

FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2020-06
August 2020

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

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*[®] is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

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Order Department
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The Board is issuing this Update to address issues identified as a result of the complexity associated with applying generally accepted accounting principles (GAAP) for certain financial instruments with characteristics of liabilities and equity. Complexity associated with the accounting is a significant contributing factor to numerous financial statement restatements and results in complexity for users attempting to understand the results of applying the current guidance. In addressing the complexity, the Board focused on amending the guidance on convertible instruments and the guidance on the derivatives scope exception for contracts in an entity's own equity.

For convertible instruments, the Board decided to reduce the number of accounting models for convertible debt instruments and convertible preferred stock. Limiting the accounting models results in fewer embedded conversion features being separately recognized from the host contract as compared with current GAAP. Convertible instruments that continue to be subject to separation models are (1) those with embedded conversion features that are not clearly and closely related to the host contract, that meet the definition of a derivative, and that do not qualify for a scope exception from derivative accounting and (2) convertible debt instruments issued with substantial premiums for which the premiums are recorded as paid-in capital.

The Board concluded that eliminating certain accounting models simplifies the accounting for convertible instruments, reduces complexity for preparers and practitioners, and improves the decision usefulness and relevance of the information provided to financial statement users. In addition to eliminating certain accounting models, the Board also decided to enhance information transparency by making targeted improvements to the disclosures for convertible instruments and earnings-per-share (EPS) guidance on the basis of feedback from financial statement users.

The Board decided to amend the guidance for the derivatives scope exception for contracts in an entity's own equity to reduce form-over-substance-based accounting conclusions. The Board observed that the application of the derivatives scope exception guidance results in accounting for some contracts as derivatives while accounting for economically similar contracts as equity. The Board also decided to improve and amend the related EPS guidance.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect entities that issue convertible instruments and/or contracts in an entity's own equity.

For convertible instruments, the instruments primarily affected are those issued with beneficial conversion features or cash conversion features because the accounting models for those specific features are removed. However, all entities that issue convertible instruments are affected by the amendments to the disclosure requirements in this Update.

For contracts in an entity's own equity, the contracts primarily affected are freestanding instruments and embedded features that are accounted for as derivatives under the current guidance because of failure to meet the settlement conditions of the derivatives scope exception related to certain requirements of the settlement assessment. The Board simplified the settlement assessment by removing the requirements (1) to consider whether the contract would be settled in registered shares, (2) to consider whether collateral is required to be posted, and (3) to assess shareholder rights. Those amendments also affect the assessment of whether an embedded conversion feature in a convertible instrument qualifies for the derivatives scope exception.

Additionally, the amendments in this Update affect the diluted EPS calculation for instruments that may be settled in cash or shares and for convertible instruments.

What Are the Main Provisions, How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP), and Why Are They an Improvement?

Convertible Instruments

Under current GAAP, there are five accounting models for convertible debt instruments. Except for the traditional convertible debt model that recognizes a convertible debt instrument as a single debt instrument, the other four models, with their different measurement guidance, require that a convertible debt instrument be separated (using different separation approaches) into a debt component and an equity or a derivative component. Convertible preferred stock also is required to be assessed under similar models.

Feedback from preparers and practitioners indicated that the current accounting guidance for convertible instruments is unnecessarily complex and difficult to navigate, resulting in applying or interpreting the guidance incorrectly or

inconsistently. Consequently, accounting for convertible instruments has been the subject of a significant number of restatements.

Feedback from users of financial statements indicated that most users do not find the current separation models for convertible instruments useful and relevant because they generally view and analyze those instruments on a whole-instrument basis. Because a convertible debt instrument is going to be either repaid at maturity or converted at conversion date(s), users of financial statements asserted that separating the instrument into two components is confusing and creates a result in the financial statements that is inconsistent with their analyses. Many users also indicated that cash (coupon) interest expense is more relevant information for their analyses, rather than an imputed interest expense that results from the separation of conversion features required by GAAP. Overall, most users of financial statements stated that they would prefer a simple recognition, measurement, and presentation approach with sufficient disclosures for convertible instruments to have a simplified and consistent starting point across entities to perform their analyses.

In response to the feedback received, the Board decided to simplify the accounting for convertible instruments by removing certain separation models in Subtopic 470-20, Debt—Debt with Conversion and Other Options, for convertible instruments. Under the amendments in this Update, the embedded conversion features no longer are separated from the host contract for convertible instruments with conversion features that are not required to be accounted for as derivatives under Topic 815, Derivatives and Hedging, or that do not result in substantial premiums accounted for as paid-in capital. Consequently, a convertible debt instrument will be accounted for as a single liability measured at its amortized cost and a convertible preferred stock will be accounted for as a single equity instrument measured at its historical cost, as long as no other features require bifurcation and recognition as derivatives. By removing those separation models, the interest rate of convertible debt instruments typically will be closer to the coupon interest rate when applying the guidance in Topic 835, Interest.

The amendments in this Update provide financial statement users with a simpler and more consistent starting point to perform analyses across entities, consistent with feedback received from users. The amendments also improve the operability of the guidance and reduce, to a large extent, the complexities in the accounting for convertible instruments and the difficulties with the interpretation and application of the relevant guidance.

To further improve the decision usefulness and relevance of the information being provided to users of financial statements, the Board decided to increase information transparency by making the following disclosure amendments in this Update for convertible instruments:

1. Add a disclosure objective

2. Add information about events or conditions that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed
3. Add information on which party controls the conversion rights
4. Align disclosure requirements for contingently convertible instruments with disclosure requirements for other convertible instruments
5. Require that existing fair value disclosures in Topic 825, Financial Instruments, be provided at the individual convertible instrument level rather than in the aggregate.

Additionally, for convertible debt instruments with substantial premiums accounted for as paid-in capital, the Board decided to add disclosures about (1) the fair value amount and the level of fair value hierarchy of the entire instrument for public business entities and (2) the premium amount recorded as paid-in capital.

Derivatives Scope Exception for Contracts in an Entity's Own Equity

Under current guidance in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity, an entity must determine whether a contract qualifies for a scope exception from derivative accounting. This guidance must be applied to freestanding financial instruments and embedded features that have all the characteristics of a derivative instrument and freestanding financial instruments that potentially are settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative instrument. The analysis to determine whether a contract meets this scope exception includes two criteria: (1) the contract is indexed to an entity's own stock and (2) the contract is equity classified. If both of those criteria are not met, the contract must be recognized as an asset or a liability.

Under Section 815-40-25 on recognition, an entity must determine whether a contract meets specific conditions to be classified as equity (referred to as the settlement criterion). Analyzing whether a contract meets the settlement criterion involves evaluating the contract's settlement optionality and conditions necessary for share settlement. The general concept behind the settlement criterion is that a contract that will settle in an entity's own equity shares meets the criterion, whereas a contract that may (or will) require settlement in cash does not. The current guidance includes seven conditions for performing this assessment and explicitly precludes considering the likelihood that an event would trigger cash settlement.

The Board received feedback that stakeholders have difficulty applying the current guidance for this exception to derivative accounting because of its lack of organization, as well as that the current guidance is rules based, internally inconsistent, and often is asserted to result in form-over-substance-based accounting conclusions.

The amendments in this Update revise the guidance in Subtopic 815-40, as follows:

1. Remove the following conditions from the settlement guidance:
 - a. Settlement in unregistered shares
 - b. Collateral
 - c. Shareholder rights.
2. Regarding the condition about failure to timely file in the settlement guidance, clarify that penalty payments do not preclude equity classification.
3. Require instruments that are required to be classified as an asset or liability under paragraph 815-40-15-8A to be measured subsequently at fair value, with changes reported in earnings and disclosed in the financial statements, which is consistent with instruments that are required to be classified as an asset or a liability under Section 815-40-25 on recognition.
4. Clarify that the scope of the disclosure requirements in Section 815-40-50 applies only to freestanding instruments. Embedded features are not subject to Section 815-40-50 requirements.
5. Clarify that the scope of the reassessment guidance in Section 815-40-35 on subsequent measurement applies to both freestanding instruments and embedded features.

The amendments in this Update to the derivatives scope exception for contracts in an entity's own equity change the population of contracts that are recognized as assets or liabilities. For a freestanding instrument, if the instrument qualifies for the derivatives scope exception under the amendments, an entity should record the instrument in equity. For an embedded feature, if the feature qualifies for the derivatives scope exception under the amendments, an entity should no longer bifurcate the feature and account for it separately.

EPS

In considering improvements to the EPS guidance, the Board focused on the areas included in the project's overall scope of convertible instruments and of instruments that qualify for the derivatives scope exception for contracts in an entity's own equity in Subtopic 815-40 and consequences of the amendments in this Update to classification, recognition, and measurement in those areas of the guidance. The amendments improve the consistency of EPS calculations by amending the guidance as follows:

1. Align the diluted EPS calculation for convertible instruments by requiring that an entity use the if-converted method. The treasury stock method should no longer be used to calculate diluted EPS for convertible instruments.

2. Require that the effect of potential share settlement be included in the diluted EPS calculation when an instrument may be settled in cash or shares. The amendments remove current guidance that allows an entity to rebut this presumption if it has a history or policy of cash settlement. This amendment affects any instrument that may be settled in cash or shares (other than certain liability-classified share-based payment arrangements) and, therefore, affects the diluted EPS calculation for both convertible instruments and contracts in an entity's own equity.
3. Include equity-classified convertible preferred stock that includes a down round feature within the scope of the recognition and measurement guidance for financial instruments that include down round features in Topic 260, Earnings Per Share, because the beneficial conversion features model is eliminated.
4. Clarify that an average market price should be used to calculate the diluted EPS denominator in cases in which the exercise prices may change on the basis of an entity's share price or changes in the entity's share price may affect the number of shares that may be used to settle a financial instrument.
5. Clarify that an entity should use the weighted-average share count from each quarter when calculating the year-to-date weighted-average share count.

When Will the Amendments Be Effective and What Are the Transition Requirements?

The amendments in this Update are effective for public business entities that meet the definition of a Securities and Exchange Commission (SEC) filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. The Board specified that an entity should adopt the guidance as of the beginning of its annual fiscal year.

The Board decided to allow entities to adopt the guidance through either a modified retrospective method of transition or a fully retrospective method of transition. In applying the modified retrospective method, entities should apply the guidance to transactions outstanding as of the beginning of the fiscal year in which the amendments are adopted. Transactions that were settled (or expired) during prior reporting periods are unaffected. The cumulative effect of the change should be recognized as an adjustment to the opening balance of retained earnings at the date of adoption. If an entity elects the fully retrospective method of transition, the

cumulative effect of the change should be recognized as an adjustment to the opening balance of retained earnings in the first comparative period presented.

An entity that has 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 Financial Instruments with Down Round Features*, and *(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*, can early adopt the amendments in this Update for convertible instruments that include a down round feature. This early adoption is permitted for fiscal years beginning after December 15, 2019.

The Board also decided to allow all entities to irrevocably elect the fair value option in accordance with Subtopic 825-10, Financial Instruments—Overall, for any financial instrument that is a convertible security upon adoption of the amendments in this Update.

Amendments to the FASB Accounting Standards Codification®

Summary of Amendments to the Accounting Standards Codification

1. The following table provides a summary of the amendments to the Accounting Standards Codification.

Codification Section	Description of Changes
Master Glossary	<ul style="list-style-type: none"> • Superseded the term <i>beneficial conversion feature</i> • Added the term <i>convertible security</i> to Subtopics 505-10, 718-10, and 815-40 • Added the terms <i>freestanding financial instrument</i> and <i>Securities and Exchange Commission (SEC) Filer</i> to Subtopic 815-40 • Added the term <i>contingently convertible instruments</i> to Subtopics 470-20 and 505-10 • Added the term <i>public business entity</i> to Subtopics 470-20 and 815-40
Subtopic 260-10, Earnings Per Share—Overall	<ul style="list-style-type: none"> • Expanded the scope of the recognition and measurement guidance to include equity-classified convertible preferred stock • Amended the method used to calculate diluted earnings per share for convertible instruments and for instruments that may be settled in cash or shares • Amended the guidance to require the use of an average market price when calculating the diluted earnings-per-share denominator for contracts with variable prices or number of shares to be issued • Amended the guidance about calculating year-to-date weighted average shares

Codification Section	Description of Changes
Subtopic 470-10, Debt—Overall	<ul style="list-style-type: none"> • Includes consequential amendments
Subtopic 470-20, Debt—Debt with Conversion and Other Options	<ul style="list-style-type: none"> • Amended the guidance on convertible debt instruments by removing accounting models for the instruments with beneficial conversion features and cash conversion features • Amended the disclosure guidance on convertible debt instruments
Subtopic 505-10, Equity—Overall	<ul style="list-style-type: none"> • Added the guidance on convertible preferred stock
Subtopic 718-10, Compensation— Stock Compensation— Overall	<ul style="list-style-type: none"> • Amended the guidance to require that convertible instruments within the scope of Topic 718 remain in that Topic when the instruments are fully vested
Subtopic 740-10, Income Taxes— Overall	<ul style="list-style-type: none"> • Removed the guidance on beneficial conversion features
Subtopic 815-10, Derivatives and Hedging—Overall	<ul style="list-style-type: none"> • Includes consequential amendments
Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives	<ul style="list-style-type: none"> • Includes consequential amendments
Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity	<ul style="list-style-type: none"> • Amended the guidance on the derivatives scope exception for contracts in an entity's own equity, including related implementation and disclosure guidance
Subtopic 825-10, Financial Instruments—Overall	<ul style="list-style-type: none"> • Added guidance requiring fair value disclosures of convertible debt instruments at the individual instrument level

Codification Section	Description of Changes
	<ul style="list-style-type: none"> <li data-bbox="439 291 877 317">Includes consequential amendments
Subtopic 835-30, Interest—Imputation of Interest	<ul style="list-style-type: none"> <li data-bbox="439 378 976 517">Removed the reference to Subtopic 470-20 about specific accounting for interest expense of convertible debt instruments with beneficial conversion features or cash conversion features

2. The Accounting Standards Codification is amended as described in paragraphs 3–62. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

3. Supersede the Master Glossary term *Beneficial Conversion Feature*, with a link to transition paragraph 815-40-65-1, as follows:

Beneficial Conversion Feature

~~A nondetachable conversion feature that is in the money at the commitment date.~~

4. Add the Master Glossary term *Convertible Security* to Subtopics 505-10, 718-10, and 815-40 as follows:

Convertible Security

A security that is convertible into another security based on a conversion rate. For example, convertible preferred stock that is convertible into common stock on a two-for-one basis (two shares of common for each share of preferred).

5. Add the Master Glossary terms *Freestanding Financial Instrument* and *Securities and Exchange Commission (SEC) Filer* to Subtopic 815-40 as follows:

Freestanding Financial Instrument

A financial instrument that meets either of the following conditions:

- a. It is entered into separately and apart from any of the entity's other financial instruments or equity transactions.

- b. It is entered into in conjunction with some other transaction and is legally detachable and separately exercisable.

Securities and Exchange Commission (SEC) Filer

An entity that is required to file or furnish its financial statements with either of the following:

- a. The Securities and Exchange Commission (SEC)
- b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

6. Add the Master Glossary term *Contingently Convertible Instruments* to Subtopics 470-20 and 505-10 as follows:

Contingently Convertible Instruments

Contingently convertible instruments are instruments that have embedded conversion features that are contingently convertible or exercisable based on either of the following:

- a. A market price trigger
- b. Multiple contingencies if one of the contingencies is a market price trigger and the instrument can be converted or share settled based on meeting the specified market condition.

A market price trigger is a market condition that is based at least in part on the issuer's own share price. Examples of contingently convertible instruments include contingently convertible debt, contingently convertible preferred stock, and the instrument described by paragraph 260-10-45-43, all with embedded market price triggers.

7. Add the Master Glossary term *Public Business Entity* to Subtopics 470-20 and 815-40 as follows:

Public Business Entity

A public business entity is a business entity meeting any one of the criteria below. Neither a **not-for-profit entity** nor an employee benefit plan is a business entity.

- a. It is required by the U.S. Securities and Exchange Commission (SEC) to file or furnish financial statements, or does file or furnish financial statements (including voluntary filers), with the SEC (including other entities whose financial statements or financial information are required to be or are included in a filing).

- b. It is required by the Securities Exchange Act of 1934 (the Act), as amended, or rules or regulations promulgated under the Act, to file or furnish financial statements with a regulatory agency other than the SEC.
- c. It is required to file or furnish financial statements with a foreign or domestic regulatory agency in preparation for the sale of or for purposes of issuing securities that are not subject to contractual restrictions on transfer.
- d. It has issued, or is a conduit bond obligor for, **securities** that are traded, listed, or quoted on an exchange or an over-the-counter market.
- e. It has one or more securities that are not subject to contractual restrictions on transfer, and it is required by law, contract, or regulation to prepare U.S. GAAP financial statements (including notes) and make them publicly available on a periodic basis (for example, interim or annual periods). An entity must meet both of these conditions to meet this criterion.

An entity may meet the definition of a public business entity solely because its financial statements or financial information is included in another entity's filing with the SEC. In that case, the entity is only a public business entity for purposes of financial statements that are filed or furnished with the SEC.

Amendments to Subtopic 260-10

8. Amend paragraph 260-10-25-1 and add the related heading and amend paragraphs 260-10-30-1, 260-10-35-1, and 260-10-45-12B, with a link to transition paragraph 815-40-65-1, as follows:

Earnings Per Share—Overall

Recognition

> Financial Instruments That Include a Down Round Feature

260-10-25-1 An entity that presents **earnings per share** (EPS) in accordance with this Topic shall recognize the value of the effect of a **down round feature** in an equity-classified freestanding **financial instrument and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance)** ~~(that is, instruments that are not convertible instruments)~~ when the down round feature is triggered. That effect shall be treated as a dividend and as a reduction of income available to common stockholders in **basic earnings per share**, in accordance with the guidance in paragraph 260-10-45-12B. See paragraphs 260-10-55-95 through 55-97 for an illustration of this guidance.

Initial Measurement

260-10-30-1 As of the date that a **down round feature** is triggered (that is, upon the occurrence of the triggering event that results in a reduction of the strike price) in an equity-classified freestanding **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance), an entity shall measure the value of the effect of the feature as the difference between the following amounts determined immediately after the down round feature is triggered:

- a. The fair value of the financial instrument (without the down round feature) with a strike price corresponding to the currently stated strike price of the issued instrument (that is, before the strike price reduction)
- b. The fair value of the financial instrument (without the down round feature) with a strike price corresponding to the reduced strike price upon the down round feature being triggered.

Subsequent Measurement

260-10-35-1 An entity shall recognize the value of the effect of a **down round feature** in an equity-classified freestanding **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) each time it is triggered but shall not otherwise subsequently remeasure the value of a down round feature that it has recognized and measured in accordance with paragraphs 260-10-25-1 and 260-10-30-1 through 30-2. An entity shall not subsequently amortize the amount in additional paid-in capital arising from recognizing the value of the effect of the down round feature.

Other Presentation Matters

> Basic EPS

> > Freestanding Equity-Classified Financial Instrument with a Down Round Feature

260-10-45-12B For a freestanding equity-classified **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) with a **down round feature**, an entity shall deduct the value of the effect of a down round feature (as recognized in accordance with paragraph 260-10-25-1 and measured in accordance with paragraphs 260-10-30-1 through 30-2) in computing income available to common stockholders when that feature has been triggered (that is, upon the occurrence of the triggering event that results in a reduction of the strike price).

9. Amend paragraphs 260-10-45-16, 260-10-45-23, 260-10-45-40, and 260-10-45-44 through 45-46, add paragraphs 260-10-45-21A and its related heading and 260-10-45-45A, and supersede paragraph 260-10-45-64, with a link to transition paragraph 815-40-65-1, as follows:

> Diluted EPS and Related Topics

> > Computation of Diluted EPS

260-10-45-16 The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, in computing the dilutive effect of convertible securities, the numerator is adjusted in accordance with the guidance in paragraph 260-10-45-40. ~~to add back any convertible preferred dividends and the after-tax amount of interest recognized in the period associated with any convertible debt. The numerator also is adjusted for any other changes in income or loss that would result from the assumed conversion of those potential common shares, such as profit sharing expenses. Similar adjustments~~ Adjustments also may be necessary for certain contracts that provide the issuer or holder with a choice between settlement methods. See Example 1 (paragraph 260-10-55-38) for an illustration of this guidance.

> > Variable Denominator

260-10-45-21A Changes in an entity's share price may affect the exercise price of a financial instrument or the number of shares that would be used to settle the financial instrument. For example, when the principal of a convertible debt instrument is required to be settled in cash but the conversion premium is required to (or may) be settled in shares, the number of shares to be included in the diluted EPS denominator is affected by the entity's share price. In applying both the treasury stock method and the if-converted method of calculating diluted EPS, the average market price shall be used for purposes of calculating the denominator for diluted EPS when the number of shares that may be issued is variable, except for contingently issuable shares within the scope of the guidance in paragraphs 260-10-45-48 through 45-57. See paragraphs 260-10-55-4 through 55-5 for implementation guidance on determining an average market price.

> > Options, Warrants, and Their Equivalents and the Treasury Stock Method

260-10-45-22 The dilutive effect of outstanding call options and warrants (and their equivalents) issued by the reporting entity shall be reflected in diluted EPS by application of the treasury stock method unless the provisions of paragraphs 260-10-45-35 through 45-36 and 260-10-55-8 through 55-11 require that another

method be applied. Equivalents of options and warrants include nonvested stock granted under a share-based payment arrangement, stock purchase contracts, and partially paid stock subscriptions (see paragraph 260-10-55-23). Antidilutive contracts, such as purchased put options and **purchased call options**, shall be excluded from diluted EPS.

260-10-45-23 Under the treasury stock method:

- a. Exercise of options and warrants shall be assumed at the beginning of the period (or at time of issuance, if later) and common shares shall be assumed to be issued.
- b. The proceeds from exercise shall be assumed to be used to purchase common stock at the average market price during the period. (See paragraphs 260-10-45-29 and 260-10-55-4 through 55-5.)
- c. The incremental shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) shall be included in the denominator of the diluted EPS computation.

Example 15 (see paragraph 260-10-55-92) provides an illustration of this guidance. See paragraph 260-10-45-21A if the exercise price of a financial instrument or the number of shares that would be used to settle the financial instrument is variable.

> > Convertible Securities and the If-Converted Method

260-10-45-40 The dilutive effect of convertible securities shall be reflected in diluted EPS by application of the **if-converted method**. Under that method:

- a. If an entity has convertible preferred stock outstanding, the preferred dividends applicable to convertible preferred stock shall be added back to the numerator. The amount of preferred dividends added back will be the amount of preferred dividends for convertible preferred stock deducted from income from continuing operations (and from net income) in computing income available to common stockholders pursuant to paragraph 260-10-45-11.
- b. If an entity has convertible debt outstanding:
 1. Interest charges applicable to the convertible debt shall be added back to the numerator. For convertible debt for which the principal is required to be paid in cash, the interest charges shall not be added back to the numerator.
 2. To the extent nondiscretionary adjustments based on income made during the period would have been computed differently had the interest on convertible debt never been recognized, the numerator shall be appropriately adjusted. Nondiscretionary adjustments include any expenses or charges that are determined based on the

income (loss) for the period, such as profit-sharing and royalty agreements.

3. The numerator shall be adjusted for the income tax effect of (b)(1) and (b)(2).
- c. The convertible preferred stock or convertible debt shall be assumed to have been converted at the beginning of the period (or at time of issuance, if later), and the resulting common shares shall be included in the denominator. See paragraph 260-10-45-21A if the incremental shares are variable (such as when calculating a conversion premium).

> > Contingently Convertible Instruments

260-10-45-44 Contingently convertible instruments shall be included in diluted EPS (if dilutive) regardless of whether the market price trigger has been met. There is no substantive economic difference between contingently convertible instruments and ~~conventional~~ convertible instruments with a market price conversion premium. The treatment for diluted EPS shall not differ because of a contingent market price trigger. The guidance provided in this paragraph also shall be applied to instruments that have multiple contingencies if one of the contingencies is a market price trigger and the instrument is convertible or settleable in shares based on meeting a market condition—that is, the conversion is not dependent (or no longer dependent) on a substantive non-market-based contingency. For example, this guidance applies if an instrument is convertible upon meeting a market price trigger or a substantive non-market-based contingency (for example, a change in control). Alternatively, if the instrument is convertible upon achieving both a market price trigger and a substantive non-market-based contingency, this guidance would not apply until the non-market-based contingency has been met. See Example 11 (paragraph 260-10-55-78) for an illustration of this guidance.

> > Contracts That May Be Settled in Stock or Cash

260-10-45-45 The effect of potential share settlement shall be included in the diluted EPS calculation (if the effect is more dilutive) for an otherwise cash-settleable instrument that contains a provision that requires or permits share settlement (regardless of whether the election is at the option of an entity or the holder, or the entity has a history or policy of cash settlement). An example of such a contract accounted for in accordance with this paragraph and paragraph 260-10-45-46 is a written call option that gives the holder a choice of settling in common stock or in cash. An election to share settle an instrument, for purposes of applying the guidance in this paragraph, does not include circumstances in which share settlement is contingent upon the occurrence of a specified event or circumstance (such as **contingently issuable shares**). In those circumstances (other than if the contingency is an entity's own share price), the guidance on contingently issuable shares should first be applied, and, if the contingency would be considered met, then the guidance in this paragraph should be applied. ~~If an entity issues a contract~~

~~that may be settled in common stock or in cash at the election of either the entity or the holder, the determination of whether that contract shall be reflected in the computation of diluted EPS shall be made based on the facts available each period. It shall be presumed that the contract will be settled in common stock and the resulting potential common shares included in diluted EPS (in accordance with the relevant provisions of this Topic) if the effect is more dilutive. Share-based payment arrangements that are payable in common stock or in cash at the election of either the entity or the grantee shall be accounted for pursuant to this paragraph and paragraph 260-10-45-46, unless the share-based payment arrangement is classified as a liability because of the requirements in paragraph 718-10-25-15 (see paragraph 260-10-45-45A for guidance for those instruments). If the payment of cash is required only upon the final liquidation of an entity, then the entity shall include the effect of potential share settlement in the diluted EPS calculation until the liquidation occurs. An example of such a contract is a written put option that gives the holder a choice of settling in common stock or in cash.~~

260-10-45-45A For a share-based payment arrangement that is classified as a liability because of the requirements in paragraph 718-10-25-15 and may be settled in common stock or in cash at the election of either the entity or the holder, determining whether that contract shall be reflected in the computation of diluted EPS shall be prepared on the basis of the facts available each period. It shall be presumed that the contract will be settled in common stock and the resulting potential common shares included in diluted EPS (in accordance with the relevant guidance of this Topic) if the effect is more dilutive. The presumption that the contract will be settled in common stock may be overcome if past experience or a stated policy provides a reasonable basis to conclude that the contract will be paid partially or wholly in cash.

260-10-45-46 A contract that is reported as an asset or liability for accounting purposes may require an adjustment to the numerator for any changes in income or loss that would result if the contract had been reported as an equity instrument for accounting purposes during the period. That adjustment is similar to the adjustments required for convertible debt in paragraph 260-10-45-40(b). ~~The presumption that the contract will be settled in common stock may be overcome if past experience or a stated policy provides a reasonable basis to believe that the contract will be paid partially or wholly in cash.~~

> Special Issues Affecting Basic and Diluted EPS

> > Participating Securities and the Two-Class Method

260-10-45-64 ~~Paragraph superseded by Accounting Standards Update No. 2020-06. A dividend equivalent that is applied to reduce the conversion price or increase the conversion ratio of a convertible security may represent a contingent beneficial conversion feature. Guidance on whether such a dividend equivalent represents a contingent beneficial conversion feature is presented in Subtopic 470-20. That~~

~~Subtopic also establishes the accounting required for contingent beneficial conversion features.~~

10. Amend the headings preceding paragraph 260-10-55-3, paragraphs 260-10-55-4 and 260-10-55-6 through 55-7 and the related headings, 260-10-55-32 through 55-34, 260-10-55-36A, 260-10-55-78 through 55-79 and their related heading, 260-10-55-82, and 260-10-55-84A through 55-84B, add paragraphs 260-10-55-84C through 55-84E and their related heading, and supersede paragraph 260-10-55-36, with a link to transition paragraph 815-40-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

>> Applying the Treasury Stock Method: Year-to-Date Computations

>>> Year-to-Date Computations

260-10-55-3 The number of incremental shares included in quarterly diluted EPS shall be computed using the average market prices during the three months included in the reporting period. For year-to-date diluted EPS, the number of incremental shares to be included in the denominator shall be determined by computing a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS computation. Example 1 (see paragraph 260-10-55-38) provides an illustration of that provision.

260-10-55-3A Computation of year-to-date diluted EPS when an entity has a year-to-date loss from continuing operations including one or more quarters with income from continuing operations and when in-the-money options or warrants were not included in one or more quarterly diluted EPS computations because there was a loss from continuing operations in those quarters is as follows. In computing year-to-date diluted EPS, year-to-date income (or loss) from continuing operations shall be the basis for determining whether or not dilutive potential common shares not included in one or more quarterly computations of diluted EPS shall be included in the year-to-date computation.

