiate an exchange or modification of the debt instrument, that would indicate that the intermediary is an agent. The intermediary may be a principal if it acquires debt from or exchanges debt with another debt holder in the market and is subject to loss as a result of the transaction.
4. If the only compensation derived by an intermediary from its arrangement with the debtor is limited to a preestablished fee, that would indicate that the intermediary is an agent. If the intermediary derives gains based on the value of the security issued by the debtor, that would indicate that the intermediary is a principal.

The Task Force reached a consensus that transactions involving the modification or exchange of debt instruments can only result in gain or loss recognition by the debtor if the conditions for extinguishment of debt described in paragraph 16 of Statement 125 are satisfied or if the consensus in this Issue requires that accounting. Accordingly, the guidance in Issue No. 87-20, "Offsetting Certificates of Deposit against High-Coupon Debt," related to loss recognition is superseded by the consensus in this Issue. The general principles outlined above would apply to the transaction described in Issue 87-20.

The examples in Exhibit 96-19A illustrate the application of the above implementation guidelines.

## **STATUS**

Statement 140 was issued in September 2000 and superseded Statement 125. Statement 140 does not change the guidance dealing with accounting for extinguishments of liabilities.

Statement 145, issued in April 2002, supersedes Statement 4. Statement 4 required that all gains and losses from extinguishment of debt be classified as extraordinary items. Statement 145 removes the extraordinary item classification requirement but does not preclude gains and losses from extinguishment of debt that meet the criteria in Opinion 30 from being classified as extraordinary items.

~~Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," which was discussed at the September 15, 2005 meeting, amends this Issue to include the change in the fair value of an embedded conversion option resulting from the modification of a convertible debt instrument in the analysis of whether there has been a substantial change in the terms of a convertible debt instrument to determine if a debt extinguishment has occurred. In addition, Issue 05-7 requires the change in the fair value of the embedded conversion option that results from a modification of the convertible debt instrument (that does not result in an extinguishment), to be accounted for as an additional debt discount or premium (similar to other fees paid to creditors) resulting in an effect on the subsequent recognition of interest expense for the associated debt instrument. At its meeting on September 28, 2005, the Board ratified the consensus modifications reached by the Task Force in this Issue.~~

~~At the March 16, 2006 meeting, the Task Force agreed to clarify that the consensus in Issue 05-7 also applies to a modification of a debt instrument that either adds or eliminates an embedded conversion option that is not bifurcated from its host contract pursuant to Statement 133. The Task Force also agreed that the scope of Issue 05-7 does not include the modification of debt instruments that either add or eliminate an embedded conversion option that is required to be bifurcated by the issuer from the host contract pursuant to Statement 133 because the Task Force did not discuss those circumstances in its deliberations on Issue 05-7.~~

Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments," which was discussed at the September 7, 2006 [and November 16, 2006] meetings, supersedes Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," and amends the guidance in this Issue to clarify that the change in the fair value of an embedded conversion option resulting from a modification in the terms of an existing debt instrument or an exchange of debt instruments should not be included in the cash flow test of whether the terms of the new debt instrument are substantially different from the terms of the original debt instrument under Issue 96-19. However, a separate analysis must be performed if the cash flow test under Issue 96-19 does not result in a conclusion that a substantial modification or an exchange has occurred. Under that separate analysis, a substantial modification or an exchange has occurred, and the issuer should apply extinguishment accounting if the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying value of the original debt instrument immediately prior to the modification or exchange. Additionally, a modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange would always be considered substantial, and debt extinguishment accounting would be required in those circumstances. In addition, Issue 06-6 requires that when a convertible debt instrument is modified or exchanged in a transaction that is not accounted for as an extinguishment, an increase in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the

modification or exchange) should reduce the carrying amount of the debt instrument (increasing a debt discount or reducing a debt premium) with a corresponding increase in additional paid-in capital. However, a decrease in the fair value of an embedded conversion option resulting from a modification or an exchange should not be recognized. At its meeting on [November 29~~XX~~, 2006], the Board ratified this amendment.

No further EITF discussion is planned.