

MINUTES



MEMORANDUM

To: Board Members

From: Distinguishing Liabilities from Equity Team (Japhet x443)

Subject: Minutes of February 5, 2020
Board Meeting on Distinguishing Liabilities and Equity (Including Convertible Debt)

Date: February 13, 2020

cc: Tosches

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board’s deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue an Accounting Standards Update or a Statement of Financial Accounting Concepts.

Topic: Distinguishing Liabilities from Equity (Including Convertible Debt)

Basis for Discussion:

FASB Memo 32, “Cover Memo”

FASB Memo 33, “Convertible Instruments and EPS”

FASB Memo 34, “Project Direction and Redeliberations Plan”

FASB Memo 34A, “Derivatives Scope Exception Redeliberations—Supplement (Package 3)”

FASB Memo 35, “Transition, Effective Date, and Next Steps”

Length of Discussion: 9:00 a.m. to 10:15 a.m. EST

Attendance:

Board members present: Golden, Kroeker, Botosan, Buesser, Cosper, Hunt, and Schroeder

Staff in charge of topic: Mazzella

Other staff at Board table: Kuhaneck, Cheng, Japhet, and Mulugeta

Outside participants: None

Type of Document and Timing Based on the Technical Plan:

The Board continued redeliberating the amendments in proposed Accounting Standards Update, *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity’s Own Equity*.

Please refer to the current technical plan for information about project deadlines.

Tentative Board Decisions:

Convertible Instruments

The Board affirmed its decisions to:

1. Clarify the scope of the guidance in Subtopic 470-20 for convertible debt instruments and in Subtopic 505-10, Equity—Overall, for convertible preferred stock **(Vote: 7-0)**
2. Clarify the difference between a convertible debt and a debt instrument that could be converted to a variable number of shares with an aggregate fair value equal to a fixed monetary amount (such as share-settled debt) **(Vote: 7-0)**
3. Remove the word *conventional* from the term *conventional convertible debt instrument* used in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity’s Own Equity **(Vote: 7-0)**
4. Align the post-vesting classification of convertible instrument awards with other financial instrument awards under Topic 718, Compensation—Stock Compensation **(Vote: 7-0)**
5. Amend disclosure guidance as follows:
 - a. Add a disclosure objective for convertible debt instruments and for convertible preferred stock
 - b. Add a disclosure requirement about events or conditions that occur during the reporting period that significantly affect the conversion conditions
 - c. Add a disclosure requirement on which party controls the conversion rights
 - d. Align the disclosure requirements for contingently convertible instruments with other convertible instruments

- e. Require that existing fair value disclosures in Topic 825, Financial Instruments, be provided at the individual instrument level rather than in the aggregate.

(Vote: 7-0)

6. Not make any amendments to the disclosure guidance in Subtopic 470-20 related to the reporting frequency. **(Vote: 7-0)**

The Board decided against:

7. Providing guidance on negative interest expense recognized from convertible debt instruments with substantial premiums, **(Vote: 7-0)**
8. Adding a requirement to disclose current nonconvertible borrowing rates for convertible debt instruments. **(Vote: 7-0)**

Earnings per Share (EPS)

The Board affirmed its decisions to:

1. Require that an entity apply the if-converted method of calculating diluted EPS to all convertible instruments and that interest expense not be added back to the numerator for convertible debt instruments if the principal is required to be settled in cash. **(Vote: 7-0)**
2. Exclude certain share-based payment arrangements (instruments that are liability-classified in accordance with guidance in paragraph 718-10-25-15) from the scope of the EPS amendments on instruments that may be settled in cash or shares. **(Vote: 7-0)**
3. Clarify that an average share price should be used in calculating the diluted EPS denominator for instruments for which (a) the exercise prices may change based on an entity's share price or (b) the changes in the entity's share price may affect the number of shares that may be used to settle a financial instrument. **(Vote: 7-0)**
4. Clarify that an entity should use the weighted average share count from each quarter when calculating the year-to-date weighted-average share count. **(Vote: 7-0)**
5. Expand the scope of the down round EPS adjustment in Topic 260, Earnings Per Share, to include equity-classified convertible preferred shares. **(Vote: 7-0)**