260-10-55-3B Therefore:

- a. When there is a year-to-date loss, potential common shares should never be included in the computation of diluted EPS, because to do so would be antidilutive.
- b. When there is year-to-date income, if in-the-money options or warrants were excluded from one or more quarterly diluted EPS computations because the effect was antidilutive (there was a loss from continuing operations in those periods), then those options or warrants should be

included in the diluted EPS denominator (on a weighted-average basis) in the year-to-date computation as long as the effect is not antidilutive. Similarly, contingent shares that were excluded from a quarterly computation solely because there was a loss from continuing operations should be included in the year-to-date computation unless the effect is antidilutive.

Example 12 (see paragraph 260-10-55-85) illustrates this guidance.

>>>> **Average Market Price**

260-10-55-4 ~~In applying the treasury stock method, the~~ The average market price of **common stock** shall represent a meaningful average. Theoretically, every market transaction for an entity's common stock could be included in determining the average market price. As a practical matter, however, a simple average of weekly or monthly prices usually will be adequate.

260-10-55-5 Generally, closing market prices are adequate for use in computing the average market price. When prices fluctuate widely, however, an average of the high and low prices for the period that the price represents usually would produce a more representative price. The method used to compute the average market price shall be used consistently unless it is no longer representative because of changed conditions. For example, an entity that uses closing market prices to compute the average market price for several years of relatively stable market prices might need to change to an average of high and low prices if prices start fluctuating greatly and the closing market prices no longer produce a representative average market price.

>>>> **Options and Warrants and Their Equivalents**

260-10-55-6 Options or warrants to purchase convertible securities shall be assumed to be exercised to purchase the **convertible security** whenever the average prices of both the convertible **security** and the common stock obtainable upon conversion are above the **exercise price** of the options or warrants. However, exercise shall not be assumed unless conversion of similar outstanding convertible securities, if any, also is assumed. The ~~{add glossary link}~~treasury stock method~~{add glossary link}~~ shall be applied to determine the incremental number of convertible securities that are assumed to be issued and immediately converted into common stock. Interest or dividends shall not be imputed for the incremental convertible securities because any imputed amount would be reversed by the if-converted adjustments for assumed conversions.

260-10-55-7 Paragraphs 260-10-55-9 through 55-11 provide guidance on how certain ~~options and warrants options, warrants, and convertible securities~~ should be included in the computation of diluted EPS. ~~Conversion or exercise~~ Exercise of the potential common shares discussed in those paragraphs shall not be reflected

in diluted EPS unless the effect is dilutive. Those potential common shares will have a dilutive effect if either of the following conditions is met:

- a. The average market price of the related common stock for the period exceeds the exercise price.
- b. The security to be tendered is selling at a price below that at which it may be tendered under the **option** or **warrant** agreement and the resulting discount is sufficient to establish an effective exercise price below the market price of the common stock obtainable upon exercise.

> > Contracts That May Be Settled in Stock or Cash

260-10-55-32 Adjustments shall be made to the numerator for contracts that are asset or liability classified, in accordance with Section 815-40-25, but for which the potential common shares are included in the denominator in accordance with the guidance in paragraph 260-10-45-45, ~~as equity instruments but for which the entity has a stated policy or for which past experience provides a reasonable basis to believe that such contracts will be paid partially or wholly in cash (in which case there will be no potential common shares included in the denominator). That is, a contract that is reported as an equity instrument for accounting purposes may require an adjustment to the numerator for any changes in income or loss that would result if the contract had been reported as an asset or liability for accounting purposes during the period.~~ For purposes of computing diluted EPS, the adjustments to the numerator are only permitted for instruments for which the effect on net income (the numerator) is different depending on whether the instrument is accounted for as an equity instrument or as an asset or liability (for example, those that are within the scope of Subtopics 480-10 and 815-40).

260-10-55-33 The references in paragraphs 260-10-45-30 and 260-10-45-45 for share-based payment arrangements that are payable in common stock or in cash at the election of either the entity or the grantee refer to using the guidance in paragraph 260-10-45-45A ~~260-10-45-45~~ for purposes of determining whether shares issuable in accordance with such plans are included in the denominator for purposes of computing diluted EPS amounts. Accordingly, the numerator is not adjusted in those circumstances. Paragraph 260-10-55-36A illustrates these requirements.

260-10-55-34 Year-to-date diluted EPS calculations may require an adjustment to the numerator in certain circumstances. For example, for contracts that are share settled for EPS purposes in which the counterparty controls the method of settlement and that would have a more dilutive effect if settled in shares, the numerator adjustment is equal to the earnings effect of the change in the fair value of the asset or liability recorded pursuant to Section 815-40-35 during the year-to-date period. In that example, the number of incremental shares included in the denominator should be determined in accordance with the guidance in paragraph

~~260-10-55-3 by calculating the number of shares that would be required to settle the contract using the average share price during the year-to-date period.~~

~~260-10-55-36 Paragraph superseded by Accounting Standards Update No. 2020-06. For contracts in which the counterparty controls the means of settlement, past experience or a stated policy is not determinative. Accordingly, in those situations, the more dilutive of cash or share settlement shall be used.~~

260-10-55-36A The following table illustrates the guidance in paragraphs 260-10-45-45 through 45-46 and 260-10-55-32 through 55-34 ~~55-36~~ for the effects of contracts that may be settled in stock or cash on the computation of diluted EPS.

Assumed Settlement for EPS Purposes ^(a)	Accounting for Book Purposes (per Topic 480 or 815)	Adjustment Required to Book Earnings (Numerator) for Purposes of Computing Diluted Earnings per Share? ^(b)	Adjustment Required to Number of Shares Included in Denominator? ^(b)
Shares	Asset/Liability	Yes (per paragraph 260-10-45-45)	Yes
Shares	Equity	No	Yes
Cash	Asset/Liability	No	No
Cash	Equity	Yes (per Topic 260)	No

(a) Note that for purposes of computing EPS, delivery of the full stated amount of cash in exchange for delivery of the full stated number of shares (physical settlement) should be considered share settlement.

(b) Except for forward purchase contracts that require physical settlement by repurchase of a fixed number of shares in exchange for cash, Topic 480 provides EPS guidance for those contracts.

> Illustrations

> > Example 11: Computation of Basic and Diluted EPS for ~~Two~~ Three Examples of Contingently Convertible Instruments

260-10-55-78 The following Cases illustrate the guidance in paragraphs 260-10-45-43 through ~~45-44~~ 45-46 related to diluted EPS computations for ~~two~~ three examples of contingently convertible instruments:

- Contingently convertible debt with a market price trigger (Case A)
- Contingently convertible debt with a market price trigger, issuer must settle the principal amount of the debt in cash, but may settle any conversion premium in either cash or stock (Case B).
- Convertible debt for which the principal and conversion premium can be settled in any combination of shares or cash (Case C).

260-10-55-79 Cases ~~A and B~~ A, B, and C share all of the following assumptions:

- Principal amount of the convertible debt: \$1,000
- Conversion ratio: 20
- Conversion price per share of common stock: \$50
Conversion price = (Convertible bond's principal amount) ÷ (Conversion ratio) = \$1,000 ÷ 20 = \$50.

- d. Share price of common stock at issuance: \$40
- e. Market price trigger: average share price for the year must exceed \$65 (130% of conversion price)
- f. Interest rate: 4%
- g. Effective tax rate: 35%
- h. Shares of common stock outstanding: 2,000.

>>> Case A: Contingently Convertible Debt with a Market Price Trigger

260-10-55-81 The holder of the debt may convert the debt into shares of common stock when the share price exceeds the market price trigger; otherwise, the holder is only entitled to the par value of the debt.

260-10-55-82 The contingently convertible debt is issued on January 1, 200X, income available to common shareholders for the year ended December 31, 200X, is \$10,000, and the average share price for the year is \$55. The issuer of the contingently convertible debt should apply the guidance in paragraphs 260-10-45-43 through 45-44 consensus in this Issue, which requires the issuer to include the dilutive effect of the convertible debt in diluted EPS even though the market price trigger of \$65 has not been met. In this Case, basic EPS is \$5.00. (Basic EPS = [Income available to common shareholders (IACS)] ÷ [Shares outstanding (SO)] = \$10,000 ÷ 2,000 shares = \$5.00 per share) and applying the if-converted method to the debt instrument dilutes EPS to \$4.96 (Diluted EPS computed using the if-converted method = [IACS + Interest (1-tax rate)] ÷ (SO + Potential common shares) = (\$10,000 + \$26) ÷ (2,000 + 20) shares = \$4.96 per share.)

>>> Case B: Contingently Convertible Debt with a Market Price Trigger, Issuer Must Settle Principal in Cash, but May Settle Conversion Premium in either Cash or Stock

260-10-55-84 The issuer of the contingently convertible debt must settle the principal amount of the debt in cash upon conversion and it may settle any conversion premium in either cash or stock. The holder of the instrument is only entitled to the conversion premium if the share price exceeds the market price trigger. The contingently convertible instrument is issued on January 1, 200X, income available to common shareholders for the year ended December 31, 200X is \$9,980, and the average share price for the year is \$64.

260-10-55-84A The if-converted method should ~~not~~ be used to determine the earnings-per-share implications of convertible debt with the characteristics described in this Case. There would be no adjustment to the numerator in the diluted earnings-per-share computation for the cash-settled portion of the instrument (the principal amount of the debt) because that portion will always be settled in cash (see paragraph 260-10-45-40). The conversion premium should be included in diluted earnings per share based on the provisions of paragraphs 260-10-45-45 through 45-46 and 260-10-55-32 through 55-36A ~~55-36~~. The convertible

debt instrument in this Case is subject to other applicable guidance in Subtopic 260-10 as well, including the antidilution provisions of that Subtopic.

260-10-55-84B In this Example, basic EPS is \$4.99, and diluted earnings per share is \$4.98. Basic EPS = IACS ÷ SO = \$9,980 ÷ 2,000 shares = \$4.99 per share. Diluted EPS would be calculated using the if-converted method by determining the number of shares needed to settle the conversion premium and adding that amount to shares outstanding to calculate the diluted EPS denominator. The average market price is used to determine the dilution in accordance with paragraph 260-10-45-21A. The effect would be dilutive in this case because the average market price of the shares exceeds the conversion price. However, if the average market price of the shares was less than the conversion price, then the conversion premium would be zero and there would be no dilutive effect. Diluted EPS = IACS ÷ (SO + Potential common shares) = (\$9,980) ÷ (2,000 + 4.38) shares = \$4.98 per share. Potential common shares = (Conversion spread value) ÷ (Average share price) = \$14 × 20 shares ÷ \$64 = 4.38 shares.

> > > Case C: Convertible Debt That the Principal and Conversion Premium Can Be Settled in Any Combination of Shares or Cash

260-10-55-84C The issuer of the convertible debt can settle the principal and the conversion premium in any combination of cash or shares (the issuer has the option). Consistent with the facts in Case B, the convertible instrument is issued on January 1, 200X, income available to common shareholders for the year ended December 31, 200X, is \$9,980, and the average share price for the year is \$64.

260-10-55-84D The if-converted method should be used to determine the earnings-per-share implications of convertible debt. The effect of settling the principal and conversion premium in shares is included for purposes of calculating diluted earnings per share in accordance with the guidance in paragraph 260-10-45-45.

260-10-55-84E In this case, basic EPS is \$4.99 (the same calculation in paragraph 260-10-55-84B), and diluted earnings per share is \$4.95. Diluted EPS is calculated using the if-converted method = [IACS + Interest (1-tax rate)] ÷ (SO + Potential common shares) = (9,980 + 26) ÷ (2,000 + 20). See paragraph 260-10-55-82 for interest expense amount.

11. Amend paragraph 260-10-65-4, with no link to a transition paragraph, as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2017-11, *Earnings Per Share (Topic 260) and Derivatives and Hedging (Topic 815): Part I, Accounting for Certain Financial Instruments with Down Round Features*

260-10-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-11, *Earnings Per Share (Topic 260) and Derivatives and Hedging (Topic 815): Part I, Accounting for Certain Financial Instruments with Down Round Features*:

- a. The pending content that links to this paragraph shall be effective as follows:
 1. For **public business entities**, for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years
 2. For all other entities, for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.
- b. For all entities, early adoption of the pending content that links to this paragraph is permitted as of the beginning of an interim period for which financial statements (interim or annual) have not been issued or have not been made available for issuance.
- c. An entity shall apply the pending content that links to this paragraph using one of the following methods:
 1. Retrospectively to outstanding **financial instruments** with a **down round feature** by means of a cumulative-effect adjustment to the statement of financial position as of the beginning of the first fiscal year and interim period(s) in which the pending content that links to this paragraph is effective. The cumulative effect of the change shall be recognized as an adjustment of the opening balance of retained earnings in the fiscal year and interim period of adoption.
 2. Retrospectively to outstanding financial instruments with a down round feature for each prior reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10.
- d. An entity shall provide the following disclosures consistent with Section 250-10-50 in the period of adoption:
 1. The nature of the change in accounting principle
 2. The method of applying the change
 3. The cumulative effect of the change on retained earnings in the statement of financial position as of the beginning of the earliest period presented in which the pending content that links to this paragraph is effective.

- e. If the pending content that links to this paragraph is applied retrospectively in accordance with (c)(2), an entity shall provide both of the following disclosures:
 - 1. A description of the prior-period information that has been retrospectively adjusted, if any
 - 2. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted.
- f. An entity that issues interim financial statements shall provide the disclosures in (d) through (e) in the financial statements of both the interim period of the change and the fiscal year of the change.
- g. See paragraph 815-40-65-1(c) for additional information about the date of adoption and transition for convertible instruments that include a down round feature.

Amendments to Subtopic 470-10

12. Amend paragraph 470-10-50-1, with a link to transition paragraph 815-40-65-1, as follows:

Debt—Overall

Disclosure

> Disclosure of Long-Term Obligations

470-10-50-1 The combined aggregate amount of maturities and sinking fund requirements for all long-term borrowings shall be disclosed for each of the five years following the date of the latest balance sheet presented. (See paragraph 505-10-50-11 for related disclosure guidance on redeemable securities Section 505-10-50 for disclosure guidance that applies to securities, including debt securities.) See Example 3 (paragraph 470-10-55-10) for an illustration of this disclosure requirement.

13. Amend paragraphs 470-10-55-11 through 55-12, with a link to transition paragraph 815-40-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 3: Disclosure of Long-Term Obligations

470-10-55-10 This Example provides an illustration of the guidance in paragraph 470-10-50-1 for disclosures for long-term borrowings and preferred stock with mandatory redemption requirements. This Example has the following assumptions.

470-10-55-11 Entity D has outstanding two long-term borrowings loans, one convertible debt, and one issue of preferred stock with mandatory redemption requirements. The first borrowing loan is a \$100 million sinking fund debenture with annual sinking fund payments of \$10 million in 19X2, 19X3, and 19X4, \$15 million in 19X5 and 19X6, and \$20 million in 19X7 and 19X8. The second borrowing loan is a \$50 million note due in 19X5. The convertible debt has a principal amount of \$70 million that is not convertible before maturity in 19X9. This convertible debt requires a 2 percent annual cumulative sinking fund payment of \$1.4 million until settled. The \$30 million issue of preferred stock requires a 5 percent annual cumulative sinking fund payment of \$1.5 million until retired.

470-10-55-12 Entity D's disclosure might be as follows.

Maturities and sinking fund requirements on long-term debt loans and convertible debt and sinking fund requirements on preferred stock subject to mandatory redemption are as follows (in thousands).

	<u>Long-term debt- loans</u>	<u>Preferred stock</u>	<u>Convertible debt</u>
19X2	\$ 10,000	\$ 1,500	\$ 1,400
19X3	10,000	1,500	1,400
19X4	10,000	1,500	1,400
19X5	65,000	1,500	1,400
19X6	15,000	1,500	1,400

14. Supersede paragraph 470-10-60-2 and its related heading, with a link to transition paragraph 815-40-65-1, as follows:

Relationships

> Equity

470-10-60-2 Paragraph superseded by Accounting Standards Update No. 2020-06. For guidance on contingently convertible securities, including those containing contingent conversion requirements that have not been met, see Subtopic 505-10.

Amendments to Subtopic 470-20

15. Supersede the Cash Conversion Subsections from Sections 05, 10, 15, 25, 30, 35, 40, 45, 50, and 55 of this Subtopic. [**Paragraphs 470-20-15-6, 470-20-25-24, 470-20-25-26, 470-20-45-3, 470-20-50-5(d), and 470-20-55-70 are amended and moved to paragraphs 470-20-15-2D, 470-20-25-15, 470-20-45-1A, 470-20-45-1B, 470-20-50-1I, and 470-20-55-1A, respectively.**]

16. Amend paragraphs 470-20-05-1 and 470-20-05-4 through 05-9 and the related heading, supersede paragraphs 470-20-05-1A and 470-20-05-12 and its related heading and the heading preceding paragraph 470-20-05-7, and add paragraphs 470-20-05-7A and 470-20-05-8A, with a link to transition paragraph 815-40-65-1, as follows:

Debt—Debt with Conversion and Other Options

Overview and Background

470-20-05-1 This Subtopic provides accounting and reporting guidance for debt (and certain preferred stock) with specific conversion features and other options as follows:

- a. Debt instruments with detachable warrants
- b. Convertible ~~debt instruments securities—general~~
- c. Subparagraph superseded by Accounting Standards Update No. 2020-06, Beneficial conversion features
- d. Interest forfeiture
- e. Induced conversions
- f. Conversion upon issuer's exercise of call option
- g. Subparagraph superseded by Accounting Standards Update No. 2020-06, Convertible instruments issued to nonemployees for goods and services
- h. Own-share lending arrangements issued in contemplation of convertible debt issuance or other financing.

470-20-05-1A Paragraph superseded by Accounting Standards Update No. 2020-06. This Subtopic presents guidance in the following two Subsections:

- a. ~~General~~
- b. ~~Cash Conversion.~~

> **Convertible Debt Instruments Securities—General**

470-20-05-4 A convertible debt ~~instrument security~~ is a complex hybrid instrument bearing an option, the alternative choices of which cannot exist independently of

one another. The holder ordinarily does not sell one right and retain the other. Furthermore the two choices are mutually exclusive; they cannot both be consummated. Thus, the instrument security will either be converted into common stock or be redeemed for cash. The holder cannot exercise the option to convert unless he forgoes the right to redemption, and vice versa.

470-20-05-5 ~~A convertible~~ Convertible debt instrument may offer advantages to both the issuer and the purchaser. From the point of view of the issuer, convertible debt has a lower interest rate than does nonconvertible debt. Furthermore, the issuer of convertible debt instruments securities, in planning its long-range financing, may view convertible debt as essentially a means of raising equity capital. Thus, if the **fair value** of the underlying common stock increases sufficiently in the future, the issuer can force conversion of the convertible debt into common stock by calling the issue for redemption. Under these market conditions, the issuer can effectively terminate the conversion option and eliminate the debt. If the fair value of the stock does not increase sufficiently to result in conversion of the debt, the issuer will have received the benefit of the cash proceeds to the scheduled maturity dates at a relatively low cash interest cost.

470-20-05-6 On the other hand, the purchaser obtains an option to receive either the face or redemption amount of the instrument security or the number of common shares into which the instrument security is convertible. If the fair value of the underlying common stock increases above the conversion price, the purchaser (either through conversion or through holding the convertible debt containing the conversion option) benefits through appreciation. The purchaser may at that time require the issuance of the common stock at a price lower than the fair value. However, should the fair value of the underlying common stock not increase in the future, the purchaser has the protection of a debt security. Thus, in the absence of default by the issuer, the purchaser would receive the principal and interest if the conversion option is not exercised.

> Beneficial Conversion Features

470-20-05-7 Entities may issue convertible debt instruments that securities and convertible preferred stock with a beneficial conversion feature. These instruments may be convertible into common stock at the lower of a conversion rate fixed at time of issuance and the commitment date or a fixed discount to the market price of the common stock at the date of conversion.

470-20-05-7A Entities also may issue convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement.

470-20-05-8 Certain convertible debt instruments may have a contingently adjustable conversion ratio; that is, a conversion price that is variable based on future events such as any of the following:

- a. A liquidation or a change in control of ~~an~~ the entity
- b. A subsequent round of financing at a price lower than the convertible security's convertible instrument's original conversion price
- c. An initial public offering at a share price lower than an agreed-upon amount.

470-20-05-8A Certain convertible debt instruments may become convertible only upon the occurrence of a future event that is outside the control of the issuer or holder.

> Interest Forfeiture

470-20-05-9 When a convertible debt instrument is converted to equity securities, sometimes the terms of conversion provide that any accrued but unpaid interest at the date of conversion is forfeited by the former debt holder. This occurs either because the conversion date falls between interest payment dates or because there are no interest payment dates (a zero coupon convertible debt instrument).

~~> Convertible Instruments Issued to Nonemployees for Goods and Services~~

470-20-05-12 ~~Paragraph superseded by Accounting Standards Update No. 2020-06. A convertible instrument that is issued to a nonemployee in exchange for goods or services or a combination of goods or services and cash and may contain a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock. This Subtopic provides related guidance.~~

17. Amend paragraph 470-20-15-2 and add paragraphs 470-20-15-2A through 15-2D, with a link to transition paragraph 815-40-65-1, as follows:

Scope and Scope Exceptions

> Instruments

470-20-15-2 The guidance in this Subtopic applies to all debt instruments. ~~The guidance on **beneficial conversion features** and conversion features that reset applies also to convertible preferred stock. The guidance in the General Subsections does not apply to those instruments within the scope of the Cash Conversion Subsections.~~ The guidance on own-share lending arrangements applies to an equity-classified share-lending arrangement on an entity's own shares when executed in contemplation of a convertible debt offering or other financing.

470-20-15-2A The guidance on convertible debt instruments in this Subtopic shall be considered after considering the guidance in the Fair Value Option Subsections of Subtopic 825-10 on financial instruments.

470-20-15-2B The guidance on convertible debt instruments in this Subtopic shall be considered after considering the guidance in Subtopic 815-15 on bifurcation of embedded derivatives for an embedded conversion option or other embedded feature (for example, an embedded prepayment option) as applicable (see paragraph 815-15-55-76A). The relevant guidance in this Subtopic does not affect an issuer's determination under Subtopic 815-15 of whether an embedded conversion option or other embedded feature shall be separately accounted for as a derivative instrument.

470-20-15-2C The guidance in this Subtopic does not apply to a convertible debt instrument award issued to a grantee that is subject to the guidance in Topic 718 on stock compensation unless the instrument is modified as described in and no longer subject to the guidance in that Topic. The guidance in this Subtopic does not apply to stock-settled debt that is subject to the guidance in Subtopic 480-10 on distinguishing liabilities from equity or other Subtopics (see paragraph 470-20-25-14), unless the stock-settled debt also contains a substantive conversion feature (as discussed in paragraphs 470-20-40-7 through 40-10) for which all relevant guidance in this Subtopic shall be considered in addition to the relevant guidance in other Subtopics.

470-20-15-2D For purposes of determining whether an instrument is within the scope of this Subtopic, ~~the Cash Conversion Subsections~~, a convertible preferred ~~stock share~~ shall be considered a convertible debt instrument if it has both of the following characteristics:

- a. It is a mandatorily redeemable financial instrument.
- b. It is classified as a liability under Subtopic 480-10.

For related implementation guidance, see paragraph 470-20-55-1A ~~470-20-55-70~~.
[Content amended as shown and moved from paragraph 470-20-15-6]

18. Amend paragraph 470-20-25-1 and supersede paragraphs 470-20-25-4 through 25-9 and their related headings, with a link to transition paragraph 815-40-65-1, as follows:

Recognition

> Overall

470-20-25-1 The guidance in this Section shall be considered after consideration of the guidance in the Fair Value Option ~~Options~~ Subsections of Subtopic 825-10 on financial instruments and the guidance in Subtopic 815-15 on bifurcation of embedded derivatives, as applicable. The guidance in this Section is organized as follows:

- a. Debt instruments with detachable warrants

- b. Subparagraph superseded by Accounting Standards Update No. 2020-06. Beneficial conversion features
- c. Subparagraph superseded by Accounting Standards Update No. 2020-06. Conversion features that reset
- d. Convertible debt instruments Conversion features that are not beneficial
- e. Subparagraph superseded by Accounting Standards Update No. 2020-06. Convertible instruments issued to nonemployees for goods and services
- f. Own-share lending arrangements issued in contemplation of convertible debt issuance.

> Beneficial Conversion Features

470-20-25-4 Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in the following paragraph and paragraph 470-20-25-6 applies to all of the following instruments if the instrument is not within the scope of the Cash Conversion Subsections:

- a. ~~Convertible securities with beneficial conversion features that must be settled in stock~~
- b. ~~Convertible securities with beneficial conversion features that give the issuer a choice of settling the obligation in either stock or cash~~
- c. ~~Instruments with beneficial conversion features that are convertible into multiple instruments, for example, a convertible preferred stock that is convertible into common stock and detachable warrants~~
- d. ~~Instruments with conversion features that are not beneficial at the commitment date (see paragraphs 470-20-30-9 through 30-12) but that become beneficial upon the occurrence of a future event, such as an initial public offering.~~

470-20-25-5 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~An embedded beneficial conversion feature present in a convertible instrument shall be recognized separately at issuance by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital. Paragraph 470-20-30-4 provides guidance on measuring intrinsic value that applies to both the determination of whether an embedded conversion feature is beneficial and the allocation of proceeds.~~

470-20-25-6 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~A contingent beneficial conversion feature shall be measured using the commitment date stock price (see paragraphs 470-20-30-9 through 30-12) but, as discussed in paragraph 470-20-35-3, shall not be recognized in earnings until the contingency is resolved.~~

~~470-20-25-7 Paragraph superseded by Accounting Standards Update No. 2020-06. For the application of Topic 740 to beneficial conversion features that result in basis differences, see paragraph 470-10-55-51.~~

> Conversion Features that Reset

~~470-20-25-8 Paragraph superseded by Accounting Standards Update No. 2020-06. If a convertible instrument has a conversion option that continuously resets as the underlying stock price increases or decreases so as to provide a fixed value of common stock to the holder at any conversion date, the convertible instrument shall be considered stock settled debt and the contingent beneficial conversion option provisions of this Subtopic would not apply when those resets subsequently occur. However, the guidance in paragraph 470-20-25-5 applies to the initial recognition of such a convertible instrument, including any initial active beneficial conversion feature. Example 4 (see paragraph 470-20-55-18) illustrates application of the guidance in this paragraph. [Content amended and moved to paragraph 470-20-25-14]~~

~~470-20-25-9 Paragraph superseded by Accounting Standards Update No. 2020-06. For guidance on a contingent conversion feature that will reduce (reset) the conversion price if the fair value of the underlying stock declines after the commitment date to or below a specified price, see paragraph 470-20-35-4.~~

19. Supersede paragraphs 470-20-25-10 through 25-11 and 470-20-25-16 through 25-20 and the related headings, amend paragraph 470-20-25-12 through 25-13 and the related heading, and add paragraphs 470-20-25-14 through 25-15, with a link to transition paragraph 815-40-65-1, as follows:

> Convertible Debt Instruments Conversion Features That Are Not Beneficial

~~470-20-25-10 Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in paragraph 470-20-25-12 addresses debt instruments that have both of the following characteristics:~~

- ~~a. The debt instrument is convertible into common stock of the issuer or an affiliated entity at a specified price at the option of the holder.~~
- ~~b. The debt instrument is sold at a price or has a value at issuance not significantly in excess of the face amount.~~

~~470-20-25-11 Paragraph superseded by Accounting Standards Update No. 2020-06. The terms of convertible debt instruments addressed by the guidance in the following paragraph generally include all of the following:~~

- ~~a. An interest rate that is lower than the issuer could establish for nonconvertible debt~~

- b. ~~An initial conversion price that is greater than the fair value of the common stock at time of issuance~~
- c. ~~A conversion price that does not decrease except pursuant to antidilution provisions.~~

~~In most circumstances, convertible debt instruments also are callable at the option of the issuer and are subordinated to nonconvertible debt.~~

470-20-25-12 ~~No~~ A debt with an embedded conversion feature shall be accounted for in its entirety as a liability and no portion of the proceeds from the issuance of the types of convertible debt instrument instruments described in the preceding two paragraphs shall be accounted for as attributable to the conversion feature unless the conversion feature is required to be accounted for separately as an embedded derivative under Subtopic 815-15 or the conversion feature results in a premium that is subject to the guidance in paragraph 470-20-25-13.

470-20-25-13 ~~It is not practicable in paragraph 470-20-25-11 to discuss all possible types of debt instruments with conversion features, debt instruments issued with stock purchase warrants, or debt instruments with a combination of such features. Instruments not explicitly discussed in that paragraph shall be dealt with in accordance with the substance of the transaction. For example, if~~ If a convertible debt instrument is issued at a substantial premium, there is a presumption that such premium represents paid-in capital.

