

FASB Emerging Issues Task Force

Issue No. 04-8

Title: The Effect of Contingently Convertible Debt on Diluted Earnings per Share

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

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Previously distributed EITF materials: Issue Summary No. 1, dated June 18, 2004; Draft Abstract, dated July 19, 2004

References:

FASB Statement No. 128, *Earnings per Share* (FAS 128)

FASB Statement No. 129, *Disclosure of Information about Capital Structure* (FAS 129)

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (FAS 150)

FASB Staff Position No. 129-1, "Disclosure Requirements under FASB Statement No. 129, *Disclosure of Information about Capital Structure*, Relating to Contingently Convertible Securities" (FSP 129-1)

EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion" (Issue 90-19)

FASB Exposure Draft, *Earnings per Share – an Amendment of FASB Statement No. 128* (FASB Exposure Draft to Amend FAS 128)

*** The alternative views presented in this Issue Summary 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 and it is ratified by the Board.**

FASB Draft Abstract on EITF Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share" (Draft Abstract)

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

APB Opinion No. 15, *Earnings per Share* (APB 15)

SEC Staff Accounting Bulletin No. 74, *Disclosure of the Impact that Recently Issued Accounting Standards will have on the Financial Statements of the Registrant when Adopted in a Future Period* (SAB 74)

International Accounting Standard 33, *Earnings per Share* (IAS 33)

Background

1. At the June 30–July 1, 2004 EITF meeting the Task Force reached a tentative consensus on the issue of when the dilutive effect of contingently convertible debt (Co-Co) should be included in diluted earnings per share. Because the tentative consensus reached by the Task Force was not one of the two alternatives presented in Issue Summary No. 1, the Task Force exposed the Draft Abstract for comment. There was also a concern expressed by some Task Force members that the tentative decision may be considered an amendment to FAS 128, and that the staff should present the issue to the Board at a public meeting to understand the Board's concerns with the Task Force's tentative consensus, if any, and whether the Board would object to the Task Force continuing to deliberate the issue. At the July 16, 2004 Board meeting, the Board considered the issue and did not object to the Task Force continuing to deliberate the issue, posting the Draft Abstract to the FASB Website for a 45-day comment period, and asking respondents to comment on whether the draft abstract should be expanded to include other instruments with similar contingencies.

2. The Draft Abstract was posted on July 19, 2004, and invited comment on whether the Draft Abstract should be expanded to include other instruments with similar contingencies.

3. The FASB staff has summarized and analyzed the comment letters received on the Draft Abstract. The comment letters have been distributed to members of the Board and Task Force, and they have been posted to the FASB website for the general public's viewing. At the September 29–30, 2004 EITF meeting, the Task Force will be asked to consider the comments received in its redeliberations on the tentative decisions reached in the Draft Abstract.

SUMMARY OF COMMENT LETTERS

4. Thirty comment letters were received on the Draft Abstract of which 29 disagreed with the tentative consensus in the Draft Abstract. One respondent agreed with the tentative consensus.

5. Of the 30 comment letters received, an analysis of those in agreement/disagreement by constituent group is as follows:

| | Agree | Disagree |
|--------------------|--------------|-----------------|
| Preparers/issuers | | 17 |
| Underwriters/users | | 8 |
| Industry groups | | 3 |
| Auditor | | 1 |
| Analyst | 1 | |
| Total | 1 | 29 |

6. Based on the comments received, the staff has identified 6 comments as significant that should be considered by the Task Force at the September 29–30, 2004 EITF meeting.

Comments

Comment 1: The Task Force's tentative decision is an amendment to FAS 128.

Comment 2: Co-Cos are economically different from conventional convertible debt with a market price premium.

Comment 3: Co-Cos are contingently issuable shares or contingently issuable potential common shares and therefore subject to the guidance in paragraphs 30-35 of FAS 128.

Comment 4: The Draft Abstract appears to create divergence with IAS 33.

