October 9, 2018

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Agenda request to address the accounting for warrant modifications

Dear Ms. Cosper:

We are submitting this letter to request that consideration be given to establishing authoritative guidance to address the accounting for warrant modifications from the issuer's perspective. We believe this could be accomplished in an expedited manner through the Emerging Issues Task Force.

As a group, we serve many middle market companies, both public and private across various industries, that modify the terms of outstanding warrants for various reasons including (1) to induce exercise to raise much needed cash and capital, (2) to reduce the exercise price of a warrant that does not have a contractual downround feature due to a subsequent issuance of stock at a lower price, (3) as a gesture of goodwill to certain investors, or (4) to induce lenders to provide additional financing. As you are likely aware, there is no authoritative guidance that directly addresses the accounting for warrant modifications. This lack of guidance leads to both diversity in practice and an increased level of risk and uncertainty on the part of preparers and auditors.

Given the lack of guidance, consideration is sometimes given to other authoritative guidance by analogy including the following:

- Accounting Standards Codification (ASC) 470-20, *Debt with Conversion and Other Options* - If a convertible debt instrument is converted to equity securities pursuant to an inducement offer, the debtor recognizes expense equal to the fair value of all securities and other consideration transferred in the transaction in excess of the fair value of securities issuable pursuant to the original conversion terms.
- ASC 718, *Stock Compensation* - Compensation cost for an equity classified award is recognized for the excess, if any, of the fair value of the modified award over the fair value of the original award immediately before its terms are modified. No special guidance is provided for a modification of a liability award that remains a liability after the modification given that liability awards are remeasured each period.
- SEC Staff Announcement: The Effect on the Calculation of Earnings Per Share for a Period That Includes the Redemption or Induced Conversion of Preferred Stock[1] - Addresses equity-classified preferred stock instruments and provides as follows:
    - For modifications and exchanges that are accounted for as extinguishments, the difference between (1) the fair value of the consideration transferred to the holders of the preferred stock and (2) the carrying amount of the preferred stock is accounted for similar to a preferred stock dividend and subtracted from (or added

[1] See ASC 260-10-S99-2.

    to) net income to arrive at income available to common stockholders in the calculation of earnings per share.
    - If convertible preferred stock is converted into other securities pursuant to an inducement offer, the excess of (1) the fair value of all securities and other consideration transferred in the transaction by the registrant to the holders of the convertible preferred stock over (2) the fair value of securities issuable pursuant to the original conversion terms is subtracted from net income to arrive at income available to common stockholders in the calculation of earnings per share. Reference is made to the guidance in ASC 470-20 to determine if the conversion of preferred stock is pursuant to an inducement offer.
- T. Kirk Crews, Office of the Chief Accountant, Remarks before the 2014 AICPA National Conference on Current SEC and PCAOB Developments - If an amendment to or exchange of preferred stock does not represent an extinguishment, the staff believes it is appropriate to analogize to the modification guidance contained in Subtopic 718-20. If the modified instrument's fair value exceeds the fair value of the original instrument, the additional fair value is recognized to reflect the modification. The staff has not objected to recording the additional fair value to retained earnings as a deemed dividend from the entity to the preferred stock holders and acknowledged that in certain unique circumstances, it may be appropriate to reflect the debit as a charge to earnings as a form of compensation for agreeing to restructure. The staff's conclusion is highly dependent on the underlying purpose for and circumstances surrounding the modification.
- Staff Accounting Bulletin Topic 5T - Accounting *for Expenses or Liabilities Paid by Principal Stockholder(s)* – The group is aware of one time that the SEC staff viewed a reduction in the exercise price of a company's warrants, and the associated increase in the fair value, as an investor relations expense. The staff viewed the warrant holders as investors and considered the change in the fair value of the warrants as subject to Topic 5T.

We, as a group, agree that the appropriate accounting treatment for a warrant modification should be based on the specific facts and circumstances including (in part) (1) the reasons for the modification, (2) the warrant holder(s)' relationship with the issuer, (3) whether the modification was extended to all or certain warrant or shareholders of a particular class, and (4) the balance sheet classification for the warrant.

That being said, we believe financial statement users, preparers and auditors would benefit from more consistent accounting for warrant modifications that could best be accomplished through a principles based approach that provides a framework for determining when the impact of a modification should be recognized (1) through earnings immediately, (2) amortized into earnings as a debt issuance cost, or, (3) as a deemed dividend or other equity transaction, as well as the related earnings per share ramifications. It would also be beneficial to address whether the issuer should recognize both increases and decreases in the fair value of a modified equity classified warrant, computed as the difference between the fair value of the warrant pre- and post-modification, or should it recognize only increases in fair value (i.e., not recognize decreases in fair value due to the modification).

We encourage you to add this matter to the standard setting agenda and reach out to us if you would like any additional insights or observations relevant to addressing this issue. Thank you for your consideration.

Sincerely,

BDO USA, LLP

BDO USA, LLP

Crowe LLP

Crowe LLP

Grant Thornton LLP

Grant Thornton LLP

Financial Reporting Advisors, LLC

Financial Reporting Advisors, LLC

Mind the GAAP

Mind the GAAP

RSM US LLP

RSM US LLP