470-20-25-14 ~~Paragraph not used. If a~~ debt convertible instrument has a conversion option that continuously resets as the underlying stock price increases or decreases so as to provide a fixed value of common stock to the holder at any conversion date, the ~~convertible-instrument~~ instrument shall be considered stock-settled debt that is subject to the guidance in Subtopic 480-10 or other Subtopics (such as Subtopic 718-10, 815-15, or 825-10), and the contingent beneficial conversion option provisions of this Subtopic would not apply when those resets subsequently occur. However, the guidance in paragraph 470-20-25-5 applies to the initial recognition of such a convertible instrument, including any initial active beneficial conversion feature. Example 4 (see paragraph 470-20-55-18) illustrates application of the guidance in this paragraph. **[Content amended as shown and moved from paragraph 470-20-25-8]**

470-20-25-15 ~~Paragraph not used. If the issuance transaction for a convertible debt instrument within the scope of this Subtopic the Cash Conversion Subsections includes other unstated (or stated) rights or privileges in addition to the convertible debt instrument, a portion of the initial proceeds shall be attributed to those rights and privileges based on the guidance in other applicable U.S. generally accepted accounting principles (GAAP).~~ **[Content amended as shown and moved from paragraph 470-20-25-24]**

~~470-20-25-16 Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in paragraphs 470-20-25-10 through 25-15 only addresses the accounting at issuance for convertible debt instruments and does not address accounting for changes to convertible debt instruments after issuance.~~

> ~~Convertible Instruments Issued to Nonemployees for Goods and Services~~

~~470-20-25-17 Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in the following paragraph and paragraph 470-20-25-19 addresses a convertible instrument that is issued or granted to a nonemployee in exchange for goods or services or a combination of goods or services and cash. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock.~~

~~470-20-25-18 Paragraph superseded by Accounting Standards Update No. 2020-06. Once the instrument is considered **issued** for accounting purposes pursuant to Subtopic 718-10, distributions paid or payable shall be characterized as financing costs (that is, interest expense or dividends). Before that time, distributions paid or payable under the instrument shall be characterized as a cost of the underlying goods or services.~~

~~470-20-25-19 Paragraph superseded by Accounting Standards Update No. 2020-06. If the convertible instrument is issued for cash proceeds that indicate that the instrument includes a beneficial conversion feature and the purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the convertible instrument shall be recognized with a corresponding increase or decrease in the purchase or sales price of the goods or services.~~

> ~~Contingent Conversion Options~~

~~470-20-25-20 Paragraph superseded by Accounting Standards Update No. 2020-06. Changes to the conversion terms that would be triggered by future events not controlled by the issuer shall be accounted for as contingent conversion options, and the intrinsic value of such conversion options shall not be recognized until and unless the triggering event occurs. The term *recognized* is used to mean that the calculated intrinsic value is recorded in equity with a corresponding discount to the convertible instrument.~~

20. Amend paragraphs 470-20-30-1 through 30-2 and their related heading and supersede paragraphs 470-20-30-3 through 30-26 and their related headings, with a link to transition paragraph 815-40-65-1, as follows:

Initial Measurement

> Debt Instruments with Detachable Warrants Call Options

~~470-20-30-1~~ The allocation of proceeds under paragraph 470-20-25-2 shall be based on the relative **fair values** of the two instruments at **time of issuance**. ~~If a commitment date must be identified in accordance with paragraphs 470-20-30-9 through 30-12 for purposes of applying the guidance on **beneficial conversion features**, that commitment date shall be used also to determine the relative fair values of all instruments issued together with a convertible instrument when allocating the proceeds to the separate instruments pursuant to this paragraph.~~

~~470-20-30-2~~ When detachable warrants (detachable call options) are issued in conjunction with a debt instrument as consideration in purchase transactions, the amounts attributable to each class of instrument issued shall be determined separately, based on values at the time of issuance. The debt discount or premium shall be determined by comparing the value attributed to the debt instrument with the face amount thereof.

> ~~Beneficial Conversion Features~~

~~470-20-30-3~~ Paragraph superseded by Accounting Standards Update No. 2020-06. ~~An embedded beneficial conversion feature recognized separately under paragraph 470-20-25-5 shall be measured initially at its intrinsic value.~~

~~470-20-30-4~~ Paragraph superseded by Accounting Standards Update No. 2020-06. ~~The following guidance on measurement of the intrinsic value of an embedded conversion feature applies for purposes of both determining whether the feature is beneficial and allocating proceeds under paragraph 470-20-25-5, if applicable.~~

~~470-20-30-5~~ Paragraph superseded by Accounting Standards Update No. 2020-06. ~~The effective conversion price based on the proceeds received for or allocated to the convertible instrument shall be used to compute the intrinsic value, if any, of the embedded conversion option. Specifically, an issuer shall do all of the following:~~

- ~~a.~~ First, allocate the proceeds received in a financing transaction that includes a convertible instrument to the convertible instrument and any other detachable instruments included in the exchange (such as detachable warrants) on a relative fair value basis.
- ~~b.~~ Second, apply the guidance beginning in paragraph 470-20-25-4 to the amount allocated to the convertible instrument.
- ~~c.~~ Third, calculate an effective conversion price and use that effective conversion price to measure the intrinsic value, if any, of the embedded conversion option.

~~Example 2 (see paragraph 470-20-55-10) illustrates the application of this guidance.~~

~~**470-20-30-6** Paragraph superseded by Accounting Standards Update No. 2020-06. Intrinsic value shall be calculated at the commitment date (see paragraphs 470-20-30-9 through 30-12) as the difference between the conversion price (see paragraph 470-20-30-5) and the fair value of the common stock or other securities into which the security is convertible, multiplied by the number of shares into which the security is convertible.~~

~~**470-20-30-7** Paragraph superseded by Accounting Standards Update No. 2020-06. The most favorable conversion price that would be in effect at the conversion date, assuming there are no changes to the current circumstances except for the passage of time, shall be used to measure the intrinsic value of an embedded conversion option. Example 3 (see paragraph 470-20-55-13) illustrates the application of this guidance.~~

~~**470-20-30-8** Paragraph superseded by Accounting Standards Update No. 2020-06. If the intrinsic value of the beneficial conversion feature is greater than the proceeds allocated to the convertible instrument, the amount of the discount assigned to the beneficial conversion feature shall be limited to the amount of the proceeds allocated to the convertible instrument.~~

>> Commitment Date

~~**470-20-30-9** Paragraph superseded by Accounting Standards Update No. 2020-06. This guidance addresses when a commitment date should occur for purposes of determining the fair value of the issuer's common stock to be used to measure the intrinsic value of an embedded conversion option.~~

~~**470-20-30-10** Paragraph superseded by Accounting Standards Update No. 2020-06. The commitment date is the date when an agreement has been reached that meets the definition of a **firm commitment**.~~

~~**470-20-30-11** Paragraph not used.~~

~~**470-20-30-12** Paragraph superseded by Accounting Standards Update No. 2020-06. If an agreement includes subjective provisions that permit either party to rescind its commitment to consummate the transaction, a commitment date does not occur until the provisions expire or the convertible instrument is issued, whichever is earlier. Both of the following are examples of subjective provisions that permit either party to rescind its commitment to consummate the transaction:~~

- ~~a. A provision that allows an investor to rescind its commitment to purchase a convertible instrument in the event of a material adverse change in the issuer's operations or financial condition~~

- b. ~~A provision that makes the commitment subject to customary due diligence or shareholder approval.~~

>> Effect of Issuance Costs

~~470-20-30-13 Paragraph superseded by Accounting Standards Update No. 2020-06. Costs of issuing convertible instruments do not affect the calculation of the intrinsic value of an embedded conversion option; specifically, issuance costs shall not be offset against the proceeds received in the issuance in calculating the intrinsic value of a conversion option. Issuance costs are limited to incremental and direct costs incurred with parties other than the investor in the convertible instrument. Any amounts paid to the investor when the transaction is consummated represent a reduction in the proceeds received by the issuer (not issuance costs) and shall affect the calculation of the intrinsic value of an embedded option.~~

>> Application to Specific Instruments

~~470-20-30-14 Paragraph superseded by Accounting Standards Update No. 2020-06. This guidance addresses the measurement of intrinsic value for the following instruments:~~

- a. ~~Instrument with a multiple step discount~~
- b. ~~Instrument paid in kind~~
- c. ~~Instrument issued as repayment for nonconvertible instrument.~~

>>> Instrument with a Multiple Step Discount

~~470-20-30-15 Paragraph superseded by Accounting Standards Update No. 2020-06. If an instrument incorporates a multiple step discount, the computation of the intrinsic value shall use the conversion terms that are most beneficial to the investor. Example 10 (see paragraph 470-20-55-69) illustrates the application of this paragraph.~~

>>> Instrument Paid in Kind

~~470-20-30-16 Paragraph superseded by Accounting Standards Update No. 2020-06. If dividends or interest on a convertible instrument must be paid in kind with the same convertible instruments as those in the original issuance and are not discretionary, the commitment date for the original instrument is the commitment date for the convertible instruments that are issued to satisfy interest or dividends requirements.~~

~~470-20-30-17 Paragraph superseded by Accounting Standards Update No. 2020-06. For purposes of the preceding paragraph, dividends or interest are not discretionary if both of the following conditions exist:~~

- a. ~~Neither the issuer nor the holder can elect other forms of payment for the dividends or interest.~~
- b. ~~If the original instrument or a portion thereof is converted before accumulated dividends or interest are declared or accrued, the holder will always receive the number of shares upon conversion as if all accumulated dividends or interest have been paid in kind.~~

~~**470-20-30-18** Paragraph superseded by Accounting Standards Update No. 2020-06. In that circumstance, the intrinsic value of the embedded conversion option in the paid-in-kind instruments is measured using the fair value of the underlying stock of the issuer at the commitment date for the original issuance. Otherwise, the commitment date for the convertible instruments issued as paid-in-kind interest or dividends is the date that the interest or the dividends are accrued and the fair value of the underlying issuer stock at the recognition or declaration date shall be used to measure the intrinsic value of the conversion option embedded in the paid-in-kind instruments.~~

>>> Instrument Issued as Repayment for Nonconvertible Instrument

~~**470-20-30-19** Paragraph superseded by Accounting Standards Update No. 2020-06. If a convertible instrument is issued as repayment of a nonconvertible instrument at the nonconvertible instrument's maturity, the fair value of the newly issued convertible instrument shall be the redemption amount owed at the maturity date of the original instrument if both of the following conditions exist:~~

- a. ~~The original instrument has matured.~~
- b. ~~The exchange of debt instruments is not a **troubled debt restructuring** that would be accounted for by the issuer under Subtopic 470-60.~~

~~**470-20-30-20** Paragraph superseded by Accounting Standards Update No. 2020-06. After the exchange accounting occurs, any intrinsic value of the embedded conversion option in the new instrument shall be measured and accounted for under paragraph 470-20-25-5 based on the proceeds received for that instrument (the satisfaction of the redemption amount of the old instrument).~~

~~**470-20-30-21** Paragraph superseded by Accounting Standards Update No. 2020-06. If the original instrument is extinguished before maturity, Subtopic 470-50 shall be applied first.~~

> Convertible Instruments Issued to Nonemployees for Goods and Services or as Consideration Payable to a Customer

~~**470-20-30-22** Paragraph superseded by Accounting Standards Update No. 2020-06. To determine the fair value of a convertible instrument granted as part of a share-based payment transaction to a nonemployee in exchange for goods or services or as consideration payable to a customer that is equity in form or, if debt~~

in form, that can be converted into equity instruments of the issuer, the entity shall first apply Topic 718 on stock compensation.

~~**470-20-30-23** Paragraph superseded by Accounting Standards Update No. 2020-06. The requirements of this Subtopic shall then be applied such that the fair value determined pursuant to Topic 718 is considered the proceeds from issuing the instrument for purposes of determining whether a beneficial conversion option exists. The measurement of the intrinsic value, if any, of the conversion option under paragraph 470-20-25-5 shall then be computed by comparing the proceeds received for the instrument (the instrument's fair value under Topic 718) to the fair value of the common stock that the grantee would receive upon exercising the conversion option. For purposes of determining whether a convertible instrument contains a beneficial conversion feature under paragraph 470-20-25-5, an entity shall use the effective conversion price based on the proceeds allocated to the convertible instrument to compute the intrinsic value, if any, of the embedded conversion option.~~

~~**470-20-30-24** Paragraph superseded by Accounting Standards Update No. 2020-06. Topic 718 shall be used both to measure the fair value of the convertible instrument and to measure the intrinsic value, if any, of the conversion option as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested. That is, in measuring the intrinsic value of the conversion option under paragraph 470-20-25-5, the fair value of the issuer's equity securities into which the instrument can be converted shall be determined as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested, and not on the commitment date specified in this Subtopic.~~

~~**470-20-30-25** Paragraph superseded by Accounting Standards Update No. 2020-06. Both of the following guidelines for determining the fair value of convertible instruments shall be used:~~

- ~~a. Subparagraph superseded by Accounting Standards Update No. 2018-07~~
- ~~b. Recent issuances of similar convertible instruments for cash to parties that only have an investor relationship with the issuer may provide the best evidence of fair value of the convertible instrument.~~
- ~~c. If reliable information under (b) is not available, the fair value of the convertible instrument shall be deemed to be no less than the fair value of the equity shares into which it can be converted.~~

~~**470-20-30-26** Paragraph superseded by Accounting Standards Update No. 2020-06. If an entity issues a convertible instrument for cash proceeds that indicate that the instrument includes a beneficial conversion option and the purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the terms of both the agreement for goods or~~

~~services and the convertible instrument shall be evaluated to determine whether their separately stated pricing is equal to the fair value of the goods or services and convertible instrument. If that is not the situation, the terms of the respective transactions shall be adjusted by measuring the convertible instrument initially at its fair value with a corresponding increase or decrease in the purchase or sales price of the goods or services. It may be difficult to evaluate whether the separately stated pricing of a convertible instrument is equal to its fair value. If an instrument issued to a goods or services provider (or purchaser) is part of a larger issuance, a substantive investment in the issuance by unrelated investors (who are not also providers or purchasers of goods or services) may provide evidence that the price charged to the goods or services provider represents the fair value of the convertible instrument.~~

21. Supersede paragraphs 470-20-35-1 through 35-5 and their related heading and 470-20-35-7 through 35-10 and their related headings and the heading preceding paragraph 470-20-35-11 and amend paragraph 470-20-35-6 and its related heading, with a link to transition paragraph 815-40-65-1, as follows:

Subsequent Measurement

> Contingently Adjustable Conversion Ratios

~~**470-20-35-1** Paragraph superseded by Accounting Standards Update No. 2020-06. If the terms of a contingent conversion option do not permit an issuer to compute the number of shares that the holder would receive if the contingent event occurs and the conversion price is adjusted, an issuer shall wait until the contingent event occurs and then compute the resulting number of shares that would be received pursuant to the new conversion price. The number of shares that would be received upon conversion based on the adjusted conversion price would then be compared with the number that would have been received before the occurrence of the contingent event. The excess number of shares multiplied by the commitment date stock price equals the incremental intrinsic value that results from the resolution of the contingency and the corresponding adjustment to the conversion price. That incremental amount shall be recognized when the triggering event occurs. Example 5 (see paragraph 470-20-55-22) illustrates the application of this guidance.~~

~~**470-20-35-2** Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in the following paragraph applies to an instrument with either of the following characteristics:~~

- ~~a. The instrument becomes convertible only upon the occurrence of a future event outside the control of the holder.~~
- ~~b. The instrument is convertible from inception but contains conversion terms that change upon the occurrence of a future event.~~

~~470-20-35-3 Paragraph superseded by Accounting Standards Update No. 2020-06. A contingent beneficial conversion feature in an instrument having the characteristics in the preceding paragraph shall not be recognized in earnings until the contingency is resolved.~~

~~470-20-35-4 Paragraph superseded by Accounting Standards Update No. 2020-06. A contingent conversion feature that will reduce (reset) the conversion price if the fair value of the underlying stock declines after the commitment date to or below a specified price is a beneficial conversion option if that specified price is below the fair value of the underlying stock at the commitment date. This is the case even if both of the following conditions exist:~~

- ~~a. The initial active conversion price is equal to or greater than the fair value of the underlying stock at the commitment date.~~
- ~~b. The contingent conversion price is greater than the then fair value of the underlying stock at the future date that triggers the adjustment to the conversion price.~~

~~A beneficial conversion amount shall be recognized for such a beneficial conversion option when the reset occurs.~~

~~470-20-35-5 Paragraph superseded by Accounting Standards Update No. 2020-06. Example 4A (see paragraph 470-20-55-19A) illustrates the application of this guidance.~~

> Interest Expense Discount Accretion and Amortization

~~470-20-35-6 Subtopic 835-10 provides overall guidance on accretion and amortization of debt premium or discount and debt issuance costs discount. This guidance addresses the following incremental matter related to interest forfeiture matters:~~

- ~~a. Subparagraph superseded by Accounting Standards Update No. 2020-06. Effects of **beneficial conversion features**~~
- ~~b. Subparagraph superseded by Accounting Standards Update No. 2020-06. Instrument with conversion feature that terminates~~
- ~~c. Subparagraph superseded by Accounting Standards Update No. 2020-06. Interest forfeiture.~~

>> Effects of Beneficial Conversion Features

~~470-20-35-7 Paragraph superseded by Accounting Standards Update No. 2020-06. Any discount recognized by the allocation of proceeds to a beneficial conversion feature under paragraph 470-20-25-5 shall be accounted for as follows:~~

- ~~a. Instruments having a stated redemption date. If a convertible instrument has a stated redemption date (such as debt and mandatorily redeemable~~

preferred stock), that discount shall be accreted from the date of issuance to the stated redemption date of the convertible instrument, regardless of when the earliest conversion date occurs. Example 7 (see paragraph 470-20-55-28) illustrates the application of this guidance.

- b. ~~Instruments involving a multiple-step discount. If an instrument incorporates a multiple-step discount and does not have a stated redemption date, that discount shall be amortized over the minimum period in which the investor can recognize that return. However, amortization recognized may require adjustment to ensure that the discount amortized at any point in time is not less than the amount the holder of the instrument could obtain if conversion occurred at that date. This method can be expressed as requiring cumulative amortization equal to the greater of the following:~~
 - 1. ~~The amount derived using the effective yield method based on the conversion terms most beneficial to the investor~~
 - 2. ~~The amount of discount that the investor can realize at that interim date.~~
- e. ~~All other instruments. If a convertible instrument does not involve a multiple-step discount and does not have a stated redemption date (such as perpetual preferred stock), that discount shall be amortized from the date of issuance to the earliest conversion date as follows:~~
 - 1. ~~For convertible preferred securities, that discount (which is analogous to a dividend) shall be recognized as a return to the preferred shareholders using the effective yield method.~~
 - 2. ~~For convertible debt securities, that discount shall be recognized as interest expense using the effective yield method.~~

All discounts retain their character such that a discount resulting from the accounting for a beneficial conversion option is amortized from the date of issuance to the earliest conversion date. For SEC registrants, other discounts on perpetual preferred stock that has no stated redemption date but that is required to be redeemed if a future event that is outside the control of the issuer occurs (such as a change in control) shall be accounted for in accordance with Section 480-10-S99.

>> Instrument with Conversion Feature that Terminates

470-20-35-8 Paragraph superseded by Accounting Standards Update No. 2020-06. This guidance applies to convertible instruments in which the beneficial conversion feature terminates after a specified time period.

470-20-35-9 Paragraph superseded by Accounting Standards Update No. 2020-06. If a convertible instrument is in the form of an equity share and the shares are required to be redeemed once the conversion feature expires, the financial instrument becomes a liability under the guidance in Topic 480 upon expiration of the conversion and paragraph 480-10-30-2 requires the issuer to reclassify an

instrument that becomes mandatorily redeemable as a liability, measured initially at fair value with a corresponding reduction of equity (no gain or loss is to be recognized). That may entail an adjustment to paid-in capital if, upon reclassification, the fair value of the liability differs from the carrying amount of the previously convertible instrument. That instrument would be subsequently measured under the provisions of Topic 480. [Content amended and moved to paragraph 505-10-35-1]

~~470-20-35-10 Paragraph superseded by Accounting Standards Update No. 2020-06. Otherwise, if a beneficial conversion option terminates after a specified time period and the instrument is then mandatorily redeemable at a premium, any resulting discount under paragraph 470-20-25-5 shall be accreted to the mandatory redemption amount. Example 6 (see paragraph 470-20-55-25) illustrates the application of this guidance.~~

>> Interest Forfeiture

470-20-35-11 If the terms of conversion of a convertible debt instrument provide that any accrued but unpaid interest at the date of conversion is forfeited by the former debt holder, that interest should be accrued or imputed to the date of conversion of the debt instrument.

22. Supersede paragraphs 470-20-40-1 through 40-3 and their related heading and 470-20-40-4A and amend paragraph 470-20-40-4 and its related heading and paragraphs 470-20-40-5 through 40-7, 470-20-40-11, 470-20-40-16, 470-20-40-18 and its related heading, and the heading preceding paragraph 470-20-40-13, with a link to transition paragraph 815-40-65-1, as follows:

Derecognition

> Beneficial Conversion Features

~~470-20-40-1 Paragraph superseded by Accounting Standards Update No. 2020-06. For instruments with **beneficial conversion features** all of the unamortized discount remaining at the date of conversion shall be recognized immediately at that date as interest expense or as a dividend, as appropriate, including both of the following amounts:~~

- ~~a. The discount originated by the beneficial conversion option accounting under paragraph 470-20-25-5~~
- ~~b. The discount from an allocation of proceeds under this Subtopic to other separable instruments included in the transaction.~~

~~470-20-40-2 Paragraph superseded by Accounting Standards Update No. 2020-06. If a convertible debt instrument containing an embedded beneficial conversion~~

~~feature is converted, and the amount of discount amortized exceeds the amount the holder realized because conversion occurred at an earlier date, no adjustment shall be made to amounts previously amortized.~~

~~**470-20-40-3** Paragraph superseded by Accounting Standards Update No. 2020-06. If a convertible debt instrument containing an embedded beneficial conversion feature is extinguished before conversion, the amount of the reacquisition price to be allocated to the repurchased beneficial conversion feature shall be measured using the intrinsic value of that conversion feature at the extinguishment date. The residual amount, if any, would be allocated to the convertible security. Thus, the issuer shall record a gain or loss on extinguishment of the convertible debt security. For guidance on classification of any gain or loss from extinguishment, see Section 470-50-45.~~

> **Contractual Conversion Features That Are Not Beneficial**

~~**470-20-40-4** If a convertible debt instrument accounted for in its entirety as a liability under paragraph 470-20-25-12 is converted into shares, cash (or other assets), or any combination of shares and cash (or other assets), in accordance with the conversion privileges provided in the terms of the instrument ~~does not include a beneficial conversion feature~~, upon conversion the carrying amount of the convertible debt instrument, including any unamortized premium ~~or discount, discount, or issuance costs~~, shall be reduced by, if any, the cash (or other assets) transferred and then shall be ~~credited to~~ recognized in the capital accounts upon conversion to reflect the shares ~~stock~~ issued and no gain or loss is recognized.~~

~~**470-20-40-4A** Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in paragraphs 470-20-40-5 through 40-10 does not apply to debt instruments that are within the scope of the Cash Conversion Subsections of Subtopic 470-20.~~

> **Conversion upon Issuer's Exercise of Call Option**

470-20-40-5 The following guidance addresses accounting for the issuance of equity securities to settle a debt instrument (pursuant to the instrument's original conversion terms) that became convertible upon the issuer's exercise of a call option:

- a. **Substantive conversion feature.** If the debt instrument contained a substantive conversion feature as of time of issuance ~~its issuance date~~, the issuance of equity securities shall be accounted for as a contractual conversion. That is, no gain or loss shall be recognized related to the equity securities issued to settle the instrument.
- b. **No substantive conversion feature.** If the debt instrument did not contain a substantive conversion feature as of time of issuance ~~its issuance date~~ (as defined in paragraphs 470-20-30-9 through 30-12), the issuance of

equity securities shall be accounted for as a debt extinguishment. That is, the **fair value** of the equity securities issued should be considered a component of the reacquisition price of the debt.

470-20-40-6 The assessment of whether the conversion feature is substantive may be performed after time of issuance ~~the issuance date~~ but shall be based only on assumptions, considerations, and marketplace information available as of time of issuance ~~the issuance date~~.

> > **Determining Whether a Conversion Feature Is Substantive**

470-20-40-7 By definition, a substantive conversion feature is at least **reasonably possible** of being exercised in the future. If the conversion price of an instrument at issuance is extremely high so that conversion of the instrument is not deemed at least reasonably possible as of time of issuance ~~its issuance date~~, then the conversion feature would not be considered substantive.

> **Interest Forfeiture**

470-20-40-11 If the terms of conversion of a convertible debt instrument provide that any accrued but unpaid interest at the date of conversion is forfeited by the former debt holder, accrued interest from the last interest payment date, if applicable, to the date of conversion, net of related income tax effects, if any, shall be charged to interest expense and credited to capital as part of the cost of securities issued. Thus, the accrued interest is accounted for in the same way as the principal amount of the debt converted and any unamortized premium, discount, or issuance costs ~~issue premium or discount~~; the net carrying amount of the debt, including any unamortized premium, discount, or issuance costs ~~premium or discount~~ and the related accrual for interest to the date of conversion, net of any related income tax effects, is a credit to the entity's capital.

> **Induced Conversions ~~Recognition of Expense Upon Conversion~~**

470-20-40-13 The guidance in paragraph 470-20-40-16 applies to conversions of convertible debt to equity securities pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance (including changes that involve the payment of consideration) for the purpose of inducing conversion. That guidance applies only to conversions that both:

- a. Occur pursuant to changed conversion privileges that are exercisable only for a limited period of time (inducements offered without a restrictive time limit on their exercisability are not, by their structure, changes made to induce prompt conversion)
- b. Include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance for

each debt instrument that is converted, regardless of the party that initiates the offer or whether the offer relates to all debt holders.

470-20-40-16 If a convertible debt instrument is converted to equity securities of the debtor pursuant to an inducement offer (see paragraph 470-20-40-13), the debtor shall recognize an 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. The fair value of the securities or other consideration shall be measured as of the date the inducement offer is accepted by the convertible debt holder. That date normally will be the date the debt holder converts the convertible debt into equity securities or enters into a binding agreement to do so. Until the debt holder accepts the offer, no exchange has been made between the debtor and the debt holder. Example 1 (see paragraph 470-20-55-1B ~~470-20-55-4~~) illustrates the application of this guidance.

> **Modifications and Extinguishments**

470-20-40-18 For additional guidance on modifications (or exchanges) and extinguishments of convertible debt instruments, ~~of debt~~, see Subtopic 470-50.

23. Add paragraphs 470-20-45-1A through 45-1B, with a link to transition paragraph 815-40-65-1, as follows:

Other Presentation Matters

470-20-45-1A Transaction costs incurred with third parties other than the investor(s) and that directly relate to the issuance of convertible debt instruments within the scope of this Subtopic ~~the Cash Conversion Subsections~~ shall be reported in accordance with the guidance in Section 835-30-45 ~~allocated to the liability and equity components in accordance with the guidance in paragraph 470-20-30-31~~. **[Content amended as shown and moved from paragraph 470-20-25-26]**

470-20-45-1B The guidance on convertible debt instruments in this Subtopic ~~in the Cash Conversion Subsections~~ does not affect an issuer's determination of whether the instruments liability component should be classified as a current liability or a long-term liability. For purposes of applying other applicable U.S. generally accepted accounting principles (GAAP) ~~GAAP~~ to make that determination, all terms of the convertible debt instrument ~~(including the equity component)~~ shall be considered. ~~Additionally, the balance sheet classification of the liability component does not affect the measurement of that component under paragraphs 470-20-35-12 through 35-16.~~ **[Content amended as shown and moved from paragraph 470-20-45-3]**

24. Supersede paragraph 470-20-50-1 and its related heading and add paragraphs 470-20-50-1A through 50-1I and their related heading, with a link to transition paragraph 815-40-65-1, as follows:

Disclosure

> Equity

470-20-50-1 Paragraph superseded by Accounting Standards Update No. 2020-06. For disclosures about securities as part of equity disclosures, see Section 505-40-50.

> Convertible Debt Instruments

470-20-50-1A The objective of the disclosure about convertible debt instruments is to provide users of financial statements with:

- a. Information about the terms and features of convertible debt instruments
- b. An understanding of how those instruments have been reported in an entity's statement of financial position and statement of financial performance
- c. Information about events, conditions, and circumstances that can affect how to assess the amount or timing of an entity's future cash flows related to those instruments.

470-20-50-1B An entity shall explain the pertinent rights and privileges of each convertible debt instrument outstanding, including, but not limited to, the following information:

- a. Principal amount
- b. Coupon rate
- c. Conversion or exercise prices or rates and number of shares into which the instrument is potentially convertible
- d. Pertinent dates, such as conversion date(s) and maturity date
- e. Parties that control the conversion rights
- f. Manner of settlement upon conversion and any alternative settlement methods, such as cash, shares, or a combination of cash and shares
- g. Terms that may change conversion or exercise prices, number of shares to be issued, or other conversion rights and the timing of those rights (excluding standard antidilution provisions)
- h. Liquidation preference and unusual voting rights, if applicable
- i. Other material terms and features of the instrument that are not listed above.