Comment 5: The Task Force should consider alternative transition provisions and effective dates to those outlined in the Draft Abstract.

Comment 6: Provide clarification concerning the impact of cash settlement provisions.

The FASB staff has provided a detailed analysis of each of those comments under the pertinent issue that will be discussed by the Task Force, or under the section "Other Comments Received."

7. The Task Force will be asked to address the following issues:

Issue 1: The Task Force will be asked to reaffirm its tentative conclusion.

Issue 2: The Task Force will also be asked to consider expanding the scope of the Draft Abstract beyond Co-Cos.

Issue 3: The Task Force will be asked to reaffirm its tentative conclusion on transition and the effective date.

Accounting Issues and Alternatives

Issue 1: Whether the Task Force should reaffirm its tentative conclusion

8. In reaffirming its tentative conclusion, the Task Force should consider Comments 1-4 and the FASB staff's response/analysis to each of those comments.

Comment 1: The Task Force's tentative conclusion is an amendment to FAS 128.

9. Twenty-five of the comment letter respondents believe that the Draft Abstract is an amendment of FAS 128, and that the EITF does not have the authority to amend an FASB statement. These respondents believe that if the tentative conclusion guidance is finalized at the September EITF meeting, the FASB Board should not ratify the consensus, but, rather, add a project to its agenda to amend FAS 128 or direct the FASB staff to include the amendment in Phase II of the liabilities and equity project.

10. These respondents believe that paragraph 32 of the contingently issuable shares guidance in FAS 128 specifically addresses transactions in which the number of shares that are contingently issuable depends on the market price of the stock, and provides that diluted earnings per share (DEPS) should reflect the number of shares that would be issued based on the current market price at the end of the period being reported on (if the effect is dilutive). These respondents believe that the draft abstract nullifies paragraphs 32 of FAS 128 because Co-Co securities would be treated the same as conventional convertible securities for DEPS purposes.

11. Some of these respondents also believe that by issuing FSP 129-1, the FASB confirmed practitioners' understanding of paragraph 32 of FAS 128 and that the Draft Abstract would nullify the guidance in FSP 129-1. These respondents do not believe that the EITF has the authority to amend FAS 128 or to rescind FSP 129-1.

12. Paragraph 2 of FSP 129-1 states that:

Statement 129 applies to all contingently convertible securities, including those containing contingent conversion requirements that have not been met and are not otherwise required to be included in the computation of diluted EPS in accordance with FASB Statement No. 128, *Earnings per Share*.

Response

13. At the June 30–July 1, 2004 EITF meeting, the Task Force considered whether the tentative conclusion in Issue 04-8 was an amendment of both FAS 128 and FSP 129-1. Although the Task Force agreed that the tentative conclusion was not an amendment, members were concerned about whether the Board agreed. Based on that concern, the Board considered whether the Task Force should continue with its deliberations of the Issue. At the July 16, 2004 Board meeting, the Board did not object to the Task Force continuing its deliberation of Issue 04-8, posting the Draft Abstract to the FASB website for comment, or requesting respondents to comment on whether the tentative conclusion should be expanded to include other instruments that are convertible or exercisable into common stock after a contingency has been resolved.

14. The FASB staff believes that the Task Force and the Board have adequately addressed the question of whether the tentative conclusion is an amendment to either FAS 128 or FSP 129-1 and, therefore, it should not be readdressed by the Task Force. Additionally, the Board will have another opportunity to consider this issue when it considers ratification of any final consensus.

Comment 2: Co-Cos are economically different from conventional convertible debt with a market price premium.

15. Fifteen respondents commented that Co-Cos are economically different from conventional convertible debt and should be treated differently for DEPS purposes. These respondents believe

that a Co-Co's contingent conversion feature (market price trigger) has significant value to the issuer because it reduces the risk, compared to conventional convertible debt, that a holder will convert the security prior to an issuer being able to exercise its call right, which provides the issuer with the ability to determine the security's outcome.

