Notice for Recipients
of This Draft EITF Abstract

July 19, 2004

This draft abstract for EITF Issue No. 04-8, "The Effect of Contingently Convertible Debt on Diluted Earnings per Share," addresses the issue of when the dilutive effect of contingently convertible debt instruments (Co-Cos) should be included in diluted earnings per share.

The draft abstract reflects the Task Force’s tentative conclusion reached at the June 30–July 1, 2004 EITF meeting that Co-Cos should be included in diluted earnings per share computations regardless of whether the market price trigger has been met.

The Task Force invites comments on all matters in the draft abstract, including the proposed transition guidance. It would be helpful if respondents would comment on the consensus, include any alternatives the Task Force should consider, and explain the reasons for the positions taken.

The Task Force also invites comments on whether the draft abstract should be expanded to include other instruments with similar contingencies (any expansion would not change the method of earnings per share computation for those instruments, rather it would just address whether those instruments should be included in the calculation of diluted earnings per share). Respondents should identify those instruments and provide reasons why they believe those instruments should or should not be included in diluted earnings per share. Comments will be considered by the Task Force at the September 29–30, 2004 EITF meeting.

Responses from interested parties wishing to comment on the draft abstract and on whether the draft abstract should be expanded, must be received in writing by September 3, 2004. Interested parties should submit their comments by email to director@fasb.org, File Reference No. EITF0408. Responses should not be sent by fax.

EITF ABSTRACTS

Issue No. 04-8

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

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004

References: FASB Statement No. 128, *Earnings per Share*

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

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

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

ISSUE

1. Contingently convertible debt instruments, commonly referred to as Co-Cos, are financial instruments that add a contingent feature to a convertible debt instrument. Co-Cos are generally convertible into common shares of the issuer after the common stock price has exceeded a predetermined threshold for a specified time period (market price trigger). Currently, most issuers of Co-Cos exclude the potential dilutive effect of the conversion feature from diluted earnings per share (EPS) until the market price contingency is met.

2. While the terms of Co-Cos vary, a typical Co-Co includes a contingent market price trigger that exceeds a specified conversion price of the issuer's underlying stock price by a certain percentage (usually 110 percent, 120 percent, or 130 percent) on the date of issuance. Some Co-Cos have floating market price triggers under which conversion is dependent upon the market price of the stock exceeding the conversion price by a certain percentage(s) at specified times during the life of the debt. Other Co-Cos require the market price trigger to be sustained for a specified period, for example, 20 percent above the conversion price for a 30-day period. In addition, Co-Cos may have additional features such as parity features, issuer call options, and investor put options.

3. A Co-Co usually has a conversion price that exceeds the market price of the underlying stock at its issuance date and a market price trigger that exceeds the conversion price. For example, assume a Co-Co is issued for $1,000 and is convertible into 10 shares of common stock. A typical relationship of the relevant prices is as follows:

- Common stock price at Co-Co's issuance date—$80
- Implied conversion price—$100 ($1,000/10 shares into which the debt converts)
- "Market price trigger" permitting conversion—$120.

The market price trigger is higher than the conversion price and, accordingly, the instrument is less likely to be converted than a convertible debt instrument without the market price trigger. Most issuers do not include the dilutive effect of the instrument in diluted EPS unless the market price trigger has been achieved—that is, the market price of the common stock exceeds $120 for the specified period. In contrast, if the instrument did not include the market price trigger, the dilutive effect of the instrument would have been included in diluted EPS from the date that the instrument was issued (even though the stock price may not have exceeded the implied conversion price).

4. The issue is when the dilutive effect of contingently convertible debt instruments (Co-Cos) should be included in diluted earnings per share.

EITF DISCUSSION

5. The Task Force reached a consensus that Co-Cos should be included in diluted earnings per share computations (if dilutive) regardless of whether the market price trigger (or other contingent feature) has been met. That is, Co-Cos are not contingently issuable shares (paragraphs 30–35 of Statement 128) or contingently issuable potential common shares (paragraph 35 of Statement 128) because the Co-Cos have been issued and are outstanding. Accordingly, Co-Cos should be accounted for as convertible debt pursuant to paragraphs 26–28 of Statement 128 for purposes of calculating diluted EPS.

Transition

6. The consensus reached by the Task Force in this Issue is effective for reporting periods ending after December 15, 2004. Prior period earnings per share amounts presented for comparative purposes should be restated to conform to this consensus.