470-20-50-1C An entity shall provide the following incremental information for **contingently convertible instruments** or the instruments that are described in paragraphs 470-20-05-8 through 05-8A:

- a. Events or changes in circumstances that would adjust or change the contingency or would cause the contingency to be met
- b. Information on whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share (EPS) and the reasons why or why not
- c. Other information that is helpful in understanding both the nature of the contingencies and the potential impact of conversion.

470-20-50-1D An entity shall disclose the following information for each convertible debt instrument as of each date for which a statement of financial position is presented.

- a. The unamortized premium, discount, or issuance costs and, if applicable, the premium amount recorded as paid-in capital in accordance with paragraph 470-20-25-13
- b. The net carrying amount
- c. For **public business entities**, the **fair value** of the entire instrument and the level of the fair value hierarchy in accordance with paragraphs 825-10-50-10 through 50-15.

See Example 11 (paragraph 470-20-55-69A) for an illustration of this disclosure requirement.

470-20-50-1E An entity shall disclose the following information as of the date of the latest statement of financial position presented:

- a. Changes to conversion or exercise prices that occur during the reporting period other than changes due to standard antidilution provisions
- b. Events or changes in circumstances that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed
- c. Number of shares issued upon conversion, exercise, or satisfaction of required conditions during the reporting period
- d. Maturities and sinking fund requirements for convertible debt instruments for each of the five years following the date of most recent statement of financial position presented in accordance with paragraph 470-10-50-1.

470-20-50-1F An entity shall disclose the following information about interest recognized for each period for which a statement of financial performance is presented:

- a. The effective interest rate for the period

- b. The amount of interest recognized for the period disaggregated by both of the following (see Example 12 [paragraph 470-20-55-69D] for an illustration of this disclosure requirement):
1. The contractual interest expense
 2. The amortization of the premium, discount, or issuance costs.

470-20-50-1G If the conversion option of a convertible debt instrument is accounted for as a derivative in accordance with Subtopic 815-15, an entity shall provide disclosures in accordance with Topic 815 for the conversion option in addition to the disclosures required by this Section, if applicable.

470-20-50-1H If a convertible debt instrument is measured at fair value in accordance with the Fair Value Option Subsections of Subtopic 825-10, an entity shall provide disclosures in accordance with Subtopic 820-10 and Subtopic 825-10 in addition to the disclosures required by this Section, if applicable.

470-20-50-1I An entity shall disclose ~~All of~~ the following information about derivative transactions entered into in connection with the issuance of convertible debt instruments within the scope of this Subtopic ~~the Cash Conversion Subsections~~ regardless of whether such derivative transactions are accounted for as assets, liabilities, or equity instruments:

- a. The terms of those derivative transactions (including the terms of settlement)
- b. How those derivative transactions relate to the instruments within the scope of this Subtopic ~~the Cash Conversion Subsections~~
- c. The number of shares underlying the derivative transactions
- d. The reasons for entering into those derivative transactions.

An example of a derivative transaction entered into in connection with the issuance of a convertible debt an instrument within the scope of this Subtopic ~~the Cash Conversion Subsections~~ is the purchase of call options that are expected to substantially offset changes in the fair value or the potential dilutive effect of the conversion option. Derivative instruments also are subject to the disclosure guidance in Topic 815. [Content amended as shown and moved from paragraph 470-20-50-5(d)]

25. Supersede paragraphs 470-20-55-1 and its related headings, 470-20-55-10 through 55-17 and their related headings, 470-20-55-19A through 55-66 and their related headings, and 470-20-55-69 and its related heading, add paragraphs 470-20-55-1A through 55-1B and their related headings and 470-20-55-69A through 55-69F and their related headings, and amend paragraphs 470-20-55-18 through 55-19, with a link to transition paragraph 815-40-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

>> Example 1: Induced Conversions of Convertible Securities

470-20-55-1 Paragraph superseded by Accounting Standards Update No. 2020-06. The following Cases illustrate application of the guidance in paragraph 470-20-40-16 to induced conversions of convertible securities:

- a. ~~Reduced conversion price for conversion before determination date, increase in bond fair value (Case A)~~
- b. ~~Reduced conversion price for conversion before determination date, decrease in bond fair value (Case B).~~ **[Content moved to paragraph 470-20-55-1B]**

> Implementation Guidance

>> Scope Application to a Convertible Preferred Stock Share

470-20-55-1A An example of a convertible preferred stock share that paragraph ~~470-20-15-2D~~ ~~470-20-15-6~~ requires an entity consider as a convertible debt instrument for purposes of the scope application of this Subtopic ~~the Cash Conversion Subsections~~ is a convertible preferred stock share that has a stated redemption date and also would require the issuer to settle the face amount of the instrument in cash upon exercise of the conversion option. Such a convertible preferred stock share is a mandatorily redeemable financial instrument and is classified as a liability under Subtopic 480-10 because it embodies an unconditional obligation to redeem the instrument by transferring assets at a specified or determinable date (or dates). **[Content amended as shown and moved from paragraph 470-20-55-70]**

> Illustrations

>> Example 1: Induced Conversions of Convertible Securities

470-20-55-1B The following Cases illustrate application of the guidance in paragraph 470-20-40-16 to induced conversions of convertible securities:

- a. Reduced conversion price for conversion before determination date, increase in bond **fair value** (Case A)
- b. Reduced conversion price for conversion before determination date, decrease in bond fair value (Case B). **[Content moved from paragraph 470-20-55-1]**

>> Example 2: Evaluating Whether an Embedded Conversion Option Is Beneficial to Holder

470-20-55-10 Paragraph superseded by Accounting Standards Update No. 2020-06. This Example illustrates the guidance in paragraph 470-20-30-5.

470-20-55-11 Paragraph superseded by Accounting Standards Update No. 2020-06. Assume Entity A issues for \$1 million convertible debt with a par amount of \$1 million and 100,000 detached warrants. The convertible debt is convertible at a conversion price of \$10 per share (holder would receive 100,000 shares of Entity A common stock upon conversion). The fair value of Entity A's stock at the commitment date is \$10. Further, assume that the ratio of the relative fair values of the convertible debt and the detached warrants is 75 to 25. After allocating 25 percent or \$250,000 of the proceeds to the detached warrants (based on relative fair values), the convertible debt is recorded on the balance sheet at \$750,000 (net of the discount that arises from the allocation of proceeds to the warrants), and the detached warrants are recorded in paid-in capital in the balance sheet at \$250,000.

470-20-55-12 Paragraph superseded by Accounting Standards Update No. 2020-06. Entity A must evaluate whether the embedded conversion option within the debt instrument is beneficial (has intrinsic value) to the holder. The effective conversion price (that is, the allocated proceeds divided by the number of shares to be received on conversion) based on the proceeds of \$750,000 allocated to the convertible debt is \$7.50 ($\$750,000 \div 100,000$ shares). The intrinsic value of the conversion option therefore is \$250,000 $\{[(100,000 \text{ shares}) \times (\$10.00 - \$7.50)]\}$ and is recognized as a reduction to the carrying amount of the convertible debt and an addition to paid-in capital. The total debt discount immediately after the initial accounting is performed is \$500,000 (\$250,000 from the allocation of proceeds to the warrants and an additional \$250,000 from the measurement of the intrinsic value of the conversion option). The same answer would result if the debt had been issued without detachable warrants for \$750,000 in proceeds.

>> Example 3: Conversion Price to Be Used to Measure Intrinsic Value

470-20-55-13 Paragraph superseded by Accounting Standards Update No. 2020-06. This Example illustrates the guidance in paragraph 470-20-30-7.

470-20-55-14 Paragraph superseded by Accounting Standards Update No. 2020-06. Assume Entity A, a private entity, issues for \$1 million a convertible instrument that is convertible 4 years after issuance at a conversion price of \$10 per share (fair value of the stock is \$10 at the commitment date). The instrument also contains a provision that the conversion price adjusts from \$10 to \$7 per share if Entity A does not have an initial public offering with a per share price of \$13 or more within 3 years. Entity B, a private entity, issues for \$1 million a convertible instrument that is convertible 4 years after issuance at a conversion price of \$7 per share (fair value of the stock is \$10 at the commitment date). The instrument also

contains a provision that the conversion price adjusts from \$7 to \$10 per share if Entity B successfully completes an initial public offering for a per share price of \$13 or more within 3 years.

~~470-20-55-15 Paragraph superseded by Accounting Standards Update No. 2020-06. The active conversion price for both Entity A and Entity B is \$7, which is the conversion option price that would apply if there were no change in circumstances after the issuance date other than the passage of time. The intrinsic value of the conversion option of \$428,571 $[(\$1 \text{ million} \div \$7) \times (\$10 - \$7)]$ should be recognized at the issuance date of the convertible instrument. If an event occurs that triggers a decrease in the number of shares to the holder upon conversion (the initial public offering in this Example), the intrinsic value of the adjusted conversion option should be recomputed using the commitment date fair value of the underlying stock and the proceeds received for or allocated to the convertible instrument in the initial accounting.~~

~~470-20-55-16 Paragraph superseded by Accounting Standards Update No. 2020-06. If the amortized amount of discount on the convertible instrument resulting from the initial measurement of the intrinsic value of the conversion option before the adjustment exceeds the remeasured intrinsic value of the conversion option after the adjustment, the excess amortization charge should not be reversed. Any unamortized amount of that original discount amount that exceeds the amount necessary for the total discount (amortized and unamortized) to be equal to the intrinsic value of the adjusted conversion option should be reversed through a debit to paid-in capital (as an adjustment to the intrinsic value measurement of the conversion option). The adjusted unamortized discount, if any, should be amortized using the interest method pursuant to the recommended guidance in this Subtopic.~~

~~470-20-55-17 Paragraph superseded by Accounting Standards Update No. 2020-06. For example, assume in this Case that Entity A had an amortized discount of \$85,714 and the remaining unamortized discount was \$342,857 at the time it completed an initial public offering for a per share price of more than \$13. Entity A would remeasure the intrinsic value of the conversion option based on the adjusted conversion price of \$10 per share and determine that there is no intrinsic value of the adjusted conversion option because the adjusted conversion price equals the fair value of the common stock at the initial commitment date. Entity A would reverse the entire \$342,857 of remaining unamortized discount (credit) with an offsetting entry (debit) to additional paid-in capital. The \$85,714 of discount previously amortized is not reversed.~~

> > Example 4: Stock-Settled Debt

~~470-20-55-18 This Example illustrates the guidance in paragraph 470-20-25-14 470-20-25-8.~~

470-20-55-19 If the conversion price was described as \$1 million divided by the market price of the common stock on the date of the conversion, that is, resetting at the date of conversion, the holder is guaranteed to receive \$1 million in value upon conversion and, therefore, ~~there is no beneficial conversion option and the debt convertible instrument would be considered stock-settled debt. However, if the conversion price does not fully reset (for example, resets on specified dates before maturity), the reset represents a contingent beneficial conversion feature subject to this Subtopic.~~

>> Example 4A: Resets

470-20-55-19A Paragraph superseded by Accounting Standards Update No. 2020-06. This Example illustrates the guidance in paragraph 470-20-35-4.

470-20-55-20 Paragraph superseded by Accounting Standards Update No. 2020-06. Assume Entity A issues for \$1 million a convertible debt instrument with a conversion option that allows the holder to convert the instrument at \$12.50 per share for 80,000 shares of Entity A's common stock. The fair value of the common stock is \$10 at the commitment date. The debt instrument also provides that if the market price of Entity A's common stock falls to \$7 or less at any point during the conversion term, then the conversion price resets to \$8.75 per share (the instrument would then become convertible into 114,286 shares).

470-20-55-21 Paragraph superseded by Accounting Standards Update No. 2020-06. A contingent beneficial conversion amount of \$142,858 ~~[((\$1 million ÷ \$8.75) × (\$10.00 – \$8.75)]~~ is required to be calculated at the commitment date but only recognized when and if Entity A's stock price falls to \$7 or less. The accretion of this discount would be required from the date the stock price falls to \$7 or less (regardless of the fact that the conversion price resets to \$8.75 per share) in accordance with this Subtopic.

>> Example 5: Contingent Conversion Option Does Not Permit Calculation of Shares Received on Conversion

470-20-55-22 Paragraph superseded by Accounting Standards Update No. 2020-06. This Example illustrates the guidance in paragraph 470-20-35-1.

470-20-55-23 Paragraph superseded by Accounting Standards Update No. 2020-06. Assume Entity A issues for \$1 million a convertible debt instrument that is convertible into 100,000 shares of Entity A common stock (\$10 conversion price) when the fair value of the stock is \$10. This instrument provides that if Entity A subsequently issues common stock at a price less than \$10, the conversion price adjusts to 90 percent of that subsequent issue price.

470-20-55-24 Paragraph superseded by Accounting Standards Update No. 2020-06. If Entity A subsequently issues common stock at a price of \$8 per share, the

holder's conversion price adjusts to \$7.20 ($\$8 \times 90\%$) and the holder now would receive 138,888 shares ($\$1 \text{ million} \div \7.20) upon conversion, an increase of 38,888 shares from the 100,000 shares that would have been received before the occurrence of the contingent event. The incremental intrinsic value that results from triggering the contingent option is \$388,888—calculated as 38,888 shares \times \$10 stock price at the commitment date or, alternatively, $(\$1 \text{ million} \div \$7.20) \times (\$10 - \$7.20)$ —and would be recognized upon the subsequent issuance of common stock at the \$8 per share price. The accretion of this discount would be required from the date the common stock was subsequently issued at \$8 per share in accordance with this Subtopic.

>> Example 6: Beneficial Conversion Option Terminates After a Specified Time Period and Instrument then Mandatorily Redeemable at a Premium

470-20-55-25 Paragraph superseded by Accounting Standards Update No. 2020-06. This Example illustrates the guidance in paragraph 470-20-35-10.

470-20-55-26 Paragraph superseded by Accounting Standards Update No. 2020-06. Assume Entity A issues for \$1 million a convertible debt instrument that is convertible by the holder 1 year from issuance into 120,000 shares of Entity A common stock (fair value of Entity A's common stock at the commitment date is \$10). If the instrument is not converted at the end of 1 year, Entity A is required to redeem it for \$1.2 million.

470-20-55-27 Paragraph superseded by Accounting Standards Update No. 2020-06. The debt instrument contains a beneficial conversion option with an intrinsic value of \$200,000—that is, $(120,000 \text{ shares} \times \$10 \text{ per share})$ (which is equal to the fair value of stock to be received upon conversion)—\$1 million (proceeds received). The total proceeds of \$1 million are therefore allocated as follows: \$800,000 to the convertible debt and \$200,000 to the conversion option (recognized as additional paid-in capital). The debt is then accreted from \$800,000 to the \$1.2 million redemption amount over the 1 year period to the required redemption date in accordance with this Subtopic.

>> Example 7: Beneficial Conversion Features or Contingently Adjustable Conversion Ratios

470-20-55-28 Paragraph superseded by Accounting Standards Update No. 2020-06. The following Cases illustrate the guidance for **beneficial conversion features** or contingently adjustable conversion ratios for convertible securities:

- a. Instrument is convertible at inception, fixed dollar conversion terms (Base Case) (Case A).
- b. Instrument is not convertible at inception, fixed dollar conversion terms (Base Case) (Case B).
- c. Paragraph superseded by Maintenance Update No. 2016-05.

- d. ~~Instrument contains a fixed percentage conversion feature dependent on a future event (Case D).~~
- e. ~~Convertible instrument contains fixed terms that change based on a future event (Case E).~~
- f. ~~Conversion is dependent on a future event and terms are variable (Case F).~~
- g. ~~Extinguishment of convertible debt that includes a beneficial conversion feature (Case G).~~

>>> Case A: Instrument Is Convertible at Inception, Fixed Dollar Conversion Terms (Base Case)

470-20-55-29 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case illustrates the guidance in paragraph 470-20-35-7.

470-20-55-30 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case has the following assumptions:

- a. ~~\$1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance~~
- b. ~~Convertible at date of issuance~~
- c. ~~Convertible at \$40 per share~~
- d. ~~Fair value of common stock at commitment date equals \$50 per share.~~

470-20-55-31 Paragraph superseded by Accounting Standards Update No. 2020-06. The calculation is as follows.

Fair value at commitment date	\$ _____ 50
Conversion price (stated and will not change)	\$ _____ 40
Intrinsic value of beneficial conversion feature	\$ _____ 250,000 ^(a)
Amount to record at date of issuance	\$ _____ 250,000

(a) ~~Convertible into 25,000 shares $(1,000,000 \div 40)$ with an intrinsic value of \$10 $(50 - 40)$ or overall: $(1,000,000 \div 40) \times (50 - 40)$.~~

470-20-55-32 Paragraph superseded by Accounting Standards Update No. 2020-06. The beneficial conversion feature is calculated at its intrinsic value (that is, the difference between the conversion price and the fair value of the common stock into which the debt is convertible, multiplied by the number of shares into which the debt is convertible) at the commitment date. A portion of the proceeds from issuance of the convertible debt, equal to the intrinsic value, is then allocated to additional paid-in capital. Because the debt has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five-year period from the date of issuance to the stated redemption date.

470-20-55-33 Paragraph superseded by Accounting Standards Update No. 2020-06. Entry at date of issuance.

Cash	\$ 1,000,000	
Debt Discount	250,000	
Debt		\$ 1,000,000
Additional paid-in capital		250,000

>>> Case B: Instrument Is Not Convertible at Inception, Fixed Dollar Conversion Terms (Base Case)

470-20-55-34 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case illustrates the guidance in paragraph 470-20-35-7.

470-20-55-35 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case has the following assumptions:

- a. ~~\$1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance~~
- b. ~~Convertible in one year~~
- c. ~~Convertible at \$40 per share~~
- d. ~~Fair value of common stock at commitment date equals \$50 per share.~~

470-20-55-36 Paragraph superseded by Accounting Standards Update No. 2020-06. The calculation is as follows.

Fair value at commitment date	\$ 50
Conversion price (stated and will not change)	\$ 40
Intrinsic value of beneficial conversion feature	\$ 250,000 ^(a)
Amount to record over period to stated redemption	\$ 250,000

(a) $(1,000,000 \div 40) \times (50 - 40)$.

470-20-55-37 Paragraph superseded by Accounting Standards Update No. 2020-06. The beneficial conversion feature is calculated at its intrinsic value at the commitment date (that is, the difference between the conversion price and the fair value of the common stock into which the debt is convertible, multiplied by the number of shares into which the debt is convertible). A portion of the proceeds from issuance of the convertible debt, equal to the intrinsic value, is then allocated to additional paid-in capital. Because the debt has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five year period from the date of issuance to the stated redemption date.

470-20-55-38 Paragraph superseded by Accounting Standards Update No. 2020-06. Entry at date of issuance.

Cash	\$ 1,000,000	
Debt discount	250,000	
Debt		\$ 1,000,000
Additional paid-in capital		250,000

470-20-55-39 Paragraph not used.

470-20-55-40 Paragraph not used.

470-20-55-41 Paragraph not used.

470-20-55-42 Paragraph not used.

470-20-55-43 Paragraph not used.

>>> Case D: Instrument Containing a Fixed Percentage Conversion Feature Dependent on a Future Event

470-20-55-44 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case illustrates the guidance in paragraphs 470-20-35-2 through 35-3.

470-20-55-45 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case has the following assumptions:

- a. ~~\$1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance~~
- b. ~~Convertible upon an initial public offering~~
- c. ~~Convertible at 80 percent of stock price at commitment date (that is, \$40)~~
- d. ~~Fair value of common stock at commitment date equals \$50 per share.~~

470-20-55-46 Paragraph superseded by Accounting Standards Update No. 2020-06. The calculation is as follows.

Initial public offering price	<u>\$ 50</u>	<u>\$ 60</u>	<u>\$ 70</u>
Stock price at commitment date	<u>\$ 50</u>	<u>\$ 50</u>	<u>\$ 50</u>
80% of stock price at commitment date	<u>\$ 40</u>	<u>\$ 40</u>	<u>\$ 40</u>
 Intrinsic value of beneficial conversion feature at commitment date	 \$ 250,000 ^(a)	 \$ 250,000 ^(b)	 \$ 250,000 ^(c)
(a) $(1,000,000 \div 40) \times (50 - 40)$			
(b) $(1,000,000 \div 40) \times (50 - 40)$			
(c) $(1,000,000 \div 40) \times (50 - 40)$			

~~470-20-55-47 Paragraph superseded by Accounting Standards Update No. 2020-06. The instrument is not convertible at the commitment date, however it will become convertible and that conversion feature will be beneficial if an initial public offering is completed. The intrinsic value of the beneficial conversion feature is calculated at the commitment date using the stock price as of that date, that is, \$250,000. However, that amount would only be recorded at the date an initial public offering is completed. If the IPO were completed on the third anniversary of the debt issuance, the discount amount would be recorded at that date and amortized over a two-year period ending on the stated redemption date of the debt.~~

~~470-20-55-48 Paragraph superseded by Accounting Standards Update No. 2020-06. Entry at issuance.~~

Cash	\$ 1,000,000	
Debt		\$ 1,000,000
 Entry at initial public offering:		
Debt discount	\$ 250,000	
Additional paid-in capital		\$ 250,000

>>> Case E: Convertible Instrument Containing Fixed Terms that Change Based on a Future Event

~~470-20-55-49 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case illustrates the guidance in paragraphs 470-20-35-2 through 35-3 and 470-20-35-7.~~

~~470-20-55-50 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case has the following assumptions:~~

- ~~a. \$1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance~~
- ~~b. Convertible at date of issuance~~
- ~~c. Convertible at 80 percent of stock price at commitment date (that is, \$40)~~

d. Fair value of common stock at commitment date equals \$50 per share and if there is an initial public offering, the conversion feature adjusts to the lesser of \$30 or 80 percent of the initial public offering price.

470-20-55-51 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case has the following assumptions:

Fair value at commitment date	\$ 50
Conversion price at commitment date	\$ 40
Intrinsic value of basic beneficial conversion feature at commitment date	\$ 250,000 ^(a)
Conversion price at contingency resolution	unknown
Intrinsic value of contingent beneficial conversion feature at commitment date	unknown

(a) $(1,000,000 \div 40) \times (50 - 40)$

470-20-55-52 Paragraph superseded by Accounting Standards Update No. 2020-06. This instrument includes a basic beneficial conversion feature that is not contingent upon the occurrence of a future event and a contingent beneficial conversion feature. Accordingly, the intrinsic value of the basic beneficial conversion feature of \$250,000 is calculated at the commitment date and recorded at the issuance date. Because the debt has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five year period from the date of issuance to the stated redemption date.

470-20-55-53 Paragraph not used.

470-20-55-54 Paragraph superseded by Accounting Standards Update No. 2020-06. Entry at date of issuance.

Cash	\$ 1,000,000	
Debt discount	250,000	
Debt		\$ 1,000,000
Additional paid-in capital		250,000

470-20-55-54A Paragraph superseded by Accounting Standards Update No. 2020-06. The terms of the convertible debt instrument do not permit the number of shares that would be received upon conversion if an initial public offering occurs to be calculated at the commitment date.

>>> Case F: Conversion Dependent on a Future Event and Terms Are Variable

470-20-55-55 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case illustrates the guidance in paragraph 470-20-35-2 through 35-3.

470-20-55-56 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case has the following assumptions:

- a. ~~\$1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance~~
- b. ~~Convertible at date of issuance~~
- c. ~~Convertible at 80 percent of stock price at commitment date (that is, \$40)~~
- d. ~~Fair value of common stock at commitment date equals \$50 per share~~
- e. ~~If the stock price increases at least 15 percent one year after an initial public offering, the conversion feature adjusts to 65 percent of the fair value of the common stock 1 year after the initial public offering.~~

470-20-55-57 Paragraph superseded by Accounting Standards Update No. 2020-06. The calculation is as follows.

Fair value at commitment date	\$ 50
Conversion price at commitment date	\$ 40
Conversion price at contingency resolution	unknown
Intrinsic value of basic beneficial conversion feature at commitment date	\$ 250,000 ^(a)
Intrinsic value of contingent beneficial conversion feature at commitment date	unknown

(a) $(1,000,000 \div 40) \times (50 - 40)$

470-20-55-58 Paragraph superseded by Accounting Standards Update No. 2020-06. The amount of the beneficial conversion feature is measured using the terms of the beneficial conversion feature that are operative at issuance, that is, the 20 percent discount. The intrinsic value of that beneficial conversion feature (\$250,000) is calculated at the commitment date and recorded at the issuance date. Because the debt has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five-year period from the date of issuance to the stated redemption date.

470-20-55-59 Paragraph not used.

470-20-55-60 Paragraph superseded by Accounting Standards Update No. 2020-06. Entry at date of issuance.

Cash	\$ 1,000,000	
Debt discount	— 250,000	
Debt		\$ 1,000,000
Additional paid-in capital		— 250,000

~~470-20-55-60A Paragraph superseded by Accounting Standards Update No. 2020-06. The terms of the convertible debt instrument do not permit the number of shares that would be received upon conversion if an initial public offering occurs to be calculated at the commitment date.~~

>>> Case G: Extinguishment of Convertible Debt that Includes a Beneficial Conversion Feature

~~470-20-55-61 Paragraph superseded by Accounting Standards Update No. 2020-06. This Case illustrates the guidance in paragraph 470-20-40-3.~~

~~470-20-55-62 Paragraph superseded by Accounting Standards Update No. 2020-06. Both of the following conditions exist at the commitment date:~~

- ~~a. Proceeds for sale of zero coupon convertible debt are \$100.~~
- ~~b. Intrinsic value of beneficial conversion feature is \$90.~~

~~470-20-55-63 Paragraph superseded by Accounting Standards Update No. 2020-06. At the commitment date, the issuer records \$90 as discount on the debt with the offsetting entry to additional paid-in capital. The remainder (\$10) is recorded as debt and is accreted to its full face value of \$100 over the period from the issuance date until the stated redemption date of the instrument (3 years). The debt is subsequently extinguished one year after issuance.~~

~~470-20-55-64 Paragraph superseded by Accounting Standards Update No. 2020-06. All of the following conditions exist at the extinguishment date:~~

- ~~a. The reacquisition price is \$150.~~
- ~~b. The intrinsic value of the beneficial conversion feature at the extinguishment date is \$80.~~
- ~~c. The carrying value of debt is \$22.~~

~~The net carrying value of the debt one year after issuance is calculated using the effective interest method to amortize the debt discount over three years.~~

~~470-20-55-65 Paragraph superseded by Accounting Standards Update No. 2020-06. At the date of extinguishment, the extinguishment proceeds should first be allocated to the beneficial conversion feature (\$80). The remainder (\$70) is allocated to the extinguishment of the convertible security.~~

470-20-55-66 Paragraph superseded by Accounting Standards Update No. 2020-06. Entry to record the extinguishment.

Debt	\$ 22	
Equity (paid in capital)	— 80	
Loss on extinguishment	— 48	
Cash		\$ 150

>> Example 10: Multiple-Step Discount

470-20-55-69 Paragraph superseded by Accounting Standards Update No. 2020-06. This Example illustrates the application of paragraphs 470-20-30-15 and 470-20-35-7 to an instrument that incorporates a multiple-step discount. If an instrument provides for a 15 percent discount to the market price after 3 months, a 25 percent discount after 6 months, a 35 percent discount after 9 months, and a 40 percent discount after 1 year, paragraph 470-20-30-15 requires that the computation of the intrinsic value be made using the conversion terms that are most beneficial to the investor; that is, the discount would be 40 percent and the amortization period would be 1 year. However, paragraph 470-20-35-7 indicates that the amortization recognized may require adjustment to ensure that the discount amortized at any point in time is not less than the amount the holder of the instrument could obtain if conversion occurred at that date. That is, at the end of 3 months, at least the 15 percent discount should have been recognized. Paragraph 470-20-35-7(a) states that, if a convertible instrument has a stated redemption date, the discount shall be accreted from the date of issuance to the stated redemption date of the convertible instrument, regardless of when the earliest conversion date occurs.

>> Example 11: Disclosure of the Information in the Statement of Financial Position

470-20-55-69A This Example provides an illustration of the guidance in paragraph 470-20-50-1D based on the assumption that Entity A is a public business entity and has two convertible debt instruments outstanding as of December 31, 20X7, and 20X6.

470-20-55-69B The following illustrates the disclosures in a tabular format.

The following is a summary of Entity A's convertible debt instruments as of December 31, 20X7 (in thousands).

	<u>Principal Amount</u>	<u>Unamortized Debt</u>		<u>Net Carrying Amount</u>	<u>Fair Value</u>	
		<u>Discount and Issuance Costs</u>			<u>Amount</u>	<u>Leveling</u>
<u>1.2% convertible debt due on December 31, 20X8</u>	\$ 1,000	\$ (18)		\$ 982	\$ 1,100	Level 2
<u>Zero-coupon convertible debt due on December 31, 20X9</u>	500	(9)		491	462	Level 3

The following is a summary of Entity A's convertible debt instruments as of December 31, 20X6 (in thousands).