16. In addition, a holder of the Co-Co can be exposed to economic loss due to the presence of a market price trigger in a Co-Co compared to conventional convertible debt. For example, consider the case in which the issuer sells a \$1,000 contingently convertible bond that has a market price trigger of 120 percent of the conversion price of \$100. If at maturity the issuer's stock price is \$115, the holder will receive \$1,000, whereas if the holder had been able to convert he would have received 10 shares at \$115, or \$1,150. The \$150 differential represents a real economic loss to the holder that would not have occurred had the investor held a conventional convertible bond.

17. These respondents further commented that the contingency feature is a negotiated term similar to other features such as the term of the instrument, the coupon rate, and put/call dates, and is not a non-substantive embedded feature whose sole purpose is to circumvent the DEPS provisions of FAS 128. All Co-Co terms, including the market-price trigger, are negotiated in good faith with the underwriters, have important economic substance to both the instrument's issuer and holder, and affect the pricing of an instrument.

18. One respondent agreed that an out-of-the money price condition (market price trigger) present in a Co-Co is economically similar to an out-of-the money conversion price on a conventional convertible security and that both should be assumed converted for DEPS (if dilutive).

Response

19. Issue Summary No. 1 described how contingently convertible debt instruments are structured including some of the more complex features of Co-Cos, such as parity provisions and issuer call options. That Issue Summary also provided examples of how Co-Cos work, the underlying economics behind issuing them, and when Co-Cos can be settled in cash or stock.

Therefore, the FASB staff believes that the Task Force sufficiently considered the structuring and economics of Co-Cos and considered the view also expressed by these respondents' when reaching its tentative decision.

20. The FASB staff does not believe that there was any new or additional information provided by these respondents that should be considered by the Task Force at the September 29–30, 2004 Task Force meeting,

Comment 3: Co-Cos are contingently issuable shares or contingently issuable potential common shares.

21. Twenty comment letter respondents believe that Co-Cos either meet the definition of contingently issuable shares as defined in paragraphs 30-34 of FAS 128 or are contingently issuable potential common shares as defined in paragraph 35 of FAS 128. These respondents acknowledge that FAS 128 does not define or discuss the term contingently convertible, but believe a reasonable interpretation of paragraphs 30-35 (which has been consistently applied by entities and auditors) leads one to conclude that Co-Cos fall within this guidance. The basis for these respondents' conclusion is that the underlying common shares have not been issued and are only issuable upon the occurrence of certain triggering events, such as a market price trigger; and paragraph 32 of FAS 128 requires that the computation of DEPS shall reflect the number of contingently issuable shares that would be issued based on the current market price at the end of the reporting period. If a Co-Cos market price trigger has not been achieved at the end of a reporting period, then the contingently issuable shares would not be included in the computation of DEPS.

Response

22. Issue Summary No. 1 presented two alternatives for the Task Force's consideration as to when the dilutive effect of contingently convertible debt with a market price trigger should be included in DEPS. View A in that Issue Summary is consistent with the comment letter respondents' views. Proponents of View A believe that Co-Cos are a form of contingently issuable potential common shares that should be excluded from DEPS until the market price trigger has been met. View A proponents also believe that FSP 129-1 was issued because FAS

128 does not require the dilutive effect of Co-Cos to be included in DEPS when the contingency has not been met.

23. The FASB staff does not believe that there was any new or additional information provided by these respondents that needs further consideration by the Task Force at the September 29–30, 2004 EITF meeting, and that the information provided by these respondents was previously considered by the Task Force at the June 30–July 1, 2004 meeting. However, the Task Force will be asked to reaffirm its conclusion.

24. The Task Force's tentative decision was based on the conclusion that Co-Cos are issued securities similar to convertible debt with a market price premium and that both securities are a form of potential common stock¹. In FAS 128, convertible securities with a market price premium are assumed to be converted even when the conversion price has not been met (conversion would not be assumed if the effect would be antidilutive) and uneconomical for the holder.² The market price trigger embedded in a Co-Co security is a form of an additional premium and should be treated similarly to convertible securities with a market price premium for DEPS because the out-of-the money market price condition present in a Co-Co is economically similar to an out-of-the money conversion price on a conventional convertible security.