The Board also decided to clarify that the guidance on contracts that may be settled in cash or shares does not apply to contingently issuable shares and that if cash settlement is more dilutive than share settlement, share settlement should not be presumed. **(Vote: 7-0)**

Derivatives Scope Exception

The Board affirmed its decisions to:

1. Clarify that the reassessment guidance in paragraph 815-40-35-8 applies to both freestanding instruments and embedded features (similar to the scope as written in paragraph 815-40-15-5). **(Vote: 7-0)**
2. Add a cross-reference in Section 815-40-35 to the guidance in Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, on the accounting for embedded features upon a change in assessment of the derivatives scope exception. **(Vote: 7-0)**
3. Remove the table on embedded written put options and forward purchase contracts in paragraph 815-40-55-11 (and the related paragraphs 815-40-55-8 through 55-10). **(Vote: 7-0)**
4. Clarify that penalty payments, if the entity fails to make timely filings with the U.S. Securities and Exchange Commission, would not preclude equity classification under paragraph 815-40-25-10(d) because they would not result in settlement of a contract. **(Vote: 7-0)**
5. Expand the scope of the subsequent measurement guidance in paragraph 815-40-35-4 (which requires fair value measurement) to include instruments that failed the indexation criterion under Section 815-40-15. **(Vote: 7-0)**
6. Amend disclosure guidance in Subtopic 815-40 as follows:
 - a. Add a disclosure objective to Section 815-40-50.
 - b. Modify the disclosure requirement in paragraph 815-40-50-5(d) about the fair value of settlement alternatives to parallel the disclosure requirement in paragraph 480-10-50-2(a) through (b).
 - c. Modify the scope of Section 815-40-50 on disclosure to apply only to freestanding instruments. Embedded features would not be subject to Section 815-40-50 requirements.

(Vote: 7-0)

The Board decided to:

7. Remove from the scope of the project proposed amendments that would have added a remote likelihood threshold to existing guidance in Section 815-40-15 and changed the reassessment frequency and disclosures. **(Vote: 7-0)**
8. Add a separate project to its technical agenda to explore improvements to aspects of the derivatives scope exception guidance in Subtopic 815-40. The objective and scope of this separate project will be discussed at a future Board meeting. **(Vote: 5-2)**

Transition

The Board affirmed its decisions to:

1. Require an entity to apply a modified retrospective method of transition with an option for full retrospective transition for the derivatives scope exception and convertible instruments amendments. **(Vote: 7-0)**
2. Require specific transition disclosures in Topic 250, Accounting Changes and Error Corrections, based on the method of transition selected. **(Vote: 7-0)**
3. Allow entities that have not yet adopted the amendments in Accounting Standards Update No. 2017-11, *Earnings per Share (Topic 260)*, *Distinguishing Liabilities from Equity (Topic 480)*, *Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financing Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*, to early adopt the amendments for convertible instruments that include down round features. **(Vote: 7-0)**

The Board decided to:

1. Align the transition guidance for EPS amendments with the transition guidance for convertible instruments and the derivatives scope exception and require a transition disclosure about the effect of the change on affected per-share amounts in the period of adoption. **(Vote: 7-0)**
2. Allow an entity to make a one-time irrevocable election to apply the fair value option, subject to Subtopic 825-10, to convertible instruments, as of the date of adoption of the final Update. **(Vote: 7-0)**

Effective Date

The Board decided that a final Update will be effective for:

1. Public business entities that are not smaller reporting companies (as defined by the SEC), for fiscal years beginning after December 15, 2021, and interim periods within those fiscal years **(Vote: 7-0)**
2. All other entities, for fiscal years beginning after December 15, 2023, and interim periods within those fiscal years. **(Vote: 7-0)**

The Board also decided that all entities will have an option for early adoption for fiscal periods beginning after December 15, 2020 (including interim periods within the same fiscal year). **(Vote: 7-0)**

Next Steps

The Board directed the staff to draft an Accounting Standards Update and distribute that draft for external review.

General Announcements: None