	<u>Principal Amount</u>	<u>Unamortized Debt</u>		<u>Net Carrying Amount</u>	<u>Fair Value</u>	
		<u>Discount and Issuance Costs</u>			<u>Amount</u>	<u>Leveling</u>
<u>1.2% convertible debt due on December 31, 20X8</u>	\$ 1,000	\$ (35)		\$ 965	\$ 1,015	Level 2
<u>Zero-coupon convertible debt due on December 31, 20X9</u>	500	(14)		486	450	Level 3

470-20-55-69C The disclosures may be provided alternatively in narrative descriptions.

1.2 Percent Convertible Debt Instrument Due on December 31, 20X8

As of December 31, 20X7, and 20X6, the net carrying amount of the convertible debt instrument was \$982,000 and \$965,000, respectively, with unamortized debt discount and issuance costs of \$18,000 and \$35,000. The estimated fair value (Level 2) of the convertible debt instrument was \$1,100,000 and \$1,015,000, respectively, as of December 31, 20X7, and 20X6.

Zero-Coupon Convertible Debt Instrument Due on December 31, 20X9

As of December 31, 20X7, and 20X6, the net carrying amount of the convertible debt instrument was \$491,000 and \$486,000, respectively, with unamortized debt discount and issuance costs of \$9,000 and \$14,000. The estimated fair value (Level 3) of the convertible debt instrument was \$462,000 and \$450,000, respectively, as of December 31, 20X7, and 20X6.

>> Example 12: Disclosure of the Information in the Statement of Financial Performance

470-20-55-69D This Example provides an illustration of the guidance in paragraph 470-20-50-1F(b) based on the assumption that Entity A has two convertible debt instruments issued before January 1, 20X5, and still outstanding as of December 31, 20X7.

470-20-55-69E The following illustrates the disclosures in a tabular format.

The following provides a summary of the interest expense of Entity A's convertible debt instruments (in thousands).

	<u>Year Ended December 31,</u>		
	<u>20X7</u>	<u>20X6</u>	<u>20X5</u>
<u>Coupon interest</u>	<u>\$ 12</u>	<u>\$ 12</u>	<u>\$ 12</u>
<u>Amortization of debt discount and issuance costs</u>	<u>22</u>	<u>22</u>	<u>21</u>
<u>Total</u>	<u>\$ 34</u>	<u>\$ 34</u>	<u>\$ 33</u>

470-20-55-69F The disclosures may be provided alternatively in narrative descriptions.

For the years ended December 31, 20X7, 20X6, and 20X5, the total interest expense was \$34,000, \$34,000, and \$33,000 with coupon interest expense of \$12,000 for each year and the amortization of debt discount and issuance costs of \$22,000, \$22,000, and \$21,000, respectively.

Amendments to Subtopic 470-50

26. Supersede paragraph 470-50-40-16, with a link to transition paragraph 815-40-65-1, as follows:

Debt—Modifications and Extinguishments

Derecognition

> Subsequent Accounting for Modifications and Exchanges If Extinguishment Accounting Is Not Applied

470-50-40-16 Paragraph superseded by Accounting Standards Update No. 2020-06. The issuer shall 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.

Amendments to Subtopic 505-10

27. Amend paragraph 505-10-05-3 and add paragraphs 505-10-05-5 through 05-7 and their related heading, with a link to transition paragraph 815-40-65-1, as follows:

Equity—Overall

Overview and Background

505-10-05-3 Equity, sometimes referred to as net assets, is the residual interest in the assets of an entity that remains after deducting its liabilities. The Subtopics of the Equity Topic provide guidance on several specific elements of transactions, accounts and financial instruments that are classified as components of equity as well as overall general guidance related to equity. Issues that relate to whether a specific financial instrument shall be classified as equity or outside of the equity classification are addressed in Topic 480 as well as other Topics (such as Topic 815 on derivatives and hedging) that address these classification matters.

505-10-05-4 Other Topics, including industry-specific Topics, also contain guidance related to specific equity matters associated with those Topics. Equity guidance in those Topics is intended to be incremental to the guidance otherwise established in this Topic.

> Convertible Preferred Stock

505-10-05-5 Entities may issue convertible preferred stock that may be convertible into common stock at the lower of a conversion rate fixed at time of issuance and a fixed discount to the market price of the common stock at the date of conversion.

505-10-05-6 Certain convertible preferred stock may have a contingently adjustable conversion ratio. Examples of a conversion price that is variable based on future events are the following:

- a. A liquidation or a change in control of an entity
- b. A subsequent round of financing at a price lower than the **convertible security's** original conversion price
- c. An initial public offering at a share price lower than an agreed-upon amount.

505-10-05-7 Certain convertible preferred stock may become convertible only upon the occurrence of a future event outside the control of the holder.

28. Amend paragraph 505-10-15-2, with a link to transition paragraph 815-40-65-1, as follows:

Scope and Scope Exceptions

> Instruments

505-10-15-2 The guidance in this Subtopic applies to all of the following instruments and activities:

- a. Transactions in an entity's own common stock
- b. Receivables related to the issuance of equity interests and the appropriation of retained earnings
- c. ~~Subparagraph superseded by Accounting Standards Update No. 2020-06. 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 earnings per share (EPS) in accordance with the requirements of Topic 260.~~
- d. Convertible preferred stock, unless the guidance in other Subtopics (such as Subtopic 470-20 on debt with conversion and other options or 480-10 on distinguishing liabilities from equity) requires that the convertible preferred stock be classified as a liability. The relevant guidance in this Subtopic shall be considered after an issuer's determination under Subtopic 815-15 on embedded derivatives of whether an embedded conversion option or other embedded feature in convertible preferred stock should be accounted for separately as a derivative instrument (see paragraph 815-15-55-76B). The guidance in this Subtopic does not apply to convertible preferred stock that is issued as awards to a grantee in exchange for goods or services received (or to be received) that are within the scope of Topic 718 on stock compensation unless the instrument is modified in accordance with and no longer subject to the guidance in that Topic.

29. Add Section 505-10-35, with a link to transition paragraph 815-40-65-1, as follows:

Subsequent Measurement

General

505-10-35-1 ~~If convertible preferred stock is a convertible instrument is in the form of an equity share and the shares are required to be redeemed once the conversion feature expires, the financial instrument becomes a liability under the guidance in Topic 480 upon expiration of the conversion feature and paragraph 480-10-30-2 requires the issuer to reclassify an instrument that becomes mandatorily redeemable as a liability, measured initially at fair value with a~~

corresponding reduction of equity (no gain or loss is to be recognized). That may entail an adjustment to paid-in capital if, upon reclassification, the fair value of the liability differs from the carrying amount of the previously convertible preferred stock instrument. That financial instrument would be subsequently measured under the provisions of Topic 480. **[Content amended as shown and moved from paragraph 470-20-35-9]**

30. Supersede paragraphs 505-10-50-6 through 50-10A and their related heading and add paragraphs 505-10-50-12 through 50-18 and their related heading, with a link to transition paragraph 815-40-65-1, as follows:

Disclosure

~~> Contingently Convertible Securities~~

~~505-10-50-6 Paragraph superseded by Accounting Standards Update No. 2020-06. To comply with the general disclosure requirements of paragraph 505-10-50-3, the significant terms of the conversion features of the contingently convertible **security** shall be disclosed to enable users of financial statements to understand the circumstances of the contingency and the potential impact of conversion. Quantitative and qualitative terms of the contingently convertible **security**, disclosure of which would be helpful in understanding both the nature of the contingency and the potential impact of conversion, include all of the following:~~

- ~~a. Events or changes in circumstances that would cause the contingency to be met and any significant features necessary to understand the conversion rights and the timing of those rights (for example, the periods in which the contingency might be met and the securities may be converted if the contingency is met)~~
- ~~b. The conversion price and the number of shares into which a security is potentially convertible~~
- ~~c. Events or changes in circumstances, if any, that could adjust or change the contingency, conversion price, or number of shares, including significant terms of those changes~~
- ~~d. The manner of settlement upon conversion and any alternative settlement methods (for example, cash, shares, or a combination).~~

~~505-10-50-7 Paragraph superseded by Accounting Standards Update No. 2020-06. In order to meet the disclosure requirements of the preceding paragraph, the possible conversion prices and dates as well as other significant terms for each convertible instrument shall be disclosed. For example:~~

The Company is obligated to issue X shares and as the market price of the common stock decreases, the Company is obligated to issue an additional X shares for each \$1 decrease in the stock price.

~~505-10-50-8 Paragraph superseded by Accounting Standards Update No. 2020-06. Additionally, the issuer shall disclose in the notes to financial statements the terms of the transaction, including the excess of the aggregate fair value of the instruments that the holder would receive at conversion over the proceeds received and the period over which the discount is amortized.~~

~~505-10-50-9 Paragraph superseded by Accounting Standards Update No. 2020-06. Disclosures shall indicate whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share (EPS) and the reasons why or why not.~~

~~505-10-50-10 Paragraph superseded by Accounting Standards Update No. 2020-06. Disclosures of information about derivative instruments entered into in connection with the issuance of the contingently convertible securities may be useful in terms of fully explaining the potential impact of the contingently convertible securities. That information might include the terms of those derivative instruments (including the terms of settlement), how those instruments relate to the contingently convertible securities, and the number of shares underlying the derivative instruments. One example of a transaction entered into in connection with the issuance of a contingently convertible security is the purchase of a call option such that the terms of the purchased call option would be expected to substantially offset changes in value of the written call option embedded in the convertible security. Derivative instruments are also subject to disclosure information, as required by Topic 815.~~

~~505-10-50-10A Paragraph superseded by Accounting Standards Update No. 2020-06. For incremental disclosure requirements of debt with conversion and other options, see paragraphs 470-20-10-2 and 470-20-50-3 through 50-6.~~

> Convertible Preferred Stock

~~505-10-50-12 The objective of the disclosure about convertible preferred stock is to provide users of financial statements with:~~

- ~~a. Information about the terms and features of convertible preferred stock~~
- ~~b. An understanding of how those instruments have been reported in an entity's statement of financial position and statement of financial performance~~
- ~~c. Information about events, conditions, and circumstances that can affect how to assess the amount or timing of an entity's future cash flows related to those instruments.~~

505-10-50-13 To comply with the general disclosure requirements of paragraph 505-10-50-3, an entity shall explain the pertinent rights and privileges of each outstanding instrument, including, but not limited to, the following information:

- a. Number of shares issued and par value
- b. Dividends
- c. Conversion or exercise prices or rates and number of shares into which the instrument is potentially convertible
- d. Pertinent dates, such as conversion date(s)
- e. Parties that control the conversion rights
- f. Manner of settlement upon conversion and any alternative settlement methods, such as cash, shares, or a combination of cash and shares
- g. Terms that may change conversion or exercise prices, number of shares to be issued, or other conversion rights and the timing of those rights (excluding standard antidilution provisions)
- h. Liquidation preference required by paragraph 505-10-50-4 and unusual voting rights
- i. Other material terms and features of the instrument that are not listed above.

505-10-50-14 An entity shall provide the following incremental information for **contingently convertible instruments** or the instruments that are described in paragraphs 505-10-05-6 through 05-7:

- a. Events or changes in circumstances that would adjust or change the contingency or would cause the contingency to be met
- b. Information on whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share (EPS) and the reasons why or why not
- c. Other information that is helpful in understanding both the nature of the contingencies and the potential impact of conversion.

505-10-50-15 An entity shall disclose the amount of dividends declared for each period for which a statement of financial performance is presented, in addition to the disclosures required by paragraph 505-10-50-5.

505-10-50-16 An entity shall disclose the following as of the date of the latest statement of financial position presented:

- a. Changes to conversion or exercise prices that occur during the reporting period other than changes due to standard antidilution provisions
- b. Events or changes in circumstances that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed
- c. The number of shares issued upon conversion, exercise, or satisfaction of required conditions during the reporting period.

505-10-50-17 If a conversion option is accounted for as a derivative in accordance with Subtopic 815-15, an entity shall provide disclosures in accordance with Topic 815 for the conversion option in addition to the disclosures required by the guidance in this Section, if applicable.

505-10-50-18 An entity shall disclose the following information about derivative transactions entered into in connection with the issuance of convertible preferred stock within the scope of this Subtopic regardless of whether such derivative transactions are accounted for as assets, liabilities, or equity instruments:

- a. The terms of those derivative transactions (including the terms of settlement)
- b. How those derivative transactions relate to the instruments within the scope of this Subtopic
- c. The number of shares underlying the derivative transactions
- d. The reasons for entering into those derivative transactions.

31. Supersede paragraph 505-10-60-2, with a link to transition paragraph 815-40-65-1, as follows:

Relationships

> Debt

~~**505-10-60-2** Paragraph superseded by Accounting Standards Update No. 2020-06. For guidance on the measurement and recognition as equity of beneficial conversion features of convertible debt and certain preferred stock, see Subtopic 470-20.~~

Amendments to Subtopic 718-10

32. Supersede paragraph 718-10-35-9A and amend paragraph 718-10-35-10, with a link to transition paragraph 815-40-65-1, as follows:

Compensation—Stock Compensation—Overall

Subsequent Measurement

> Awards May Become Subject to Other Guidance

~~**718-10-35-9A** Paragraph superseded by Accounting Standards Update No. 2020-06. A convertible instrument award granted to a nonemployee in exchange for goods or services to be used or consumed in a grantor's own operations is subject to recognition and measurement guidance in this Topic until the award is fully vested. Once vested, a convertible instrument award that is equity in form, or debt~~

~~in form, that can be converted into equity instruments of the grantor, shall follow recognition and measurement through reference to other applicable generally accepted accounting principles (GAAP), including Subtopic 470-20 on debt with conversion and other options.~~

718-10-35-10 A **freestanding financial instrument** or a convertible security issued to a grantee that is subject to initial recognition and measurement guidance within this Topic shall continue to be subject to the recognition and measurement provisions of this Topic throughout the life of the instrument, unless its terms are modified after any of the following:

- a. Subparagraph superseded by Accounting Standards Update No. 2019-08.
- b. Subparagraph superseded by Accounting Standards Update No. 2019-08.
- c. A grantee vests in the award and is no longer providing goods or services.
- d. A grantee vests in the award and is no longer a customer.
- e. A grantee is no longer an employee.

718-10-35-10A Only for purposes of paragraph 718-10-35-10, a **modification** does not include a change to the terms of an award if that change is made solely to reflect an **equity restructuring** provided that both of the following conditions are met:

- a. There is no increase in fair value of the award (or the ratio of **intrinsic value** to the exercise price of the award is preserved, that is, the holder is made whole) or the antidilution provision is not added to the terms of the award in contemplation of an equity restructuring.
- b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

Amendments to Subtopic 740-10

33. Supersede paragraph 740-10-55-51 and its related heading, with a link to transition paragraph 815-40-65-1, as follows:

Income Taxes—Overall

Implementation Guidance and Illustrations

> Implementation Guidance

> > Application of Accounting Requirements for Income Taxes to Specific Situations

>>> Examples of Temporary Differences

>>>> Beneficial Conversion Features

~~740-10-55-51 Paragraph superseded by Accounting Standards Update No. 2020-06. The issuance of convertible debt with a beneficial conversion feature results in a basis difference for purposes of applying this Topic. The recognition of a beneficial conversion feature effectively creates two separate instruments—a debt instrument and an equity instrument—for financial statement purposes while it is accounted for as a debt instrument, for example, under the U.S. Federal Income Tax Code. Consequently, the reported amount in the financial statements (book basis) of the debt instrument is different from the tax basis of the debt instrument. The basis difference that results from the issuance of convertible debt with a beneficial conversion feature is a temporary difference for purposes of applying this Topic because that difference will result in a taxable amount when the reported amount of the liability is recovered or settled. That is, the liability is presumed to be settled at its current carrying amount (reported amount). The recognition of deferred taxes for the temporary difference of the convertible debt with a beneficial conversion feature should be recorded as an adjustment to additional paid-in capital. Because the beneficial conversion feature (an allocation to additional paid-in capital) created the basis difference in the debt instrument, the provisions of paragraph 740-20-45-11(c) apply and therefore the establishment of the deferred tax liability for the basis difference should result in an adjustment to the related components of shareholders' equity.~~

Amendments to Subtopic 815-10

34. Amend paragraphs 815-10-15-74 and 815-10-15-77 through 15-78, with a link to transition paragraph 815-40-65-1, as follows:

Derivatives and Hedging—Overall

Scope and Scope Exceptions

> Instruments

>> Instruments Not within Scope

>>> Certain Contracts Involving an Entity's Own Equity

815-10-15-74 Notwithstanding the conditions of paragraphs 815-10-15-13 through 15-139, the reporting entity shall not consider the following contracts to be derivative instruments for purposes of this Subtopic:

- a. Contracts issued or held by that reporting entity that are both:

1. Indexed to its own stock (see Section 815-40-15)
 2. Classified in stockholders' equity in its statement of financial position (see Section 815-40-25).
- b. Contracts issued by the entity that are subject to Topic 718. If any such contract ceases to be subject to Topic 718 in accordance with paragraphs 718-10-35-9 through 35-14, the terms of that contract shall then be analyzed to determine whether the contract is subject to this Subtopic. An award that ceases to be subject to Topic 718 in accordance with those paragraphs shall be analyzed to determine whether it is subject to this Subtopic.
- c. Any of the following contracts:
1. A contract between an acquirer and a seller to enter into a business combination
 2. A contract to enter into an **acquisition by a not-for-profit entity**
 3. A contract between one or more NFPs to enter into a **merger of not-for-profit entities**.
- d. Forward contracts that require settlement by the reporting entity's delivery of cash in exchange for the acquisition of a fixed number of its equity shares (forward purchase contracts for the reporting entity's shares that require physical settlement) that are accounted for under paragraphs 480-10-30-3 through 30-5, 480-10-35-3, and 480-10-45-3.

815-10-15-77 For guidance on determining whether a freestanding financial instrument or embedded feature is not precluded from qualifying for the first part of the scope exception in paragraph 815-10-15-74(a), see the guidance beginning in paragraph 815-40-15-5. For guidance on determining whether a freestanding financial instrument or embedded feature qualifies for the second part of the scope exception in paragraph 815-10-15-74(a), see the guidance beginning in paragraph 815-40-25-1.

815-10-15-78 Paragraph 815-40-25-39 explains that, for purposes of evaluating under this Subtopic whether an embedded derivative indexed to an entity's own stock would be classified in stockholders' equity if freestanding, the additional considerations necessary for equity classifications beginning in paragraph 815-40-25-7 do not apply if the hybrid contract is a ~~conventional~~ convertible debt instrument in which the holder may only realize the value of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of shares or the equivalent amount of cash (at the discretion of the issuer).

35. Amend paragraph 815-10-50-8A and its related heading and add paragraph 815-10-50-8B, with a link to transition paragraph 815-40-65-1, as follows:

Disclosure

> ~~Contingently~~ Convertible Securities

815-10-50-8A For guidance on disclosures of information about derivative instrument transactions entered into in connection with the issuance of the ~~contingently~~ convertible securities, see paragraph 470-20-50-11 for convertible debt instruments and paragraph 505-10-50-18 for convertible preferred stock 505-10-50-10.

815-10-50-8B The disclosure guidance on convertible debt instruments in Section 470-20-50 and on convertible preferred stock in Section 505-10-50 also shall be considered after considering the disclosure guidance in this Section for a conversion option accounted for as a derivative instrument.

Amendments to Subtopic 815-15

36. Amend paragraphs 815-15-25-14 through 25-15, with a link to transition paragraph 815-40-65-1, as follows:

Derivatives and Hedging—Embedded Derivatives

Recognition

> Applying the Separate Instrument Criterion

815-15-25-14 The criterion in paragraph 815-15-25-1(c) is not met if the separate instrument with the same terms as the embedded derivative would be classified as a liability (or an asset in some circumstances) under the provisions of Topic 480 but would be classified in stockholders' equity absent the provisions in that Topic. For purposes of analyzing the application of paragraph 815-10-15-74(a) to an embedded derivative as though it were a separate instrument, paragraphs 480-10-25-4 through 25-14 shall be disregarded. Those embedded features are analyzed by applying other applicable guidance (such as the guidance in Subtopic 815-40 on contracts in entity's own equity).

815-15-25-15 Paragraph 815-40-25-39 states that, for purposes of evaluating under paragraph 815-15-25-1 whether an embedded derivative indexed to an entity's own stock would be classified in stockholders' equity if freestanding, the additional considerations necessary for equity classification beginning in paragraph 815-40-25-7 do not apply if the hybrid contract is a ~~conventional~~ convertible debt instrument (see paragraph 815-40-25-41) in which the holder may only realize the value of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of shares or the equivalent amount of cash (at the discretion of the issuer). However, paragraph 815-40-25-40 states that those additional considerations do apply when an issuer is evaluating whether

any embedded derivative other than those discussed in paragraph 815-40-25-39 is an equity instrument and thereby excluded from the scope of this Subtopic.

37. Amend paragraph 815-15-55-76A and its related heading and paragraphs 815-15-55-218 through 55-219 and add paragraph 815-15-55-76B, with a link to transition paragraph 815-40-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Certain Convertible ~~Debt Instruments~~ Securities

815-15-55-76A The following steps specify how an issuer shall apply the guidance on accounting for embedded derivatives in this Subtopic to a convertible debt instrument within the scope of ~~the Cash Conversion Subsections of Subtopic 470-20.~~

- a. Step 1. Identify embedded features, including other than the embedded conversion option that must be evaluated under Subtopic 815-15.
- b. Step 2. Apply the guidance in Subtopic 815-15 to determine whether any of the embedded features identified in Step 1 must be separately accounted for as derivative instruments. ~~Paragraph 470-20-15-4 states that the guidance for a convertible debt instrument within the scope of the Cash Conversion Subsections of Subtopic 470-20 does not affect an issuer's determination of whether an embedded feature shall be separately accounted for as a derivative instrument.~~
- c. Step 3. Apply the guidance in Subtopic 470-20 ~~paragraph 470-20-25-23~~ to account for the convertible debt instrument (including the embedded conversion option and any other embedded features, which are not separately accounted for as a derivative instrument in Step 2) as a liability ~~separate the liability component (including any embedded features other than the conversion option) from the equity component.~~
- d. Step 4. If one or more embedded features are required to be separately accounted for as a derivative instrument based on the analysis performed in Step 2, that embedded derivative shall be separated from the host contract liability component ~~in accordance with the guidance in this Subtopic. Separation of an embedded derivative from the liability component would not affect the accounting for the equity component.~~

815-15-55-76B An issuer should follow steps similar to those in paragraph 815-15-55-76A to apply the accounting guidance for embedded derivatives in this Subtopic to convertible preferred stock within the scope of Subtopic 505-10, except that in Step 3 the convertible preferred stock (including the conversion option and any other embedded features, which are not separately accounted for as a

derivative instrument in Step 2) should be accounted for as equity in accordance with Subtopic 505-10.

> Illustrations

> > Example 13: Applying the Bifurcation Criteria

> > > Case U: Convertible Debt Instrument

815-15-55-217 In a convertible debt instrument, an investor receives a below-market interest rate and receives the option to convert its debt instrument into the equity of the issuer at an established conversion rate. The terms of the conversion require that the issuer deliver shares of stock to the investor.

815-15-55-218 This instrument essentially contains a call option on the issuer's stock. Under the provisions of this Subtopic, the accounting by the issuer and investor can differ. The issuer's accounting depends on whether a separate instrument with the same terms as the embedded written option would be a derivative instrument pursuant to Section 815-10-15. ~~Because~~ Assuming the option is indexed to the issuer's own stock and a separate instrument with the same terms would be classified in stockholders' equity in the statement of financial position, the written option is not considered to be a derivative instrument for the issuer under paragraph 815-10-15-74(a) and should not be separated from the host contract.

815-15-55-219 In contrast, if the terms of the conversion allow for a cash settlement rather than delivery of the issuer's shares at the investor's option, the exception in paragraph 815-10-15-74(a) for the issuer does not apply because the contract would not be classified in stockholders' equity in the issuer's statement of financial position. In that circumstance, the issuer should separate the embedded derivative from the host contract and account for it pursuant to the provisions of this Subtopic because both of the following conditions exist:

- a. An option based on the entity's stock price is not clearly and closely related to an interest-bearing debt instrument.
- b. The option would not be considered an equity instrument of the issuer (see paragraph 815-40-25-4(a)(2)).

815-15-55-220 Similarly, if the convertible debt is indexed to another entity's publicly traded common stock, the issuer should separate the embedded derivative from the host contract and account for it pursuant to the provisions of this Subtopic because both of the following conditions exist:

- a. An option based on another entity's stock price is not clearly and closely related to an investment in an interest-bearing note.
- b. The option would not be considered an equity instrument of the issuer.

815-15-55-221 The exception in paragraph 815-10-15-74 does not apply to the investor's accounting. Therefore, in both circumstances described, the investor should separate the embedded option contract from the host contract and account for the embedded option contract pursuant to the provisions of this Subtopic because the option contract is based on the price of another entity's equity instrument and thus is not clearly and closely related to an investment in an interest-bearing note. However, if the terms of conversion do not allow for a cash settlement and if the common stock delivered upon conversion is privately held (that is, is not readily convertible to cash), the embedded derivative would not be separated from the host contract because it would not meet the criteria for net settlement as discussed beginning in paragraph 815-10-15-99.

Amendments to Subtopic 815-40

38. Amend paragraphs 815-40-15-2 through 15-5 and the related heading, 815-40-15-7C through 15-7D, and 815-40-15-8A and add paragraph 815-40-15-2A and the heading preceding paragraph 815-40-15-8, with a link to transition paragraph 815-40-65-1, as follows:

Derivatives and Hedging—Contracts in Entity's Own Equity

Scope and Scope Exceptions

> Instruments

815-40-15-2 The guidance in this Subtopic applies to ~~freestanding contracts~~ **{add glossary link}**freestanding contracts**{add glossary link}** that are potentially indexed to, and potentially settled in, an entity's own stock. ~~Paragraph 815-40-55-1 provides related implementation guidance.~~

815-40-15-2A The scope of this Subtopic includes security price guarantees or other **financial instruments** indexed to, or otherwise based on, the price of the entity's stock that are issued in connection with a business combination and that are accounted for as contingent consideration.

- ~~a. Subparagraph superseded by Accounting Standards Update No. 2018-07~~
- ~~b. Subparagraph superseded by Accounting Standards Update No. 2018-07~~ **[Content amended as shown and moved from paragraph 815-40-55-1]**

815-40-15-3 The guidance in this Subtopic does not apply to any of the following:

- a. Subparagraph superseded by Accounting Standards Update No. 2020-06. Either the ~~derivative instrument~~ component or the ~~financial instrument~~ if the derivative instrument component is embedded in and not detachable from the financial instrument
- b. Contracts that are issued to compensate grantees in a **share-based payment arrangement** within the scope of Topic 718
- c. Subparagraph superseded by Accounting Standards Update No. 2018-07
- d. A written put option and a purchased call option embedded in the shares of a noncontrolling interest of a consolidated subsidiary if the arrangement is accounted for as a financing under the guidance beginning in paragraph 480-10-55-53
- e. Financial instruments that are within the scope of Topic 480 (see paragraph 815-40-15-12).

815-40-15-4 ~~Item (a) in the preceding paragraph does not negate the applicability of this Subtopic (as further discussed in paragraphs 815-40-25-39 through 25-40). The guidance in this Subtopic applies to derivatives embedded in contracts in analyzing the embedded feature under paragraphs 815-15-25-1(c) and 815-15-25-14 as though it were a freestanding instrument (as further discussed in paragraphs 815-40-25-39 through 25-40).~~

> **Evaluating Whether an Instrument or Embedded Feature Is Considered Indexed to an Entity's Own Stock**

815-40-15-5 The guidance in this paragraph through paragraph 815-40-15-8 applies to any **{add glossary link}**freestanding financial instrument**{add glossary link}** or embedded feature that has all the characteristics of a **{add glossary link}**derivative instrument**{add glossary link}** (see the guidance beginning in paragraph 815-10-15-83). That guidance applies for the purpose of determining whether that instrument or embedded feature qualifies for the first part of the scope exception in paragraph 815-10-15-74(a). That guidance does not address the second part of the scope exception in paragraph 815-10-15-74(a), which is addressed in Section 815-40-25. The guidance also applies to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative instrument for purposes of determining whether the instrument is within the scope of this Subtopic.

> > **Evaluation of Settlement Provisions (Step 2)**

815-40-15-7C Unless paragraph 815-40-15-7A precludes it, an An instrument (or embedded feature) shall be considered indexed to an entity's own stock if its settlement amount will equal the difference between the following:

- a. The fair value of a fixed number of the entity's equity shares

- b. A fixed monetary amount or a fixed amount of a debt instrument issued by the entity.

For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond issued by the entity shall be considered indexed to the entity's own stock.

815-40-15-7D An instrument's strike price or the number of shares used to calculate the settlement amount are not fixed if its terms provide for any potential adjustment, regardless of the probability of such adjustment(s) or whether such adjustments are in the entity's control. If the instrument's strike price or the number of shares used to calculate the settlement amount are not fixed, the instrument (or embedded feature) shall still be considered indexed to an entity's own stock if the only variables that could affect the settlement amount would be inputs to the fair value of a fixed-for-fixed forward or option on equity shares (provided that paragraph 815-40-15-7A does not preclude such a conclusion).