Comment 4: The Draft Abstract appears to create divergence with IAS 33.

25. Some respondents questioned whether the Draft Abstract creates divergence with IAS 33 because IAS 33 has similar language to FAS 128 with respect to contingently issuable shares.

Response

26. The FASB staff believes that there is a similar issue in IAS 33, and the International Accounting Standards Board (IASB) or the International Financial Reporting Interpretations

¹ The glossary to FAS 128 defines *potential common stock* as: "A security or other contract that may entitle its holder to obtain common stock during the reporting period or after the end of the reporting period."

² In basis for conclusions to FAS 128 paragraph 128 states: "One common criticism of the if-converted method is that conversion may be assumed when a convertible security appears likely to remain a senior security."

Committee (IFRIC) could decide to provide guidance on this Issue in the future that may conflict with the final consensus in Issue 04-8.

27. The Board was informed of this potential divergence with IAS 33 when considering whether the Task Force should continue to deliberate Issue 04-8, and the Board may again consider the impact of creating divergence with IAS 33 before it ratifies any consensus in Issue 04-8.

28. The FASB staff made inquiries regarding the prevalence of Co-Cos and similar instruments outside the U.S. and, based on some informal responses, believes that some foreign registrants have issued Co-Cos; but beyond these issuers there does not seem to be significant amounts of those instruments issued in foreign jurisdictions.

FASB Staff View on Comments 1-4

29. The FASB staff does not believe that there was any new or additional information provided in Comments 1-4 that requires further consideration by the Task Force because the information provided in those comments was previously considered by the Task Force and/or the Board. However, the Task Force will be asked to reaffirm its tentative conclusion at the September 29–30, 2004 EITF meeting.

Issue 2: The Task Force will also be asked to consider expanding the scope of the Draft Abstract beyond Co-Cos.

Invitation to Comment

30. The Task Force invited comment on whether the Draft Abstract should be expanded to include other instruments with similar contingencies. Three respondents commented on the invitation to comment.

31. Two of the respondents identified securities that should be considered for inclusion in the Draft Abstract. Those instruments are: contingently convertible preferred stock, contingently convertible warrants and options, and Instrument C as described in Issue 90-19 (all with market price contingencies).

32. One respondent commented that the draft abstract should not be expanded beyond Co-Cos because they believe that the contingently issuable share guidance in FAS 128 addresses the computation of DEPS for securities that have embedded contingencies.

33. One respondent commented that the Draft Abstract should address only convertible securities with market price conditions and it should not address convertible securities with other types of conversion conditions such as the occurrence of specified events; for example, an initial public offering or a change in control; an operating performance target, such as an increase in market share or earnings; some kind of performance by the investor, such as purchasing a specified amount of products or services from the issuer or selling a specified amount of the issuer's products or services to third parties; or some condition external to both issuer and investor, such as a specified increase in a stock market index or the price of a third party's shares. This respondent commented that the inclusion of the parenthetical phrase "or other contingent feature" in paragraph 5 of the Draft Abstract includes those types of specific event contingencies and effectively amends paragraphs 30, 31, 33, and 34 of FAS 128.

34. One respondent highlighted that the Draft Abstract deals only with a written call option with a market price contingency embedded in a debt security and that a similar earnings per share issue arises for a freestanding written call option with a market price contingency or other contingency. For example, an entity issues options to its employees to buy 100 shares of common stock at \$10 per share that are exercisable if the market price of the shares is \$12.50 or greater. In this example, the stock options would be dilutive using the treasury stock method when the stock price is between \$10 and \$12.50, but the options are not exercisable by contract. The respondent's view is that the entity would not apply the treasury stock method until the stock price reaches \$12.50 in accordance with paragraph 32 of FAS 128. The Draft Abstract creates doubt about whether this remains an appropriate interpretation of FAS 128.