> > Illustrative Examples

815-40-15-8 Examples 2–21 (see paragraphs 815-40-55-26 through 55-48) illustrate the application of the guidance in paragraphs 815-40-15-5 through 15-7. These examples do not address whether an instrument (or embedded feature) is classified in equity (or would be classified in equity if freestanding). These examples also do not address whether the instrument is within the scope of Topic 480 or whether the instrument would be subject to the two-class method under Topic 260.

> > Instruments Classified as Liabilities or Assets

815-40-15-8A If the instrument does not meet the criteria to be considered indexed to an entity's own stock as described in paragraphs 815-40-15-5 through 15-8, it shall be classified as a liability or an asset. See paragraph 815-40-35-4 for subsequent measurement guidance for those instruments. See paragraph 815-40-15-9 for guidance on the interaction with this Subtopic and Subtopics 815-10 and 815-15 for derivative instruments and embedded derivatives.

39. Amend paragraphs 815-40-25-1, 815-40-25-3 through 25-4, 815-40-25-6, 815-40-25-10, 815-40-25-18 and its related heading, and paragraphs 815-40-25-39 through 25-41 and their related heading, add paragraph 815-40-25-10A, and supersede paragraphs 815-40-25-11 through 25-17 and their related heading, and 815-40-25-31 through 25-35 and their related headings, with a link to transition paragraph 815-40-65-1, as follows:

Recognition

815-40-25-1 The guidance in this Section applies for the purpose of determining whether an instrument or embedded feature qualifies for the second part of the scope exception in paragraph 815-10-15-74(a). The first part of the scope exception in paragraph 815-10-15-74(a) is addressed in Section 815-40-15. The initial balance sheet classification of contracts within the scope of this Subtopic generally is based on the concept that:

- a. Contracts that require **net cash settlement** are assets or liabilities.
- b. Contracts that require settlement in shares are equity instruments.

815-40-25-2 Further, an entity shall observe both of the following:

- a. If the contract provides the counterparty with a choice of net cash settlement or settlement in shares, this Subtopic assumes net cash settlement.
- b. If the contract provides the entity with a choice of net cash settlement or settlement in shares, this Subtopic assumes settlement in shares.

815-40-25-3 Except as noted in the last sentence of this paragraph, the approach discussed in ~~the preceding two paragraphs 815-40-25-1 through 25-2~~ does not apply if settlement alternatives do not have the same economic value attached to them or if one of the settlement alternatives is fixed or contains caps or floors. In those situations, the accounting for the instrument (or combination of instruments) shall be based on the economic substance of the **transaction**. For example, if a **freestanding contract**, issued together with another instrument, requires that the entity provide to the holder a fixed or guaranteed return such that the instruments are, in substance, debt, the entity shall account for both instruments as liabilities, regardless of the settlement terms of the freestanding contract. However, ~~this Subtopic~~ the approach discussed in paragraphs 815-40-25-1 through 25-2 does apply to contracts that have settlement alternatives with different economic values if the reason for the difference is a limit on the number of shares that must be delivered by the entity pursuant to a **net share settlement** alternative.

815-40-25-4 Accordingly, unless the economic substance indicates otherwise:

- a. Contracts shall be initially classified as either assets or liabilities in both of the following situations:
 - 1. Contracts that require net cash settlement (including a requirement to net cash settle the contract if an event occurs and if that event is outside the control of the entity)
 - 2. Contracts that give the counterparty a choice of net cash settlement or settlement in shares (**physical settlement** or net share settlement).
- b. Contracts shall be initially classified as equity in both of the following situations:
 - 1. Contracts that require physical settlement or net share settlement

2. Contracts that give the entity a choice of net cash settlement or settlement in its own shares (physical settlement or net share settlement), assuming that all the criteria set forth in paragraphs 815-40-25-7 through ~~25-30~~ ~~25-35~~ and 815-40-55-2 through 55-6 have been met.

815-40-25-6 The remainder of this Section addresses the following matters:

- a. Additional conditions necessary for equity classification
- b. Settlement alternatives that differ in gain and loss positions
- c. Application of additional criteria to ~~conventional~~ convertible debt and other hybrid instruments
- d. Effect of a **registration payment arrangement**.

> Additional Conditions Necessary for Equity Classification

815-40-25-7 Contracts that include any provision that could require net cash settlement cannot be accounted for as equity of the entity (that is, asset or liability classification is required for those contracts), except in those limited circumstances in which holders of the underlying shares also would receive cash (as discussed in the following two paragraphs and paragraphs 815-40-55-2 through 55-6).

815-40-25-8 Generally, if an event that is not within the entity's control could require net cash settlement, then the contract shall be classified as an asset or a liability. However, if the net cash settlement requirement can only be triggered in circumstances in which the holders of the shares underlying the contract also would receive cash, equity classification is not precluded.

815-40-25-9 This Subtopic does not allow for an evaluation of the likelihood that an event would trigger cash settlement (whether net cash or physical), except that if the payment of cash is only required upon the final liquidation of the entity, then that potential outcome need not be considered when applying the guidance in this Subtopic.

815-40-25-10 Because any contract provision that could require net cash settlement precludes accounting for a contract as equity of the entity (except for those circumstances in which the holders of the underlying shares would receive cash, as discussed in ~~the preceding two paragraphs 815-40-25-8 through 25-9~~ and paragraphs 815-40-55-2 through 55-6), all of the following conditions must be met for a contract to be classified as equity:

- a. ~~Subparagraph superseded by Accounting Standards Update No. 2020-06. Settlement permitted in unregistered shares. The contract permits the entity to settle in unregistered shares.~~
- b. Entity has sufficient authorized and unissued shares. The entity has sufficient authorized and unissued shares available to settle the contract

- after considering all other commitments that may require the issuance of stock during the maximum period the derivative instrument could remain outstanding.
- c. Contract contains an explicit share limit. The contract contains an explicit limit on the number of shares to be delivered in a share settlement.
 - d. No required cash payment (with the exception of penalty payments) if entity fails to timely file. ~~There are no required cash payments to the counterparty~~ is no requirement to net cash settle the contract in the event the entity fails to make timely filings with the Securities and Exchange Commission (SEC).
 - e. No cash-settled **top-off or make-whole provisions**. There are no cash settled top-off or make-whole provisions.
 - f. Subparagraph superseded by Accounting Standards Update No. 2020-06. No counterparty rights rank higher than shareholder rights. There are no provisions in the contract that indicate that the counterparty has rights that rank higher than those of a shareholder of the stock underlying the contract.
 - g. Subparagraph superseded by Accounting Standards Update No. 2020-06. No collateral required. There is no requirement in the contract to post collateral at any point or for any reason.

Paragraphs 815-40-25-39 through 25-42 explain the application of these criteria to ~~conventional~~ convertible debt and other hybrid instruments.

815-40-25-10A The following conditions are not required to be considered in an entity's evaluation of net cash settlement (that is, if any one of these provisions is in a contract [or the contract is silent on these points], they should not preclude equity classification, except as described below):

- a. Whether settlement is required in registered shares, unless the contract explicitly states that an entity must settle in cash if registered shares are unavailable. Requirements to deliver registered shares do not, by themselves, imply that an entity does not have the ability to deliver shares and, thus, do not require a contract that otherwise qualifies as equity to be classified as a liability.
- b. Whether counterparty rights rank higher than shareholder rights. If the provisions of the contract indicate that the counterparty has rights that rank higher than the rights of a shareholder of the stock underlying the contract, this provision does not preclude equity classification.
- c. Whether collateral is required. A provision requiring the entity to post collateral at any time for any reason does not preclude equity classification.

>> Settlement Permitted in Unregistered Shares

815-40-25-11 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~The events or actions necessary to deliver registered shares are not controlled by an entity and, therefore, except under the circumstances described in paragraph 815-40-25-16, if the contract permits the entity to net share or physically settle the contract only by delivering registered shares, it is assumed that the entity will be required to net cash settle the contract. As a result, the contract shall be classified as an asset or a liability.~~

815-40-25-12 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~Delivery of unregistered shares in a private placement to the counterparty is within the control of an entity, as long as a failed registration statement (that is, a registration statement that was filed with the SEC and subsequently withdrawn) has not occurred within six months before the classification assessment date. If a failed registration statement has occurred within six months of the classification assessment date, whether an entity can deliver unregistered shares to the counterparty in a net share or physical settlement is a legal determination.~~

815-40-25-13 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~Accordingly, the contract shall be classified as a permanent equity instrument assuming all of the following conditions exist:~~

- ~~a. A failed registration statement does not preclude delivery of unregistered shares.~~
- ~~b. The contract permits an entity to net share settle the contract by delivery of unregistered shares.~~
- ~~c. The other conditions in this Subtopic are met.~~

815-40-25-14 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~If both the following conditions are met, then net cash settlement is assumed if the entity is unable to deliver registered shares (because it is unlikely that nonperformance would be an acceptable alternative):~~

- ~~a. A derivative instrument requires physical or net share settlement by delivery of registered shares and does not specify any circumstances under which net cash settlement would be permitted or required.~~
- ~~b. The derivative instrument does not specify how the contract would be settled in the event that the entity is unable to deliver registered shares.~~

815-40-25-15 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~Consequently, the derivative instrument shall be classified as an asset or a liability because share settlement is not within the entity's control.~~

815-40-25-16 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~If a derivative instrument involves the delivery of shares at settlement that are registered as of the inception of the derivative instrument and there are no further timely filing or registration requirements, the requirement that share delivery be~~

within the control of the entity is met, notwithstanding the guidance in paragraph 815-40-25-11.

>>> Valuation of Unregistered Shares

815-40-25-17 Paragraph superseded by Accounting Standards Update No. 2020-06. A contract may specify that the value of the unregistered shares to be privately placed under share settlement is to be determined by the counterparty using commercially reasonable means. That valuation is used to determine the number of unregistered shares that must be delivered to the counterparty. The term *commercially reasonable means* is sufficiently objective from a legal perspective to prevent a counterparty from producing an unrealistic value that would then compel an entity to net cash settle the contract. Similarly, a contractual requirement to determine the **fair value** of unregistered shares by obtaining market quotations is sufficiently objective and would not suggest that the settlement alternatives have different economic values.

>>> >> Uneconomic Settlement Alternatives

815-40-25-18 If a settlement alternative includes a penalty that would be avoided by an entity under other settlement alternatives, the uneconomic settlement alternative shall be disregarded in classifying the contract. ~~In the case of delivery of unregistered shares, a discount from the fair value of the corresponding registered shares that is a reasonable estimate of the difference in fair values between registered and unregistered shares (that is, the discount reflects the fair value of the restricted shares determined using commercially reasonable means) is not considered a penalty.~~

>> No Counterparty Rights Rank Higher than Shareholder Rights

815-40-25-31 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~To be classified as equity, a contract cannot give the counterparty any of the rights of a creditor in the event of the entity's bankruptcy. Because a breach of the contract by the entity is within its control, the fact that the counterparty would have normal contract remedies in the event of such a breach does not preclude equity classification. As a result, a contract cannot be classified as equity if the counterparty's claim in bankruptcy would receive higher priority than the claims of the holders of the stock underlying the contract.~~

815-40-25-32 Paragraph superseded by Accounting Standards Update No. 2020-06. Generally, based on existing law, a net share settled derivative instrument that an entity has a right to settle in shares even upon termination could be net share settled in bankruptcy. If the derivative instrument is not net share settled, the claim of the counterparty would not have priority over those of the holders of the underlying stock, even if the contract specified cash settlement in the event of

bankruptcy. In federal bankruptcy proceedings, a debtor cannot be compelled to affirm an existing contract that would require it to pay cash to acquire its shares (which could be the case, for example, with a physically settled forward purchase or written put). As a result, even if the contract requires that the entity (debtor) pay cash to settle the contract, the entity could not be required to do so in bankruptcy. Because of the complexity of federal bankruptcy law and related case law, and because of the differences in state laws affecting derivative instruments, it is not possible to address all of the legal issues associated with the status of the contract and the claims of the counterparty in the event of bankruptcy.

~~815-40-25-33 Paragraph superseded by Accounting Standards Update No. 2020-06. A contract provision requiring net cash settlement in the event of bankruptcy does not preclude equity classification if it can be demonstrated that, notwithstanding the contract provisions, the counterparty's claims in bankruptcy proceedings in respect of the entity could be net share settled or would rank no higher than the claims of the holders of the stock underlying the contract.~~

~~815-40-25-34 Paragraph superseded by Accounting Standards Update No. 2020-06. Determination of the status of a claim in bankruptcy is a legal determination.~~

>> No Collateral Required

~~815-40-25-35 Paragraph superseded by Accounting Standards Update No. 2020-06. A requirement to post collateral of any kind (other than the entity's shares underlying the contract, but limited to the maximum number of shares that could be delivered under the contract) under any circumstances is inconsistent with the concept of equity and, therefore, precludes equity classification of the contract.~~

> Application of Additional Criteria to ~~Conventional~~ Convertible Debt Instruments and Other Hybrid Instruments

~~815-40-25-39~~ For purposes of evaluating under paragraph 815-15-25-1 whether an **embedded derivative** indexed to an entity's own stock would be classified in stockholders' equity if freestanding, the requirements of paragraphs 815-40-25-7 through ~~25-35~~ 25-30 and 815-40-55-2 through 55-6 do not apply if the hybrid contract is a ~~conventional~~ convertible debt instrument in which the holder may only realize the value of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of shares or the equivalent amount of cash (at the discretion of the issuer).

~~815-40-25-40~~ However, the requirements of paragraphs 815-40-25-7 through ~~25-35~~ 25-30 and 815-40-55-2 through 55-6 do apply if an issuer is evaluating whether any other embedded derivative is an equity instrument and thereby excluded from the scope of Subtopic 815-10.

815-40-25-41 Instruments that provide the holder with an option to convert into a fixed number of shares (or equivalent amount of cash at the discretion of the issuer) for which the ability to exercise the option is based on the passage of time or a contingent event shall ~~be considered conventional for purposes of applying this Subtopic.~~ qualify for the exceptions included in paragraph 815-40-25-39. **Standard antidilution provisions** contained in an instrument do not preclude a conclusion that the instrument is convertible into a fixed number of shares.

40. Amend paragraphs 815-40-35-1, 815-40-35-4, and 815-40-35-8 through 35-10, with a link to transition paragraph 815-40-65-1, as follows:

Subsequent Measurement

> Overall

815-40-35-1 All contracts shall be subsequently accounted for based on the current classification and the assumed or required settlement method in Section 815-40-15 or Section 815-40-25 as follows.

> > Assets or Liabilities

815-40-35-4 All other contracts classified as assets or liabilities under Section 815-40-25 or paragraph 815-40-15-8A shall be measured subsequently at fair value, with changes in fair value reported in earnings and disclosed in the financial statements as long as the contracts remain classified as assets or liabilities.

> Reclassification of Contracts

815-40-35-8 The classification of a contract (including freestanding financial instruments and embedded features) shall be reassessed at each balance sheet date. If the classification required under this Subtopic changes as a result of events during the period (if, for example, as a result of voluntary issuances of stock the number of authorized but unissued shares is insufficient to satisfy the maximum number of shares that could be required to net share settle the contract [see discussion in paragraph 815-40-25-20]), the contract shall be reclassified as of the date of the event that caused the reclassification. There is no limit on the number of times a contract may be reclassified.

815-40-35-9 If a contract is reclassified from permanent or temporary equity to an asset or a liability, the change in fair value of the contract during the period the contract was classified as equity shall be accounted for as an adjustment to stockholders' equity. The contract subsequently shall be marked to fair value through earnings. If an embedded feature no longer qualifies for the derivatives scope exception under this Subtopic, the feature shall be separated from its host contract and accounted for as a derivative instrument in accordance with

Subtopic 815-10 and Subtopic 815-15 (if all of the criteria in paragraph 815-15-25-1 are met).

815-40-35-10 If a contract is reclassified from an asset or a liability to equity, gains or losses recorded to account for the contract at fair value during the period that the contract was classified as an asset or a liability shall not be reversed. The contract shall be marked to fair value immediately before the reclassification. An embedded derivative that qualifies for the derivatives scope exception upon reassessment under this Subtopic that was separated from its host contract and accounted for as a derivative instrument in accordance with Subtopic 815-10 shall be reclassified to equity. The previously bifurcated embedded derivative shall not be recombined with its host contract.

41. Supersede paragraph 815-40-50-1, add paragraphs 815-40-50-1A and 815-40-50-2A and its related heading, and amend paragraphs 815-40-50-2 and 815-40-50-5, with a link to transition paragraph 815-40-65-1, as follows:

Disclosure

815-40-50-1 Paragraph superseded by Accounting Standards Update No. 2020-06. ~~Changes in the fair value of all contracts classified as assets or liabilities shall be disclosed in the financial statements as long as the contracts remain classified as assets or liabilities. [Content moved to paragraph 815-40-50-2A]~~

815-40-50-1A The disclosure guidance in this Section should help a user of financial statements understand the following:

- a. Information about the terms and features of contracts in an entity's own equity within the scope of this Subtopic
- b. How those instruments have been reflected in the issuer's statement of financial position and statement of financial performance
- c. Information about events, conditions, and circumstances that can affect how to assess the amount or timing of an entity's future cash flows but has not yet been reflected in the financial statements.

815-40-50-2 The disclosure guidance in this Subtopic applies to freestanding instruments that are potentially indexed to, and potentially settled in, an entity's own equity, regardless of whether the contract meets the criteria to qualify for the scope exception in Sections 815-40-15 and 815-40-25. Some contracts that are classified as assets or liabilities meet the definition of a derivative instrument under the provisions of Subtopic 815-10. The related disclosures that are required by Sections 815-10-50, 815-25-50, 815-30-50, and 815-35-50 also are required for those contracts. Equity-classified contracts under the provisions of this Subtopic are not required to provide the disclosures required by Section 505-10-50, other than those described in paragraph 815-40-50-5.

> Fair Value Disclosures

815-40-50-2A Changes in the **fair value** of all contracts classified as assets or liabilities shall be disclosed in the financial statements as long as the contracts remain classified as assets or liabilities. **[Content moved from paragraph 815-40-50-1]**

> Reclassifications and Related Accounting Policy Disclosures

815-40-50-3 Contracts within the scope of this Subtopic may be required to be reclassified into (or out of) equity during the life of the instrument (in whole or in part) pursuant to the provisions of paragraphs 815-40-35-8 through 35-13. An issuer shall disclose contract reclassifications (including partial reclassifications), the reason for the reclassification, and the effect on the issuer's financial statements.

> Interaction with Disclosures about Capital Structure

815-40-50-5 The disclosures required by Section 505-10-50 apply to all contracts within the scope of this Subtopic as follows:

- a. In the case of an option or forward contract indexed to the issuer's equity, the pertinent information to be disclosed under Section 505-10-50 about the contract includes all of the following:
 1. The forward rate
 2. The option strike price
 3. The number of issuer's shares to which the contract is indexed
 4. The settlement date or dates of the contract
 5. The issuer's accounting for the contract (that is, as an asset, liability, or equity).
- b. If the terms of the contract provide settlement alternatives, those settlement alternatives shall be disclosed under Section 505-10-50, including ~~both~~ all of the following:
 1. Who controls the settlement alternatives and a description of those alternatives
 2. The maximum number of shares that could be required to be issued to net share settle a contract, if applicable. Paragraph 505-10-50-3 requires additional disclosures for actual issuances and settlements that occurred during the accounting period.
- c. If a contract does not have a fixed or determinable maximum number of shares that may be required to be issued, the fact that a potentially infinite number of shares could be required to be issued to settle the contract shall be disclosed under Section 505-10-50.
- d. For each settlement alternative, the amount that would be paid, or the number of shares that would be issued and their fair value, determined under the conditions specified in the contract if the settlement were to

~~occur at the reporting date. A contract's current fair value for each settlement alternative (denominated, as relevant, in monetary amounts or quantities of shares) and how changes in the fair value price of the issuer's equity shares instruments affect those settlement amounts (for example, the issuer is obligated to issue an additional X shares or pay an additional Y dollars in cash for each \$1 decrease in the fair value of one share stock price) shall be disclosed under Section 505-10-50. (For some issuers, a tabular format may provide the most concise and informative presentation of these data.)~~

- e. The disclosures required by paragraph 505-10-50-11 shall be made for any equity instrument in the scope of this Subtopic that is (or would be if the issuer were a public entity) classified as temporary equity. (That paragraph applies to redeemable stock issued by nonpublic entities, regardless of whether the private entity chooses to classify those securities as temporary equity.)
- f. The disclosures required by paragraph 505-10-50-18 also shall be made for an equity-classified contract within the scope of this Subtopic that is entered into in connection with the issuance of convertible preferred stock.

42. Supersede paragraph 815-40-55-1 and its related heading and paragraphs 815-40-55-8 through 55-12 and their related heading, amend paragraphs 815-40-55-7 and 815-40-55-13, and add paragraph 815-40-55-25A, with a link to transition paragraph 815-40-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

>> Scope Application

~~815-40-55-1 Paragraph superseded by Accounting Standards Update No. 2020-06. The scope of this Subtopic includes security price guarantees or other financial instruments indexed to, or otherwise based on, the price of the entity's stock that are issued in connection with a business combination and that are accounted for as contingent consideration.~~

- a. ~~Subparagraph superseded by Accounting Standards Update No. 2018-07~~
- b. ~~Subparagraph superseded by Accounting Standards Update No. 2018-07 [Content moved to paragraph 815-40-15-2A]~~

>> Additional Conditions for Equity Classification—Net Cash Settlement and Consideration to Holders of Underlying Shares

815-40-55-2 An event that causes a change in control of an entity is not within the entity's control and, therefore, if a contract requires **net cash settlement** upon a change in control, the contract generally must be classified as an asset or a liability.

> > Application of This Subtopic to Specific Instruments

815-40-55-7 The following guidance reflects the application of this Subtopic to certain freestanding derivative financial instruments that are indexed to, and potentially settled in, an entity's own stock, specifically:

- a. ~~Subparagraph superseded by Accounting Standards Update No. 2020-06. Embedded written put options and forward purchase contracts~~
- b. Forward sale contracts, written call options or warrants, and purchased put options
- c. Purchased call options
- d. Detachable stock purchase warrants
- e. Put warrants.

>>> Embedded Written Put Options and Forward Purchase Contracts

815-40-55-8 ~~Paragraph superseded by Accounting Standards Update No. 2020-06. Paragraph 815-40-15-3(e) explains that financial instruments that are within the scope of Topic 480 are not subject to any of the provisions of this Subtopic. See paragraph 480-10-55-63 for a table for freestanding written put options and forward purchase contracts that are accounted for under Topic 480. The guidance that follows applies to embedded derivatives analyzed under paragraph 815-15-25-4(c).~~

815-40-55-9 ~~Paragraph superseded by Accounting Standards Update No. 2020-06. The entity (the buyer) agrees to buy from the seller shares at a specified price at some future date. The contract may be settled by **physical settlement, net share settlement**, or net cash settlement, or the issuing entity or the counterparty may have a choice of settlement methods. Application of this Subtopic to purchased call options is discussed in paragraph 815-40-55-14.~~

815-40-55-10 ~~Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in the following table includes shareholder rights (sometimes referred to as SHARP rights) issued by the entity to shareholders that give the shareholders the right to put a specified number of common shares to the entity for cash.~~

815-40-55-11 ~~Paragraph superseded by Accounting Standards Update No. 2020-06. The guidance in this Subtopic would be applied as follows.~~

	One Settlement Method			Entity Choice			Counterparty Choice		
	Physical ^(a)	Net Share	Net Cash	Net Share or Physical ^(a)	Net Share or Net Cash	Net Cash or Physical ^(a)	Net Share or Physical ^(a)	Net Share or Net Cash	Net Cash or Physical ^(a)
(1) Initial Classification:									
Equity ^(b)	x	x		x	x	x	x		
Asset or Liability			x					x	x
(2) Initial Measurement, Subsequent Classification and Measurement:									
Fair value, permanent equity—no changes in fair value ^(c)		x		x ^(d)	x ^(d)				
Fair value, transfer to temporary equity—amount equal to cash redemption amount ^{(e)(f)(g)}	x					x ^(h)	x ^(h)		
Fair value, asset or liability—adjusted for changes in fair value ⁽ⁱ⁾			x				x ^(a)	x ^(a)	

- (a) Physical settlement of the contract requires that the entity deliver cash to the holder in exchange for the shares.
- (b) Equity or temporary equity classification is only appropriate if the conditions in Section 815-40-25 do not require asset or liability classification of the contract.
- (c) If the contracts are ultimately physically settled by the entity, requiring that the entity deliver cash, or are ultimately settled in net cash, the amount of cash paid or received should be reported as a reduction of, or as an addition to, contributed capital.
- (d) Classification and measurement guidance within temporary equity applies only to public entities.
- (e) If the contracts are ultimately settled in net cash or net shares, the amount reported in temporary equity should be transferred and reported as an addition to permanent equity.
- (f) Subsequent changes in fair value should be reported in earnings and disclosed in the financial statements.
- (g) If the contracts are ultimately settled in shares, any gains or losses on those contracts should continue to be included in earnings.

Note: In all cases above, the contracts must be reassessed at each reporting period in order to determine whether or not the contract must be reclassified.

815-40-55-12 Paragraph superseded by Accounting Standards Update No. 2020-06. See paragraph 480-10-55-63 for a table for freestanding written put options and forward purchase contracts that are accounted for under Topic 480. This table applies to ~~embedded derivatives~~ analyzed under paragraph 815-15-25-1(c).

>>> Forward Sale Contracts, Written Call Options or Warrants, and Purchased Put Options

815-40-55-13 The issuing entity (the seller) agrees to sell shares of its stock to the buyer of the contract at a specified price at some future date. The contract may be settled by {add glossary link}physical settlement{add glossary link}, {add glossary link}net share settlement{add glossary link}, or net cash settlement, or the issuing entity or counterparty may have a choice of settlement methods. The guidance in this Subtopic would be applied as follows.

[The table is not shown here because it is unchanged.]

> Illustrations

815-40-55-25A The Examples in paragraphs 815-40-55-26 through 55-48 illustrate the application of the guidance beginning in paragraph 815-40-15-5.

43. Add paragraph 815-40-65-1 and its related headings as follows:

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2020-06, 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

815-40-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2020-06, *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*:

- a. The pending content that links to this paragraph shall be effective as follows:
 1. For **public business entities** that meet the definition of a **Securities and Exchange Commission (SEC) filer**, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. The one-time determination of whether an entity is eligible to be a smaller reporting company shall be based on an entity’s most recent determination as of August 5, 2020, in accordance with SEC regulations.
 2. For all other entities, for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years.
 3. Early application is permitted for all entities, but no earlier than for fiscal years beginning after December 15, 2020, including interim periods within those fiscal years.
- b. An entity shall apply the pending content that links to this paragraph using one of the following two methods:
 1. On a modified retrospective basis to financial instruments outstanding as of the beginning of the fiscal year of adoption, with the cumulative effect of initially applying the pending content that links to this paragraph recognized at the date of initial application through an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position). Under this method, earnings-per-share amounts shall not be restated in prior periods presented.
 2. On a retrospective basis to financial instruments outstanding as of the beginning of the first comparative reporting period for each prior

- reporting period presented in accordance with the guidance on accounting changes in paragraphs 250-10-45-5 through 45-10.
- c. All entities that have not yet adopted the pending content that links to paragraph 260-10-65-4 may early adopt the pending content that links to this paragraph related to recognition and measurement for any **convertible security** that includes a **down round feature** in financial statements for fiscal years or interim periods that have not yet been issued or made available for issuance. This early adoption is permitted for fiscal years beginning after December 15, 2019.
- d. An entity may irrevocably elect the fair value option in accordance with Subtopic 825-10 for any liability-classified **financial instrument** that is a convertible security that is within the scope of that Subtopic. For items measured at **{add glossary link to 2nd definition}fair value{add glossary link to 2nd definition}** in accordance with this paragraph, the difference between the carrying amount and the fair value shall be recorded by means of a cumulative-effect adjustment to the opening retained earnings balance as of the beginning of the first reporting period that an entity has adopted the pending content that links to this paragraph.
- e. An entity shall disclose the following in the period that the entity adopts the pending content that links to this paragraph:
1. The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle.
 2. The method of applying the change.
 3. The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the beginning of the first period for which the pending content that links to this paragraph is initially applied.
 4. For entities that present earnings-per-share information, the effect of the change on affected per-share amounts for the period of adoption.
- f. An entity that elects the full retrospective method of adoption in (b)(2) also shall disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted.
- g. An entity that issues interim financial statements shall provide the disclosures in (e) and (f), if applicable, in each interim financial statement of the year of change and the annual financial statement of the period of the change.