35. That respondent further asked the Task Force to consider an employee stock option to buy 100 shares of common stock at \$10 per share that is exercisable only if an employee's business unit increases its market share by a specified amount, for example, 8 percent. When the stock

price is greater than \$10 per share but the employee's business unit has not achieved the market share goal, the employee's options would be dilutive under the treasury stock method but the options would not be contractually exercisable. The respondent's view is that the entity would not apply the treasury stock method until the market share goal is achieved in accordance with paragraph 34 of FAS 128. The Draft Abstract creates doubt about whether this remains an appropriate interpretation of FAS 128.

36. The FASB staff believes that paragraph 109 of FAS 128 provides adequate guidance on when employee stock options are considered issued and included in the computation of DEPS and therefore should not be considered in the redeliberations of Issue 04-8. Paragraph 109 of FAS 128 provides that for performance-based stock options whose issuance is contingent upon satisfying conditions in addition to the mere passage of time, those options are considered to be contingently issuable shares for DEPS purposes, and employee stock options are not considered to be contingently issuable shares if issuance is contingent solely on vesting. The Board made a distinction between time-related contingencies and contingencies requiring specific achievement.

Alternative Views on Issue 2

View A: The Draft Abstract's tentative conclusion should apply only to Co-Cos.

37. Proponents of View A believe that the scope of the Draft Abstract should be limited solely to the Co-Co instrument that was addressed at the June 30–July 1, 2004 EITF meeting, and should not be expanded to address other instruments or other types of contingencies. These proponents believe that the Task Force was requested to address a specific instrument with a specific type of contingency (market price trigger) and that the Draft Abstract should be limited to addressing that specific fact pattern.

View B: The Draft Abstract should apply to all issued securities that have embedded contingent conversion features

38. Proponents of View B believe that the Draft Abstract's tentative conclusion should be applied to all issued securities that have embedded contingent conversion features such as market price contingencies and other types of contingencies; for example, an initial public offering or a change in control. (Contingently convertible debt, mandatorily redeemable contingently convertible preferred stock, and Instrument C³ of Issue 90-19 with a market price trigger are examples of issued securities with embedded contingent conversion features.) These proponents believe that the Draft Abstract's principle should be applied to all issued securities with embedded contingencies and not be limited to co-cos. To do otherwise would provide structuring opportunities for entities to circumvent the tentative conclusion in the Draft Abstract. For example, entities could issue mandatorily redeemable contingently convertible preferred stock with a market price trigger in place of a Co-Co security to circumvent the tentative conclusion.

39. That view would be consistent with some Board member's comments that the Draft Abstract should not focus on a type of instrument but on an accounting principle.

View C: The Draft Abstract should apply to all issued securities that are convertible or exercisable based on a contingency.

40. Proponents of View C agree with View B and believe that the Draft Abstract's tentative conclusion should be applied to all issued securities with embedded contingent conversion features; however, proponents of View C would also include freestanding instruments such as a freestanding warrant that is exercisable only upon the occurrence of a contingency. These proponents believe that the Draft Abstract's principle should be applied to all contingencies in issued securities and not be limited to embedded contingencies in a host instrument. To do otherwise would provide structuring opportunities for entities to circumvent the tentative conclusion in the Draft Abstract. For example, entities could issue debt and simultaneously issue a freestanding warrant with a contingency which would result in different DEPS treatment than that proposed in the Draft Abstract for a Co-Co.

³ Instrument C is described in Issue 90-19 as follows: "Upon conversion, the issuer must satisfy the accreted value of the obligation (the amount accrued to the benefit of the holder exclusive of the conversion spread) in cash and may satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock."

41. That view would also be consistent with some Board member's comments that the Draft Abstract should not focus on a type of instrument but on an accounting principle.

Issue 3: The Task Force will be asked to reaffirm its tentative decisions on transition and the effective date.

Comment 5: The Task Force should consider alternative transition provisions and effective dates.

42. The Draft Abstract proposes that its effective date would be for reporting periods ending after December 15, 2004, and prior period earnings per share amounts presented would be restated to conform to the consensus.

Transition provision

43. Of the twelve respondents that addressed transition, 11 respondents proposed alternative transition provisions (some respondents proposed more than one alternative to address different scenarios) with one respondent in favor of the Draft Abstract's transition provision.

View A: Grandfather existing Co-Cos.

44. Proponents of View A, of which there were 10 respondents, believe that Co-Cos that have been issued prior to the Draft Abstract's ratification by the Board should be grandfathered and exempted from the consensus and that the consensus should apply only to Co-Cos issued or modified subsequent to the date of Board ratification. This transition guidance would be consistent with that in Issue 90-19, for Instrument C.

45. In Issue 90-19 the Task Force reached a consensus that the guidance for Instrument C should be applied prospectively to instruments issued after January 24, 2002 (the date the Issue was finalized by the Task Force). These respondents believe that entities made major economic decisions under the then current accounting interpretations and should be permitted the accounting treatment reflected by the rules that were in effect at the time the instruments were

issued. Furthermore, these respondents believe that the proposed transition provision (retroactive restatement) would result in issuers who would incur significant costs to exchange, redeem, or modify instruments in an effort to avoid dilution or prevent DEPS from being materially diluted upon adoption of the Draft Abstract.

View B: Prospective transition

46. Two comment letter respondents proposed that for instruments whose terms are amended prior to the adoption of the consensus, such that the new terms are not subject to the consensus, the consensus should be applied prospectively, and previously reported DEPS should not be restated during periods preceding the modification. Therefore, entities should compute DEPS based on the terms of securities in place at the date of the adoption of the Draft Abstract. View B proponents believe that requiring restatement of DEPS would result in an increase in diluted EPS during the period the securities are modified solely due to the change in those securities' terms.

View C: Modified restatement

47. Three comment letter respondents proposed limiting restatement to those instruments that are still in existence in the quarter that the Draft Abstract is ratified by the Board. These respondents believe that restatement of prior periods' diluted EPS for instruments that already have been repaid or converted would not provide benefit to users of financial statements and may even create confusion. However, restatement for instruments in place at the date of adoption would be meaningful information for users of the financial statements. View C proponents believe an entity should restate its DEPS based on the Task Force's consensus for securities in place at the date of adoption. The periods of restatement would include the period in which the as modified security was outstanding.

View D: Retroactive restatement

48. The transition provision proposed in the Draft Abstract would require all prior periods presented to be restated to conform to the consensus in the Draft Abstract. This view is included to facilitate the Task Force's deliberations on transition.

Response/Analysis

49. When analyzing these alternative transition provisions, the Task Force should consider recent Board deliberations on the earnings per share convergence project, past precedent where earnings per share guidance was not implemented retroactively, and earnings per share comparability between reporting periods.

50. During the Board's redeliberations on the short-term FASB Exposure Draft to Amend FAS 128, the Board decided that retroactive restatement is not appropriate for instruments that have already been settled in cash and for instruments whose terms have been modified such that the issuer no longer has the option to settle the instrument with shares at the date of adoption of the final standard (this view is consistent with View C above—modified restatement). The Board's view was that requiring retroactive restatement for those scenarios would introduce a lack of comparability between an entity's reporting periods because an entity would assume conversion and report dilution in the reporting periods prior to cash settlement or instrument modification, and report little, if any, dilution in the period that the instrument was settled in cash or modified to be settled in cash.

51. Retroactive restatement generally is the preferable transition method and is typically the method of implementing changes in earnings per share computational guidance. However, retroactive restatement has not always been the preferable transition provision. In Issue 90-19, the Task Force agreed that for Instrument C the consensus would be applied prospectively for only new instruments issued subsequent to the finalization of the Issue 90-19 (January 24, 2002). The Task Force's consideration of a prospective transition should be deliberated in the context of what the entities and their auditors believed when Co-Cos were developed (November 2000); that the conclusion reached in applying paragraphs 30-35 of FAS 128 to contingently convertible

debt instruments was reasonable (this view is consistent with View A above—grandfather existing Co-Cos).