Amendments to Subtopic 825-10

44. Amend paragraph 825-10-15-5, with a link to transition paragraph 815-40-65-1, as follows:

Financial Instruments—Overall

Scope and Scope Exceptions

Fair Value Option

> Instruments

825-10-15-5 No entity may elect the fair value option for any of the following financial assets and financial liabilities:

- a. An investment in a subsidiary that the entity is required to consolidate.
- b. An interest in a variable interest entity (VIE) that the entity is required to consolidate.
- c. Employers' and plans' obligations (or assets representing net overfunded positions) for pension benefits, other postretirement benefits (including health care and life insurance benefits), postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation arrangements, as defined in Topics 420; 710; 712; 715; 718; and 960.
- d. Financial assets and financial liabilities recognized under leases as defined in Subtopic 842-10. (This exception does not apply to a guarantee of a third-party lease obligation or a contingent obligation arising from a cancelled lease.)
- e. Deposit liabilities, withdrawable on demand, of banks, savings and loan associations, credit unions, and other similar depository institutions.
- f. Financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity (including temporary equity) ~~(for example, a convertible debt instrument within the scope of the Cash Conversion Subsections of Subtopic 470-20 or a convertible debt security with a noncontingent beneficial conversion feature).~~

45. Add paragraph 825-10-50-11A, with a link to transition paragraph 815-40-65-1, as follows:

Disclosure

> Fair Value of Financial Instruments

825-10-50-11A See paragraph 470-20-50-1D for additional guidance on disclosures about fair value of convertible debt instruments.

Amendments to Subtopic 825-20

46. Amend paragraph 825-20-15-4, with a link to transition paragraph 815-40-65-1, as follows:

Financial Instruments—Registration Payment Arrangements

Scope and Scope Exceptions

> Transactions

825-20-15-4 The guidance in this Subtopic does not apply to any of the following:

- a. Arrangements that require registration or listing of convertible debt instruments or convertible preferred stock if the form of consideration that would be transferred to the counterparty is an adjustment to the conversion ratio. See Subtopic 470-20 on debt with conversion and other options or Subtopic 505-10 on equity for related guidance. ~~(Subtopic 470-20 provides guidance on accounting for convertible instruments with contingently adjustable conversion ratios.)~~
- b. Arrangements in which the amount of consideration transferred is determined by reference to either of the following:
 1. An observable market other than the market for the issuer's stock
 2. An observable index.For example, if the consideration to be transferred if the issuer is unable to obtain an effective registration statement is determined by reference to the price of a commodity. See Subtopic 815-15 for related guidance.
- c. Arrangements in which the financial instrument or instruments subject to the arrangement are settled when the consideration is transferred (for example, a warrant that is contingently puttable if an effective registration statement for the resale of the equity shares that are issuable upon exercise of the warrant is not declared effective by the SEC within a specified grace period).

Amendments to Subtopic 835-30

47. Amend paragraph 835-30-15-4, with a link to transition paragraph 815-40-65-1, as follows:

Interest—Imputation of Interest

Scope and Scope Exceptions

> Other Considerations

835-30-15-4 This Subtopic does not modify the following accounting guidance addressed in other Topics:

- a. ~~Subparagraph superseded by Accounting Standards Update No. 2020-06. The accounting for convertible debt securities described in Subtopic 470-20~~
- b. The guidance that deferred income taxes should not be accounted for on a discounted (present value) basis in Subtopic 740-10.

Amendments to Subtopic 848-20

48. Amend the current content of paragraph 848-20-35-8, with a link to transition paragraph 815-40-65-1, as follows:

Reference Rate Reform—Contract Modifications

Subsequent Measurement

> Optional Expedient: Contract Modifications Due to Reference Rate Reform

> > Contracts within the Scope of Topic 470

848-20-35-8 If an entity elects the optional expedient in this paragraph, the entity shall account for a modification of a contract within the scope of Topic 470 that meets the scope of paragraphs 848-20-15-2 through 15-3 in accordance with paragraphs 470-50-40-14, ~~470-50-40-16~~, 470-50-40-17(b), and 470-50-40-18(b) as if the modification was not substantial. That is, the original contract and the new contract shall be accounted for as if they were not substantially different from one another, and the modification shall not be accounted for in the same manner as a debt extinguishment in accordance with paragraph 470-50-40-13.

Amendments to Status Sections

49. Amend paragraph 260-10-00-1, by adding the following items to the table, as follows:

260-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
260-10-25-1	Amended	2020-06	08/05/2020
260-10-30-1	Amended	2020-06	08/05/2020
260-10-35-1	Amended	2020-06	08/05/2020
260-10-45-12B	Amended	2020-06	08/05/2020
260-10-45-16	Amended	2020-06	08/05/2020
260-10-45-21A	Added	2020-06	08/05/2020
260-10-45-23	Amended	2020-06	08/05/2020
260-10-45-40	Amended	2020-06	08/05/2020
260-10-45-44	Amended	2020-06	08/05/2020
260-10-45-45	Amended	2020-06	08/05/2020
260-10-45-45A	Added	2020-06	08/05/2020
260-10-45-46	Amended	2020-06	08/05/2020
260-10-45-64	Superseded	2020-06	08/05/2020
260-10-55-3	Amended	2020-06	08/05/2020
260-10-55-4	Amended	2020-06	08/05/2020
260-10-55-6	Amended	2020-06	08/05/2020
260-10-55-7	Amended	2020-06	08/05/2020
260-10-55-32 through 55-34	Amended	2020-06	08/05/2020
260-10-55-36	Superseded	2020-06	08/05/2020
260-10-55-36A	Amended	2020-06	08/05/2020
260-10-55-78	Amended	2020-06	08/05/2020
260-10-55-79	Amended	2020-06	08/05/2020
260-10-55-82	Amended	2020-06	08/05/2020
260-10-55-84A	Amended	2020-06	08/05/2020
260-10-55-84B	Amended	2020-06	08/05/2020
260-10-55-84C through 84E	Added	2020-06	08/05/2020
260-10-65-4	Amended	2020-06	08/05/2020

50. Amend paragraph 470-10-00-1, by adding the following items to the table, as follows:

470-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
470-10-50-1	Amended	2020-06	08/05/2020

Paragraph	Action	Accounting Standards Update	Date
470-10-55-11	Amended	2020-06	08/05/2020
470-10-55-12	Amended	2020-06	08/05/2020
470-10-60-2	Superseded	2020-06	08/05/2020

51. Amend paragraph 470-20-00-1, by adding the following items to the table, as follows:

470-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Beneficial Conversion Feature	Superseded	2020-06	08/05/2020
Contingently Convertible Instruments	Added	2020-06	08/05/2020
Firm Commitment (2nd def.)	Superseded	2020-06	08/05/2020
Issued, Issuance, or Issuing of an Equity Instrument	Superseded	2020-06	08/05/2020
Not-for-Profit Entity	Added	2020-06	08/05/2020
Public Business Entity	Added	2020-06	08/05/2020
Public Entity (2nd def.)	Superseded	2020-06	08/05/2020
Security (2nd def.)	Added	2020-06	08/05/2020
Troubled Debt Restructuring	Superseded	2020-06	08/05/2020
470-20-05-1	Amended	2020-06	08/05/2020
470-20-05-1A	Superseded	2020-06	08/05/2020
470-20-05-4 through 05-7	Amended	2020-06	08/05/2020
470-20-05-7A	Added	2020-06	08/05/2020

Paragraph	Action	Accounting Standards Update	Date
470-20-05-8	Amended	2020-06	08/05/2020
470-20-05-8A	Added	2020-06	08/05/2020
470-20-05-9	Amended	2020-06	08/05/2020
470-20-05-12	Superseded	2020-06	08/05/2020
470-20-05-13	Superseded	2020-06	08/05/2020
470-20-10-1	Superseded	2020-06	08/05/2020
470-20-10-2	Superseded	2020-06	08/05/2020
470-20-15-2	Amended	2020-06	08/05/2020
470-20-15-2A through 15-2D	Added	2020-06	08/05/2020
470-20-15-3 through 15-6	Superseded	2020-06	08/05/2020
470-20-25-1	Amended	2020-06	08/05/2020
470-20-25-4 through 25-11	Superseded	2020-06	08/05/2020
470-20-25-12	Amended	2020-06	08/05/2020
470-20-25-13	Amended	2020-06	08/05/2020
470-20-25-14	Added	2020-06	08/05/2020
470-20-25-15	Added	2020-06	08/05/2020
470-20-25-16 through 25-20	Superseded	2020-06	08/05/2020
470-20-25-21 through 25-27	Superseded	2020-06	08/05/2020
470-20-30-1	Amended	2020-06	08/05/2020
470-20-30-2	Amended	2020-06	08/05/2020
470-20-30-3 through 30-26	Superseded	2020-06	08/05/2020
470-20-30-27 through 30-31	Superseded	2020-06	08/05/2020
470-20-35-1 through 35-5	Superseded	2020-06	08/05/2020
470-20-35-6	Amended	2020-06	08/05/2020
470-20-35-7 through 35-10	Superseded	2020-06	08/05/2020
470-20-35-11	Amended	2020-06	08/05/2020
470-20-35-12 through 35-20	Superseded	2020-06	08/05/2020
470-20-40-1 through 40-3	Superseded	2020-06	08/05/2020
470-20-40-4	Amended	2020-06	08/05/2020
470-20-40-4A	Superseded	2020-06	08/05/2020

Paragraph	Action	Accounting Standards Update	Date
470-20-40-5 through 40-7	Amended	2020-06	08/05/2020
470-20-40-11	Amended	2020-06	08/05/2020
470-20-40-13	Amended	2020-06	08/05/2020
470-20-40-16	Amended	2020-06	08/05/2020
470-20-40-18	Amended	2020-06	08/05/2020
470-20-40-19 through 40-26	Superseded	2020-06	08/05/2020
470-20-45-1A	Added	2020-06	08/05/2020
470-20-45-1B	Added	2020-06	08/05/2020
470-20-45-3	Superseded	2020-06	08/05/2020
470-20-50-1	Superseded	2020-06	08/05/2020
470-20-50-1A through 1I	Added	2020-06	08/05/2020
470-20-50-3 through 50-6	Superseded	2020-06	08/05/2020
470-20-55-1	Superseded	2020-06	08/05/2020
470-20-55-1A	Added	2020-06	08/05/2020
470-20-55-1B	Added	2020-06	08/05/2020
470-20-55-10 through 55-17	Superseded	2020-06	08/05/2020
470-20-55-18	Amended	2020-06	08/05/2020
470-20-55-19	Amended	2020-06	08/05/2020
470-20-55-19A through 55-66	Superseded	2020-06	08/05/2020
470-20-55-69A through 55-69F	Added	2020-06	08/05/2020
470-20-55-69 through 55-82	Superseded	2020-06	08/05/2020

52. Amend paragraph 470-50-00-1, by adding the following items to the table, as follows:

470-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Beneficial Conversion Feature	Superseded	2020-06	08/05/2020
470-50-40-16	Superseded	2020-06	08/05/2020

53. Amend paragraph 505-10-00-1, by adding the following items to the table, as follows:

505-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Contingently Convertible Instruments	Added	2020-06	08/05/2020
Convertible Security	Added	2020-06	08/05/2020
Security (1st def.)	Superseded	2020-06	08/05/2020
505-10-05-3	Amended	2020-06	08/05/2020
505-10-05-5 through 05-7	Added	2020-06	08/05/2020
505-10-15-2	Amended	2020-06	08/05/2020
505-10-35-1	Added	2020-06	08/05/2020
505-10-50-6 through 50-10A	Superseded	2020-06	08/05/2020
505-10-50-12 through 50-18	Added	2020-06	08/05/2020
505-10-60-2	Superseded	2020-06	08/05/2020

54. Amend paragraph 718-10-00-1, by adding the following items to the table, as follows:

718-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Convertible Security	Added	2020-06	08/05/2020
718-10-35-9A	Superseded	2020-06	08/05/2020
718-10-35-10	Amended	2020-06	08/05/2020

55. Amend paragraph 740-10-00-1, by adding the following item to the table, as follows:

740-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
740-10-55-51	Superseded	2020-06	08/05/2020

56. Amend paragraph 815-10-00-1, by adding the following items to the table, as follows:

815-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-10-15-74	Amended	2020-06	08/05/2020
815-10-15-77	Amended	2020-06	08/05/2020
815-10-15-78	Amended	2020-06	08/05/2020
815-10-50-8A	Amended	2020-06	08/05/2020
815-10-50-8B	Added	2020-06	08/05/2020

57. Amend paragraph 815-15-00-1, by adding the following items to the table, as follows:

815-15-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
815-15-25-14	Amended	2020-06	08/05/2020
815-15-25-15	Amended	2020-06	08/05/2020
815-15-55-76A	Amended	2020-06	08/05/2020
815-15-55-76B	Added	2020-06	08/05/2020
815-15-55-218	Amended	2020-06	08/05/2020
815-15-55-219	Amended	2020-06	08/05/2020

58. Amend paragraph 815-40-00-1, by adding the following items to the table, as follows:

815-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Convertible Security	Added	2020-06	08/05/2020

Paragraph	Action	Accounting Standards Update	Date
Freestanding Financial Instrument	Added	2020-06	08/05/2020
Not-for-Profit Entity	Added	2020-06	08/05/2020
Public Business Entity	Added	2020-06	08/05/2020
Security (2nd def.)	Added	2020-06	08/05/2020
Securities and Exchange Commission (SEC) Filer	Added	2020-06	08/05/2020
815-40-15-2	Amended	2020-06	08/05/2020
815-40-15-2A	Added	2020-06	08/05/2020
815-40-15-3 through 15-5	Amended	2020-06	08/05/2020
815-40-15-7C	Amended	2020-06	08/05/2020
815-40-15-7D	Amended	2020-06	08/05/2020
815-40-15-8	Amended	2020-06	08/05/2020
815-40-15-8A	Amended	2020-06	08/05/2020
815-40-25-1	Amended	2020-06	08/05/2020
815-40-25-3	Amended	2020-06	08/05/2020
815-40-25-4	Amended	2020-06	08/05/2020
815-40-25-6	Amended	2020-06	08/05/2020
815-40-25-10	Amended	2020-06	08/05/2020
815-40-25-10A	Added	2020-06	08/05/2020
815-40-25-11 through 25-17	Superseded	2020-06	08/05/2020
815-40-25-18	Amended	2020-06	08/05/2020
815-40-25-31 through 25-35	Superseded	2020-06	08/05/2020
815-40-25-39 through 25-41	Amended	2020-06	08/05/2020
815-40-35-1	Amended	2020-06	08/05/2020
815-40-35-4	Amended	2020-06	08/05/2020
815-40-35-8 through 35-10	Amended	2020-06	08/05/2020
815-40-50-1	Superseded	2020-06	08/05/2020
815-40-50-1A	Added	2020-06	08/05/2020
815-40-50-2	Amended	2020-06	08/05/2020

Paragraph	Action	Accounting Standards Update	Date
815-40-50-2A	Added	2020-06	08/05/2020
815-40-50-5	Amended	2020-06	08/05/2020
815-40-55-1	Superseded	2020-06	08/05/2020
815-40-55-7	Amended	2020-06	08/05/2020
815-40-55-8 through 55-12	Superseded	2020-06	08/05/2020
815-40-55-13	Amended	2020-06	08/05/2020
815-40-55-25A	Added	2020-06	08/05/2020
815-40-65-1	Added	2020-06	08/05/2020

59. Amend paragraph 825-10-00-1, by adding the following items to the table, as follows:

825-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
825-10-15-5	Amended	2020-06	08/05/2020
825-10-50-11A	Added	2020-06	08/05/2020

60. Amend paragraph 825-20-00-1, by adding the following item to the table, as follows:

825-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
825-20-15-4	Amended	2020-06	08/05/2020

61. Amend paragraph 835-30-00-1, by adding the following item to the table, as follows:

835-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
835-30-15-4	Amended	2020-06	08/05/2020

62. Amend paragraph 848-20-00-1, by adding the following item to the table, as follows:

848-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
848-20-35-8	Amended	2020-06	08/05/2020

The amendments in this Update were adopted by the affirmative vote of the seven members of the Financial Accounting Standards Board.

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cospers
Marsha L. Hunt
R. Harold Schroeder

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The Board is issuing this Update to address issues identified as a result of the complexity associated with applying GAAP for certain financial instruments with characteristics of liabilities and equity. In addressing the complexity, the Board focused on amending the guidance on convertible instruments and the guidance on the derivatives scope exception for contracts in an entity's own equity.

Background Information

BC3. In June 2015, the Financial Accounting Standards Advisory Council (FASAC) initiated its periodic survey to solicit input from stakeholders on the Board's agenda priorities. This survey also was extended to the FASB's other advisory groups, including the Emerging Issues Task Force (EITF), the Investor Advisory Committee (IAC), the Not-for-Profit Advisory Committee, the Private Company Council (PCC), and the Small Business Advisory Committee (SBAC). Preparers and practitioners prioritized distinguishing liabilities from equity as an area of financial reporting that needed improvement.

BC4. On August 4, 2016, the Board issued an Invitation to Comment, *Agenda Consultation*. The Invitation to Comment included four topics that were identified on the basis of the results of the FASAC survey and other input from stakeholders, such as the Academic Resource Group and the participants at the annual Financial Reporting Issues Conference. Chapter 3 of the Invitation to Comment addressed distinguishing liabilities from equity. The other topics included were intangible assets (including research and development), pensions and other postretirement benefit plans, and reporting performance and cash flows. The Invitation to Comment requested that stakeholders prioritize which of the four topics the Board should consider adding to its agenda. At its January 25, 2017 meeting, the Board discussed the feedback received from stakeholders on Chapter 3 and potential research paths to consider. Preparers and practitioners ranked distinguishing liabilities from equity as their first priority, while users ranked the topic as their third priority.

BC5. At its September 20, 2017 meeting, the Board decided to make concurrent improvements to the Conceptual Framework and make targeted improvements to certain standards-level projects, including distinguishing liabilities from equity, that are not dependent on improvements to the Conceptual Framework. The objective of this approach was to improve the Conceptual Framework without delaying needed improvements to standards-level projects.

BC6. In setting the scope of the project, the Board decided to focus on improving troublesome areas of the current guidance, specifically convertible instruments and the derivatives scope exception for contracts in an entity's own equity, rather than undertaking a comprehensive approach of revisiting all of the liabilities and equity guidance. The current standards-level guidance incorporates a number of inconsistencies when compared with the existing definition of a liability in FASB Concepts Statement No. 6, *Elements of Financial Statements*. Inconsistency exists because the current definition of *liability* in Concepts Statement 6 focuses on whether an entity has an obligation to transfer assets, while current standards-level guidance classifies certain share-settled instruments as liabilities under Topic 480, Distinguishing Liabilities from Equity, and Subtopic 815-40. The Board decided not to resolve the existing inconsistencies as part of this Update. Accordingly, Topic 480 is not within the scope of this Update, and the amendments to Subtopic 815-40 in this Update are not based on the definition of a liability under Concepts Statement 6.

BC7. Additionally, in setting the scope of this project, the Board decided not to amend derivative accounting under Topic 815, with the exception of amendments to Subtopic 815-40 as it relates to whether a contract is within the scope of derivative accounting and any related consequential amendments. Said differently, the scope of this Update does not include amendments to measurement of a freestanding instrument or embedded feature if it is determined to be within the scope of the derivative accounting requirements under Topic 815.

Benefits and Costs

BC8. The FASB's Rules of Procedure states:

The mission of the FASB is to establish and improve standards of financial accounting and reporting that foster financial reporting by nongovernmental entities that provides decision-useful information to investors and other users of financial reports.

BC9. In fulfilling that mission, the Board follows certain precepts, including issuing standards only when the expected benefits of the resulting information justify the expected costs. The Board strives to determine that a standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. The Board's assessment of the costs and the benefits of applying new

guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC10. Paragraph OB2 of FASB Concepts Statement No. 8, *Conceptual Framework for Financial Reporting, Chapter 1, The Objective of General Purpose Financial Reporting*, and *Chapter 3, Qualitative Characteristics of Useful Financial Information*, states the following:

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit. [Footnote reference omitted.]

BC11. The objective of the amendments in this Update, which is consistent with the objective of general purpose financial reporting, is to improve, simplify, and enhance the financial reporting requirements for convertible instruments and contracts in an entity's own equity.

BC12. Over the course of the project, the Board and staff conducted extensive outreach with users, preparers, and practitioners to obtain information about specific areas for which current GAAP could be improved and potential solutions in those areas. Those outreach activities included more than 60 interactions with more than 310 preparers, practitioners, academics, industry groups, users, regulators, and others; 30 group meetings with more than 50 users; 23 comment letters in response to the proposed Update from preparers, practitioners, industry groups, and others; 24 comment letters in response to Chapter 3 of the Invitation to Comment from users, preparers, practitioners, industry groups, and others; 1 public roundtable about the Invitation to Comment with 16 preparers, practitioners, industry representatives, and users; 1 nonpublic workshop with 17 preparers, practitioners, and industry representatives; and numerous additional discussions. Nonpublic entities also were represented in the outreach efforts through discussions with the PCC and practitioners.

BC13. On July 31, 2019, the Board issued 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*. The Board received 23 comment letters on the proposed Update. Overall, respondents supported the Board's efforts to simplify the accounting for certain convertible instruments and contracts in an entity's own equity, although feedback was mixed on certain amendments related to the derivatives scope exception in the proposed Update as described further in paragraphs BC76 and BC77. In addition to feedback received from comment letters, the staff conducted outreach with users and advisory or professional groups to supplement comment letter

feedback and ensure that the Board received feedback on specific questions that were included in the proposed Update. In evaluating the expected costs and expected benefits of the amendments in the proposed Update, the Board decided to remove certain aspects of the derivatives scope exception amendments from the project on the basis of the comment letter feedback about the potential cost and complexity of introducing a likelihood threshold into the derivatives scope exception guidance. The Board decided that additional research was needed on those potential improvements.

BC14. On the basis of extensive due process and significant stakeholder input, the Board concluded that the amendments in this Update provide users with more relevant information than does current GAAP. In particular, the amendments provide the following benefits:

- a. Reduce the number of accounting models for convertible instruments. The Board expects that those changes will result in simplified guidance for preparers and practitioners (resulting in less restatements) and that the financial reporting results will be easier, more consistent, and more relevant for users to understand (resulting in less manual adjustments in users' analysis).
- b. Reduce form-over-substance-based accounting conclusions for contracts in entity's own equity by removing three of the settlement conditions. The Board expects that this will improve the operability of guidance.
- c. Increase the consistent measure of EPS. The Board expects that more consistent calculations of diluted EPS for both convertible instruments and contracts that may be settled in cash or shares will improve the usefulness of the diluted EPS measure.

BC15. As with any new guidance, there will be costs to implement the amendments in this Update. The Board notes that the incremental ongoing costs are expected to be less significant compared with the costs of initially implementing the amendments and significantly less than the costs of applying current GAAP. When making its decisions, the Board considered costs together with the overall benefits as well as the benefits and costs of specific requirements. The magnitude of the following costs will vary depending on several factors, including the complexity of an entity's capital structure:

- a. Initial costs to educate employees about how to apply the new requirements, as well as how to explain the effects of the changes on the entity's financial statements to financial statement users
- b. Initial costs to perform contract reviews to determine whether an entity should have a change in the classification (and accounting) for certain contracts in the entity's own equity
- c. Initial and ongoing costs to implement internal control processes and judgments that are required by the amended guidance, including the related cost associated with external auditors.

BC16. Overall, the Board concluded that the expected benefits of the amendments in this Update justify the expected costs. The Board does not anticipate that entities will incur significant costs as a result of the amendments and expects that the costs of applying the amendments will be significantly less than applying current GAAP. The amendments are expected to significantly reduce the complexity of applying current GAAP requirements to convertible instruments and contracts in an entity's own equity. The amendments are expected to provide the benefit of improving consistent application of GAAP and make GAAP more relevant and decision useful for financial statement users.

Basis for Conclusions

Convertible Instruments

Background

BC17. The Board received significant feedback over the years from a variety of stakeholders indicating that the accounting guidance for convertible instruments (including convertible debt instruments and convertible preferred stock) is complex and difficult to navigate, resulting in excessive costs to comply, including costs of maintaining controls and audit costs. Furthermore, the complexity and difficulty of navigating and understanding the guidance are often asserted to be a significant contributing factor to accounting restatements. Accordingly, the Board decided to reconsider the accounting guidance on convertible instruments to improve the operability of the guidance, reduce the accounting complexity, and improve the decision usefulness of the information provided to users of financial statements.

BC18. Currently, there are five accounting models in the Codification for convertible debt instruments:

- a. The embedded derivative model (Subtopic 815-15) to account for convertible debt instruments with embedded conversion features that are not clearly and closely related to the host contract, that meet the definition of a derivative, and that do not meet the criteria for the derivatives scope exception. Under this model, conversion features are bifurcated as derivatives from the host contract and measured at fair value.
- b. The cash conversion model (Subtopic 470-20) to account for convertible debt instruments that may be settled entirely or partially in cash upon conversion. Under this model, the host contract is measured at the fair value of a similar debt without conversion features, and conversion features are recorded as equity components at the residual amount.
- c. The beneficial conversion feature model (Subtopic 470-20) to account for convertible debt instruments with conversion features that are in the money at the commitment date or that become in the money at a later date after the occurrence of a contingent event. Under this model,

- conversion features are recorded as equity components at intrinsic value, and the host contract is recorded at the residual amount.
- d. The substantial premium model (Subtopic 470-20) to account for convertible debt instruments issued at substantial premiums. Under this model, the premiums are recorded as paid-in capital.
 - e. The traditional convertible debt model (Subtopic 470-20) to account for other convertible debt instruments as a single debt instrument measured at amortized cost.

BC19. Similarly, convertible preferred stock is required to be assessed under the embedded derivative model, the cash conversion model (if the convertible preferred stock is mandatorily redeemable and classified as a liability under Subtopic 480-10, Distinguishing Liabilities from Equity—Overall), and the beneficial conversion feature model before it may be accounted for as a single equity instrument under the traditional convertible preferred stock model.

BC20. Each of the models listed above, except for the traditional convertible debt model or the traditional convertible preferred stock model, requires separating embedded conversion features from the host contract and has its specific separation approach, measurement model, and accounting treatment that are different from those for the other models.

BC21. The Codification guidance was built on a significant amount of disparate legacy GAAP that was developed on a piecemeal basis since the 1970s to address new types of instruments and emerging issues in practice. As a result, there often are path dependencies among different models of convertible instruments (for example, an instrument needs to be assessed under the embedded derivative model before assessing the other models), while there is a lack of consistent principles applied across those models. Furthermore, the guidance for the various models (other than the embedded derivative model) is commingled in Subtopic 470-20, making it difficult to navigate.

Simplified Accounting Models

BC22. Feedback from preparers and practitioners indicated that multiple models for economically similar instruments create unnecessary complexity and significant cost to account for convertible instruments. Furthermore, the volume of guidance to consider increases the risk that stakeholders (a) are unaware of certain guidance and, therefore, do not consider the relevant guidance for an applicable model, (b) incorrectly assess which model is applicable and, therefore, apply the guidance inappropriately, or (c) have different interpretations of how to apply the guidance for certain models, thereby resulting in diversity in practice. Consequently, accounting for convertible instruments has been the subject of a significant number of restatements, particularly related to application of the beneficial conversion feature model.

BC23. The Board received feedback from financial statement users indicating that most users do not find the current separation models for convertible instruments useful and relevant because they generally view and analyze those instruments on a whole-instrument basis. Because a convertible debt instrument is going to be either repaid at maturity or converted at conversion date(s), financial statement users asserted, during outreach, that separating the instrument into two components is confusing and creates a result in the financial statements that is inconsistent with their analyses. Therefore, in circumstances in which the host contract and embedded conversion features have been separated, financial statement users typically recombine those components into one instrument and then apply their assumptions and models for analyses. Many financial statement users also indicated that cash (coupon) interest expense is more relevant information for their analyses, rather than an imputed interest expense that results from the separation of conversion features required by GAAP. Some financial statement users calculate their own normal marginal borrowing rates, if needed, that are different from the effective interest rate determined under GAAP (for example, under the cash conversion model, the effective interest rate is the borrowing rate of a similar debt without conversion features). Financial statement users commented that the comprehensive disclosures about the terms and features of convertible instruments are more important and useful for them. Overall, most financial statement users stated that they would prefer a simple recognition, measurement, and presentation approach with sufficient disclosures for convertible instruments to have a simplified and consistent starting point across entities to perform their analyses.

BC24. In response to the feedback received, the Board decided to simplify the accounting for convertible instruments by removing certain separation models (including the cash conversion model and the beneficial conversion feature model) for convertible instruments. As a result, for convertible instruments with conversion features that are not required to be accounted for as derivatives under Topic 815 or that do not result in substantial premiums accounted for as paid-in capital, the embedded conversion features no longer are separated from the host contract. Consequently, a convertible debt instrument will be accounted for as a single liability measured at its amortized cost, and a convertible preferred stock will be accounted for as a single equity instrument measured at its historical cost as long as no other features require bifurcation and recognition as derivatives. By removing those separation models, the interest rate of some convertible debt instruments typically should be closer to the coupon interest rate when applying the guidance in Topic 835, Interest.