52. The Task Force should also take into consideration situations in which the contractual terms of Co-Cos are modified so that they become an Instrument C in Issue 90-19 before the Draft Abstract's consensus is adopted. As currently proposed in the Draft Abstract, entities would apply the if-converted method to compute DEPS in the reporting periods prior to an amendment to terms that result in an Instrument C. Upon conversion to an Instrument C and in the subsequent reporting periods, the entity would apply the treasury stock method to the conversion spread as required by Issue 90-19. Applying the treasury stock method would be less dilutive than applying the if-converted method. The modification of the contractual terms of a Co-Co to become an Instrument C combined with a retroactive restatement requirement in the Draft Abstract would produce non-comparable DEPS because of the use of different methods to compute DEPS; Co-Cos would use the if-converted method and Instrument C's would use the treasury stock method. The Task Force should give consideration to restating prior periods' DEPS for all periods in which the Issue 90-19 Instrument C security and the Co-Co security have been outstanding to give effect to the terms of the instrument in place at the date of adoption of the Draft Abstract (this view is consistent with View C above—modified restatement).

Effective date

53. Three respondents commented on the effective date of the Draft Abstract. One respondent requested that the Draft Abstract's effective date be the same as the effective date of the final statement based on the FASB Exposure Draft to Amend FAS 128.

54. Two respondents commented that the effective date of the Draft Abstract should be as of the beginning of an entity's fiscal year (for calendar year entities, January 1, 2005) so as to minimize potential confusion among investors and analysts.

Response/Analysis

55. The proposed effective date for the consensus in the Draft Abstract is for reporting periods ending after December 15, 2004 (December 31, 2004 for entities with calendar year ends and quarter ends).

56. At the August 4, 2004 Board meeting, the Board decided that the effective date for the final statement related to the FASB Exposure Draft to Amend FAS 128, would be for reporting periods ending after December 15, 2004 and not for reporting periods beginning after December 15, 2004 as was proposed in the Exposure Draft. With this Board decision, the effective dates are now the same and entities would not have to restate DEPS in two consecutive reporting periods to adopt the guidance in the Draft Abstract and the guidance in the final statement.

57. Delaying the Draft Abstract's effective date to the beginning of an entity's fiscal year is not a plausible alternative because the Draft Abstract would apply primarily to public companies and those companies have an SEC disclosure requirement, SAB 74 to comply with, which requires companies to disclose the impact of accounting standards that are issued but are not yet effective. Disclosing DEPS information under the Draft Abstract's consensus and presenting DEPS on the face of the income statement under current guidance would add confusion for users of the financial statements. In addition, companies may have to restate DEPS in two consecutive reporting periods, once to comply with the final statement related to the FASB Exposure Draft to Amend FAS 128, and once to comply with the Draft Abstract's consensus.

Other Comments Received

Comment 6: Provide clarification concerning the impact of cash settlement provisions.

58. Some comment letter respondents requested that the Task Force provide clarification concerning the effect of cash settlement provisions in Co-Cos on DEPS. Some Co-Cos permit the issuer to unilaterally stipulate unconditionally, that the settlement will be in cash. Some respondents believe that if an entity unilaterally waives its right to settle the accreted value in shares, the Co-Co is effectively an Instrument C in Issue 90-19 and therefore should apply the guidance in Issue 90-19.

Response

59. Although the FASB staff believes this may be an emerging issue, it is beyond the current scope of Issue 04-8. The FASB Exposure Draft to Amend FAS 128 addresses this issue and the comment from these respondents has been directed to the earnings per share convergence project team to consider whether the Board should provide additional guidance or an explanation in the basis for conclusion to address when an entity has an option to settle in shares.