BC25. The Board also observed that for conversion features that are no longer required to be separately accounted for as equity components according to the Board's decisions, no assessment of the reclassification from equity to temporary equity, under the SEC's guidance in ASR No. 268, *Presentation in Financial Statements of "Redeemable Preferred Stocks,"* will be needed when at the balance

sheet date the issuer can be required to settle convertible instruments for cash or other assets.

BC26. The Board concluded that the amendments in this Update provide financial statement users with a simpler and more consistent starting point to perform analyses across entities, consistent with feedback received from users. The Board also concluded that the amendments improve the operability of the guidance and reduce, to a large extent, the complexities in the accounting for convertible instruments and the difficulties with interpretation and application of the relevant guidance. The majority of stakeholders who provided feedback on the amendments, including comment letter respondents, broadly agreed that the Board's decision will improve the usefulness of the information of convertible instruments, while reducing the accounting cost and complexity.

BC27. The Board considered an alternative approach to amend the accounting for convertible instruments by applying one separation model to all convertible instruments, except for those with conversion features accounted for as derivatives under Topic 815. This approach is based on the view that conversion features have inherent economic value and, therefore, should be accounted for separately. Accordingly, some stakeholders asserted that convertible instruments should be accounted for differently from similar instruments without conversion features because their economics are different. The stakeholders (including some comment letter respondents) supporting that approach asserted that, as compared with accounting for convertible instruments as a single unit of account, separating conversion features as equity components from the host contract would provide a more faithful representation of the economics of the instruments.

BC28. The stakeholders, however, proposed different ways to separate and measure conversion features. Some suggested accounting for convertible instruments based on the current cash conversion model under GAAP, which is similar to a separation approach for convertible debt instruments under IAS 32, *Financial Instruments: Presentation*. The Board observed that this approach was previously considered under a joint project by the FASB and the International Accounting Standards Board (IASB) in 2010 but was not finalized. The Board also noted that the cash conversion model was originally created to resolve a specific structuring issue related to a convertible debt instrument (that is, upon conversion, the principal must be satisfied in cash and the conversion premium may be satisfied in either cash or stock). Therefore, it is questionable whether it is appropriate to extend this model to all other convertible instruments, especially those that could not be settled in cash.

BC29. Some stakeholders suggested accounting for convertible instruments based on a model that is similar to the share-based compensation model under Topic 718, *Compensation—Stock Compensation*, by recording conversion features as equity components at fair value at the time of issuance and allocating the residual amount to the host contract. However, because there is a fundamental difference in the transaction nature and exchange timing of share-based payments

and convertible instruments, the Board concluded that it would be inappropriate to apply this approach to convertible instruments. In addition, the Board noted that there would still be complexities in the separation approach suggested by the stakeholders that would need to be further addressed. The potential solution to address those issues may not provide financial statement users with relevant and useful information and result in more accounting complexities and costs for preparers and practitioners as compared with current GAAP.

BC30. A few comment letter respondents suggested that the Board consider an approach that would require that an entity record a convertible debt instrument on the balance sheet as a single liability based on proceeds received and record a hypothetical interest expense, in addition to coupon interest expense, with an offset to additional paid-in capital. The hypothetical interest expense could be determined on the basis of the nonconvertible borrowing rate or the fair value of conversion features at the time of issuance. The Board noted that this approach would increase an entity's paid-in capital over the term of a convertible debt instrument resulting from the hypothetical interest expense. However, that approach would not address what the accounting would be upon the settlement of the instrument. The Board also questioned the conceptual and accounting appropriateness to increase an entity's paid-in capital on the basis of a hypothetical interest expense that would be even higher than the imputed interest expense under the cash conversion model.

BC31. The Board observed that, during the outreach, a clear predominance of financial statement users asserted that such a separation approach results in less useful and less relevant information for them to forecast future cash flow and assess entity value because they view and analyze the instruments on a whole-instrument basis. They also preferred to have cash (coupon) interest expense reported on the income statement, rather than an imputed interest expense that is irrelevant to their analyses or decisions. Therefore, the Board decided not to further pursue other approaches after considering that feedback.

BC32. The Board acknowledges that accounting for convertible instruments in the same way as certain instruments without conversion features does not fully reflect the difference in the economics of those arrangements. However, that difference is expected to be captured in the enhanced disclosure requirements that are deemed more important by financial statement users and in diluted EPS (for example, a convertible debt instrument has a dilutive effect on EPS, while a debt without conversion features does not). The Board concluded that accounting for convertible instruments as a single unit of account is a practical solution to improve the relevance of the financial information being provided to financial statement users.

BC33. Some comment letter respondents observed that a convertible debt instrument may occasionally be issued at a substantial premium because of a deeply in-the-money conversion feature or it may be remeasured at a fair value that is significantly greater than the par value in a business combination or debt

extinguishment. Those respondents asked that the Board provide guidance on the accounting for convertible debt instruments with substantial premiums if the amortization of the premium exceeds the contractual coupon interest expense (which would result in the recognition of net interest income), as a result of superseding the existing guidance on substantial premiums in the proposed Update. The substantial premium guidance originated in APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, and, accordingly, has been in place since the 1960s. The Board observed that the occurrence of this scenario is not historically or currently prevalent in the U.S. market. At present, the Board does not anticipate that this arrangement, which typically is driven by economic factors (such as market situation, an entity's financing resources and intent, the terms and features of the instruments, and so on), will become prevalent solely because of the changes in the accounting treatment. However, the Board understands that the current lack of prevalent occurrence of convertible debt instruments with substantial premiums may be, in part, related to the existing guidance that requires that the premiums be recorded as paid-in capital. Accordingly, the Board acknowledges those respondents' concern that this arrangement may become more prevalent if a favorable accounting effect on earnings (such as recognizing an interest income) could be achieved from substantial premiums that are attributable to the value of shares.

BC34. Therefore, the Board decided to retain the current guidance in paragraph 470-20-25-13 on the presumption that substantial premiums represent paid-in capital. That means, for a convertible debt instrument issued with a substantial premium, that premium will continue to be separated from the debt instrument and recorded as an equity component. In addition, the Board decided to require that an entity disclose the premium amount recorded as paid-in capital and the fair value amount and level of the fair value hierarchy for that entire convertible debt instrument.

BC35. The Board concluded that retaining the current guidance on substantial premiums with additional disclosure requirements provides an efficient solution to reduce the accounting effect of substantial premiums on earnings and maintains the information transparency and relevance to financial statement users. The Board acknowledges that the term *substantial premium* is not quantitatively defined in the current guidance but is unaware of issues in practice in applying that guidance. Accordingly, the Board decided to retain the current guidance without adding a definition on the existing threshold.

BC36. The Board noted that the existing guidance in paragraph 825-10-50-8 requires that a public business entity disclose the fair value and the leveling of the fair value hierarchy for all financial instruments, with the exception of equity instruments issued by the entity and classified in stockholders' equity in the statement of financial position and some other exceptions. Consequently, for convertible debt instruments that are accounted for as a single liability in accordance with the amendments in this Update, the fair value information of the entire instrument is required to be disclosed. However, for convertible debt

instruments with substantial premiums accounted for in accordance with paragraph 470-20-25-13, only the fair value information of the liability component is required to be disclosed. Considering the feedback from financial statement users that the fair value information of the entire instrument is more useful and relevant for their analyses, the Board decided that, for the convertible debt instrument accounted for as a liability component and an equity component in accordance with paragraph 470-20-25-13, the fair value information also should be disclosed for the entire instrument. The Board concluded that such alignment improves the comparability and consistency of the fair value information disclosed for all convertible debt instruments within Subtopic 470-20.

BC37. Furthermore, the Board decided to require that an entity disclose the premium amount recorded as paid-in capital for convertible debt instruments accounted for in accordance with paragraph 470-20-25-13. The Board concluded that this disclosure makes it transparent that (a) the liability balance of those convertible debt instruments does not represent the full value of the instruments and (b) different accounting treatment is applied for those convertible debt instruments as compared with other convertible debt instruments accounted for as a single liability under Subtopic 470-20. Therefore, financial statement users can make any necessary adjustment in their analyses to compare convertible debt instruments on a more consistent basis.

Disclosures

BC38. The current disclosure guidance on convertible instruments requires that an entity provide information about terms, features, and accounting effects for all convertible instruments. Information about the fair value of convertible debt instruments also is required. Feedback from stakeholders, including users of financial statements, indicated that the existing disclosure requirements for convertible instruments generally are sufficient and do not need substantial revision.

BC39. Although no significant gaps were identified between the needs of users of financial statements and the existing disclosures guidance, the amendments in this Update further improve the decision usefulness and relevance of the information provided to users of financial statements. In developing the amendments, the Board also considered, as a guide, the concepts in Chapter 8, *Notes to Financial Statements*, of Concepts Statement 8.

BC40. The Board decided to add a disclosure objective to the guidance on convertible debt instruments and convertible preferred stock. The Board concluded that the disclosure objective is important (a) for stakeholders to understand the detailed disclosure requirements and (b) to provide insight on why the Board deemed those disclosure requirements to be broadly relevant to all entities. The disclosure objective is not intended to represent additional disclosure requirements for entities.

BC41. Noting that the terms and features of convertible instruments are important information for users of financial statements to understand the instruments, the Board decided to add a disclosure requirement about events or changes in circumstances that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed. Those events or changes in circumstances could significantly affect financial statement users' assessment of the cash flow prospects of a reporting entity. The Board considered the request from some users of financial statements for disclosures about management's assessment on the likelihood of conversion but concluded that such future-oriented information would be inappropriate and impractical to disclose in the financial statements. However, the Board concluded that the disclosure about events or changes in circumstances that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed should provide users of financial statements with relevant information to make their own assessments of the likelihood of conversion.

BC42. Some comment letter respondents were concerned that this disclosure requirement may cause an adverse effect for an entity by requiring that it disclose some forward-looking or confidential information (such as change of control or business combination under negotiation, which usually affects the conversion conditions of convertible instruments). Although acknowledging this concern, the Board observed that because the events or changes in circumstances required under the disclosure requirement should be those that actually occur during the reporting period, they are factual, not future-oriented, information and do not involve any assessment or reassessment of the likelihood of their occurring.

BC43. In addition, the disclosure requirement does not obligate management to disclose all detailed information, especially the confidential information, that would cause legal harm to the entity. For example, if an entity starts exploring a potential business combination transaction that might cause the conversion contingencies of its convertible debt instrument to be met or the conversion price to be adjusted, the entity does not need to provide any information about the potential business combination transaction under this disclosure requirement because the transaction has not occurred. However, if the business combination agreement has already been signed with legal-binding effect, it should be considered having occurred even though its effective date has not yet passed. Therefore, the entity should disclose the occurrence of this business combination transaction, although the details of this transaction may not be provided.

BC44. The guidance in Subtopic 825-10, Financial Instruments—Overall, requires that public business entities disclose the fair value amount and the level of fair value hierarchy for convertible debt instruments, but the guidance does not explicitly require a disaggregated disclosure about the fair value information at an individual instrument level. However, noting the complexity of convertible debt instruments and how their terms and features could affect cash flow prospects differently, the Board concluded that the disclosure about fair value and leveling of

convertible instruments at the individual instrument level together with the related carrying amount could provide users of financial statements with more transparent and relevant information.

BC45. The Board expects that this amendment will not be complex or costly because it observed that the valuation process for convertible instruments usually is done at the individual instrument level and that entities usually disclose the carrying amount of the instruments at the instrument level. The Board also observed that many public companies already disclose the fair value information of convertible instruments at the instrument level.

BC46. Some financial statement users expressed an interest in a disclosure about an entity's current nonconvertible borrowing rate for convertible debt instruments during each reporting period, as a reference point for comparison among different entities or for certain ratio and refinancing considerations. However, noting that the purpose of this information is generally to provide an input for some financial statement users to make their predictions, the Board decided that such information would not meet the objective of general purpose financial reporting because financial reporting is not intended to provide a direct estimate of an entity's value (or inputs to its value) but is intended to provide information to assist users in making their own estimates.

BC47. The Board also noted that this requested disclosure is not supported by the Disclosure Framework, because the current nonconvertible borrowing rate (a) is not used in the measurement of the convertible debt instruments, (b) does not represent general information about an entity (such as information about an entity's activities and related parties, restrictions, segments, and so on) that if unknown to financial statement users could impair their ability to make informed resources allocation decisions, and (c) is a hypothetical and predictive rate that does not relate to past events or current conditions and circumstances that can affect an entity's cash flows.

BC48. The Board acknowledged that this rate could help some financial statement users understand how convertible debt instruments could be sensitive to potential changes to borrowing rates in the future. However, the Board concluded that information about how particular line items are sensitive to potential changes in the future because of general economic, market, or entity-specific factors is more appropriate for public companies to include in management's discussion and analysis. In addition, the Board concluded that the fair value information of convertible debt instruments provides a more relevant and comprehensive alternative measure that would be useful for financial statement users in assessing an entity's cash flow prospects. The Board noted that it would be unnecessarily costly for entities to provide such information for each reporting period that is readily available in the marketplace or relatively easy for users to obtain. The Board also is concerned about the potential for complexity and diversity in practice associated with determining nonconvertible borrowing rates if this disclosure were to be required. Therefore, the Board decided not to further

consider adding a requirement that an entity disclose the current nonconvertible borrowing rate for convertible debt instruments.

BC49. Additionally, to improve the clarity and readability of the existing disclosure guidance on convertible instruments that is contained in several Subtopics, the Board decided to centralize the disclosure guidance for convertible debt instruments in Subtopic 470-20 and for convertible preferred stock in Subtopic 505-10, Equity—Overall, with added references to other relevant Subtopics.

BC50. The existing guidance in Subtopic 470-20 requires that certain information be disclosed as of each date for which a statement of financial position is presented or for each period for which a statement of financial performance is presented. The Board acknowledges that there may be different interpretations on what period this language refers to, but it observed that public companies usually disclose relevant information about convertible instruments for both interim and annual periods. The Board also observed that similar language has been used in various Topics and the disclosure requirements for interim reporting are being evaluated under the Disclosure Framework: Disclosures—Interim Reporting project. Therefore, the Board decided not to amend the existing language related to the disclosure frequency in Subtopic 470-20 but rather to defer to that project for a more comprehensive consideration.

Other Amendments

Scope of Codification guidance on convertible instruments

BC51. The Board concluded that simplifying the accounting models for convertible instruments under the amendments in this Update significantly reduces the navigation difficulties of the guidance on convertible instruments and the risks of overlooking or inappropriately applying relevant guidance. However, because the guidance on convertible instruments continues to be contained in several Topics according to the terms and features of the instruments, the Board considered that it is necessary to clarify the scope of the guidance in Subtopic 470-20 for convertible debt instruments and in Subtopic 505-10 for convertible preferred stock to further improve the clarity and reference of related guidance.

Stock-settled debt

BC52. The Board received feedback from stakeholders indicating the existence of diversity in practice in distinguishing stock-settled debt from convertible debt when debt instruments can be converted to a variable number of shares. As a result, entities may mischaracterize and inappropriately account for those instruments. The Board decided to clarify that a debt instrument that can be converted to a variable number of shares with an aggregate fair value equal to a fixed monetary amount should be considered stock-settled debt that is subject to

the guidance in Subtopic 480-10 or other Subtopics, rather than a convertible debt instrument. However, if a stock-settled debt also contains a substantive conversion feature, relevant guidance in Subtopic 470-20 should be considered in addition to the relevant guidance in other Subtopics. The Board concluded that this clarification could, to a certain extent, alleviate the mischaracterization of stock-settled debt as a convertible debt instrument. Noting the various types of stock-settled debt in practice and the complexities in current accounting guidance, some comment letter respondents requested that the Board address those issues under this project. The Board acknowledges that some practice issues related to stock-settled debt may continue to exist, especially the issues related to different interpretations and applications of the guidance in Subtopic 480-10 and Topic 815 for certain instruments, which are beyond the scope of this project.

Conventional convertible debt instrument

BC53. The term *conventional convertible debt instrument* is used in Subtopic 815-40 to distinguish which instruments are eligible to apply a simplified assessment of the settlement criterion related to the derivatives scope exception for contracts in an entity's own equity. This term is described in the guidance as an instrument that provides the holder with an option to convert the debt instrument into a fixed number of shares (or equivalent amount of cash at the discretion of the issuer) for which the ability to exercise the option is based on the passage of time or a contingent event.

BC54. The Board observed that this term is not linked to a specific existing accounting model for convertible debt instruments and that the amendments in this Update do not change the population of convertible debt instruments that are eligible for the simplified assessment of the settlement criterion. However, this term sometimes is used interchangeably with, or interpreted as, *traditional convertible debt instrument*, which could result in misinterpretation of the guidance.

BC55. Noting that the concept of conventional convertible debt is limited to the application of the guidance in Subtopic 815-40 and already is clearly defined in that Subtopic, the Board concluded that the word *conventional* is not considered necessary and meaningful and, therefore, decided to remove it from the guidance.

Convertible instrument awards granted to employees and nonemployees

BC56. In June 2018, Accounting Standards Update No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, was issued as a simplification to align the guidance for employee share-based payments and nonemployee share-based payments.

BC57. The amendments in that Update require that a freestanding financial instrument that is subject to initial recognition and measurement guidance within Topic 718 continue to be subject to the recognition and measurement provisions of that Topic throughout the life of the instrument, unless its terms are modified after a nonemployee vests in the award and is no longer providing goods or services or a grantee is no longer an employee. However, a convertible instrument award granted to a nonemployee in exchange for goods or services to be used or consumed in a grantor's own operations currently is subject to recognition and measurement guidance in Topic 718 until the award is fully vested. Once vested, a convertible instrument follows the recognition and measurement guidance through reference to other Topics or Subtopics, including Subtopic 470-20.

BC58. As explained in the basis for conclusions of Update 2018-07, the Board received feedback indicating that convertible instrument awards rarely occur in practice. Therefore, the Board decided to defer its consideration on the post-vesting accounting for convertible instrument awards to this project in the context of the potential changes to the accounting models for convertible instruments.

BC59. The Board concluded that there is a lack of conceptual basis and economic basis to treat convertible instrument awards differently from freestanding financial instrument awards because both are payments to employees or nonemployees for goods or services. Therefore, the Board decided to align the post-vesting accounting guidance on convertible instrument awards with that for freestanding financial instrument awards.

Convertible preferred stock that includes a down round feature

BC60. In July 2017, the Board issued Update 2017-11. The primary amendments in that Update were as follows:

- a. Classification. A scope exception was created in Subtopic 815-40 to exclude a down round feature from the consideration of whether an instrument, or feature, is indexed to an entity's own stock.
- b. EPS. Entities that present EPS in accordance with Topic 260 recognize the effect of the down round feature when it is triggered. That effect is treated as a dividend and as a reduction of income available to common shareholders in basic EPS.

BC61. As a result of the Board's decisions on this project, the Board decided to amend the scope of the guidance on accounting for financial instruments that include down round features. The amendments add equity-classified convertible preferred stock that include down round features to the scope of the recognition and measurement guidance in Topic 260. These instruments were previously excluded from the scope of the guidance in Update 2017-11 because of the application of the beneficial conversion feature model. However, because the amendments in this Update supersede that model, the Board decided that the

down round model should apply to those instruments. The Board decided that a down round feature included in an equity-classified convertible preferred stock should have the same accounting treatment as a down round feature included in an equity-classified freestanding warrant or option.

BC62. The Board decided not to extend the scope of the Topic 260 recognition and measurement guidance to convertible debt instruments. The Board decided not to include convertible debt instruments in the requirements because Topic 825 requires that an entity disclose fair value information for convertible debt instruments. Therefore, the Board decided that financial statement users are provided with sufficient information for these instruments because changes in the down round feature (such as a trigger) should be captured within the fair value measure.

Derivatives Scope Exception for Contracts in an Entity's Own Equity (Subtopic 815-40)

Background

BC63. Under Subtopic 815-40, an entity must determine whether a contract meets a scope exception from derivative accounting. The guidance must be applied to:

- a. Freestanding financial instruments and embedded features that have all the characteristics of a derivative instrument
- b. Freestanding financial instruments that potentially are settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative instrument.

BC64. The analysis used to determine whether a contract meets this scope exception includes two criteria, which often are referred to in practice by their pre-Codification standards, as follows:

- a. The contract is indexed to the entity's own stock (EITF Issue No. 07-5, "Determining Whether an Instrument [or Embedded Feature] Is Indexed to an Entity's Own Stock," or the "indexation criterion")
- b. The contract is equity classified (EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," or the "settlement criterion").

BC65. If both of the above criteria are not met, the contract must be accounted for as an asset or a liability. For embedded features, this means that the embedded feature (which is referred to as an embedded derivative) must be bifurcated and accounted for separately from its host instrument under Subtopic 815-15. Conversely, if both criteria are met for a freestanding instrument, it is equity classified and is not accounted for as a derivative instrument. If both criteria are

met for an embedded feature, it would not be separated from its host contract. The likelihood of contingent events cannot be factored into the evaluation of the criteria.

BC66. The Board received feedback that stakeholders have difficulty applying the guidance for this exception to derivative accounting because of its lack of organization, as well as that the guidance is rules based, appears to lack consistency, and often results in features with relatively less economic substance fundamentally changing accounting conclusions. For example, a remote feature may drive the accounting treatment of the contract.

Indexation Criterion (Section 815-40-15)

BC67. Amendments to the indexation criterion that were included in the proposed Update are not included in the final Update. However, because those amendments were included in the proposed Update, below is an overview of the current guidance, what the Board originally proposed, stakeholder feedback on the proposal, and the Board's rationale for removing those proposed amendments.

BC68. Section 815-40-15 requires that an entity determine whether a contract is indexed to an entity's own stock. The concept of indexation is defined as an application of a two-step process, which involves:

- a. Step 1: Evaluate the feature for any contingent exercise provisions. Step 1 was not within the scope of this project.
- b. Step 2: Evaluate the feature's settlement provisions.

BC69. The fixed-for-fixed principle underlying Step 2 (analysis of the contract's settlement provisions) means that a freestanding instrument or embedded feature is considered indexed to an entity's own stock if its settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount. This fixed-for-fixed guidance was developed in contemplation of a hypothetical forward or option that has no provisions that adjust the settlement amount (adjustment provisions).

BC70. Most, if not all, contracts subject to this guidance contain adjustment provisions upon the occurrence of contingent events and, as a result, the vast majority of contracts would fail to meet the fixed-for-fixed principle. To mitigate this outcome, a list of exceptions exists to supplement the principle. The exceptions focus on the inputs to the fair value of a fixed-for-fixed forward or option on equity shares (for example, an entity's stock price, the term, or dilutive activities). Paragraph 815-40-15-7E describes the list of exceptions from the fixed-for-fixed principle. Furthermore, these exceptions are included in 20 illustrative examples (paragraphs 815-40-55-26 through 55-48) that demonstrate how to apply the indexation criterion. Consequently, the indexation criterion generally is applied in practice by determining whether the instrument's or embedded feature's fact pattern is identical or can be analogized to those illustrative examples. Because this analysis involves matching terms and features to illustrations, the evaluation

largely depends on an entity's ability to fully understand the contract's settlement provisions and the nuances of the current guidance.

BC71. In accordance with paragraph 815-40-15-7D, an entity is required to consider any potential settlement adjustment provisions, regardless of the likelihood of the contingent events occurring. The Board received feedback from practitioners that the balance sheet classification may not reflect the economics of the transaction if it is driven by the presence of a feature that would be triggered only in remote scenarios. Said differently, because of an entity's inability to factor likelihood into its indexation assessment, remote terms can drive the balance sheet classification (and subsequently, the measurement of the contract). Because of this, stakeholders often do not understand the accounting conclusion, which can lead to an entity misapplying the guidance.

BC72. To reduce the cost of applying the guidance and the ongoing cost of fair value measurements for those instruments that fail the derivatives scope exception, the Board proposed removing the requirement that an entity evaluate potential settlement adjustments if the likelihood of an adjustment occurring is remote. Said differently, the Board proposed allowing an entity to qualitatively screen out any settlement adjustments that are considered to have a remote likelihood of occurring and disregard those provisions under the assessment required in Section 815-40-15 until triggered. This approach would have retained the current guidance, including the 20 illustrative examples in the implementation guidance. While the Board acknowledges that the remote threshold would not significantly decrease complexity in evaluating the indexation criterion, the Board believed it would reduce asserted form-over-substance-based accounting conclusions that are driven by remote contingent events and may result in an outcome that can be difficult to understand.

BC73. Paragraphs 815-40-35-8 through 35-13 provide reassessment guidance for contracts in an entity's own equity. Under current guidance, the classification of a contract in an entity's own equity should be reassessed at each balance sheet date or as a result of events during the period. During initial deliberations, the Board decided that requiring reassessment at each balance sheet date would reduce the benefits of the remote threshold. As a practical application of a likelihood threshold in the guidance, the Board proposed requiring reassessment of the derivatives scope exception only upon certain triggering events, such as upon a change to the instrument's strike price or the number of shares used to calculate the settlement amount.

BC74. During initial deliberations, the Board considered whether a lower threshold than remote, such as not probable, would be more effective in improving the guidance. Some practitioners told the Board that the audit risk of evaluating remote may be higher than evaluating not probable because there is a smaller margin of error. However, other practitioners that focus on private companies and small public companies stated that the term *remote* would be helpful in evaluating the indexation criterion. The Board decided that remote is the most appropriate

threshold, considering that likelihood cannot be considered today, and that any change from the current strict guidance is an improvement. In addition, at that time, many Board members were concerned that a lower threshold, such as not probable, would stray too far from the intent of the guidance.

BC75. Additionally, during initial deliberations, the Board considered three alternative approaches—the standard antidilution approach, the predominantly derived from stock price approach, and the highly indexed approach—that would have more significantly amended the indexation guidance as compared with the addition of the remote likelihood threshold. The Board ultimately did not pursue these approaches during initial deliberations because it decided that the expected benefits would not justify the expected costs. Additionally, many stakeholders urged the Board to retain the examples included in the implementation guidance, and these approaches would have removed the examples from the guidance.

- a. Standard antidilution approach—This approach would have allowed standard antidilution provisions (as defined in the Master Glossary) to be the only acceptable deviations from the fixed-for-fixed principle under Step 2. Under this approach, if a contract includes any provisions other than standard antidilution provisions, a freestanding instrument would have to be classified as a liability and an embedded feature would have to be separately accounted for from its host contract as a derivative. Stakeholders said that this approach would have been simple and would have reduced cost and complexity from a classification standpoint because standard antidilution provisions are a narrow list of exceptions as compared with current guidance and, consequently, almost all contracts would fail the derivatives scope exception and would have to be accounted for as derivative instruments. Stakeholders said that this approach would have significantly increased cost and complexity in measurement and disclosure, however. Stakeholders, especially those that represent private companies and small public companies, were concerned about the significant costs entities would incur with an increase in recurring fair value measurements and derivative disclosure requirements.
- b. Predominantly derived from stock price approach—Under this approach, if the number of shares or a contract's strike price used to calculate the settlement amount is not fixed, the contract would still be considered indexed to an entity's own stock if the monetary value is based solely or predominantly on variations in the fair value of the issuer's equity shares. If the contract's settlement amount is derived in a way other than that, the contract would be classified as a liability. This approach would have increased an entity's exercise of judgment in applying the derivatives scope exception. Many stakeholders, and certain Board members, expressed support for this approach because it would have created a clear principle for the acceptable deviations from the principle, rather than a list of exceptions based on a desired balance sheet classification.

However, some stakeholders, especially those representing private companies and small public companies, had concerns about the cost of a quantitative assessment. Stakeholders and some Board members also had concerns about this approach because of diversity in practice about interpreting the term *predominant*. They also had concerns that this approach might ultimately have resulted in similar balance sheet classification conclusions as the amendments, but with additional costs of creating new systems and implementing entirely new guidance.

- c. Highly indexed approach—Under this approach, an entity would have to quantitatively determine how indexed a contract is to its own stock and evaluate it against a *highly indexed* threshold, similar to how an entity assesses if a hedge is highly effective under Topic 815. The Board observed that developing a hypothetical instrument that could be applied to all contracts within the scope of Section 815-40-15 would be challenging. While having a standardized hypothetical underlying instrument would increase comparability of accounting conclusions, it would reduce how representative the hypothetical instrument is of all contracts. A standardized hypothetical instrument would require exhaustive implementation guidance and would not simplify the indexation criterion. There were concerns about the difficulties that private companies would have in measuring their own equity to perform a quantitative highly indexed assessment and the costs associated with that assessment.

BC76. Comment letter respondents' feedback on the remote likelihood threshold was linked to their feedback on the proposed reassessment guidance. Comment letter feedback on these aspects of the proposed Update was mixed. While respondents generally supported reducing form-over-substance-based accounting conclusions and agreed that remote settlement features should be disregarded for purposes of classifying contracts in an entity's own equity, they had mixed views about whether remote would be an operable and/or auditable threshold and whether the Board went far enough to effectively improve the derivatives scope exception guidance. Additionally, auditing standard setters observed that operability concerns are often accompanied by or are the basis for auditability concerns. They noted that while there are situations in which qualitative thresholds are both operable and auditable, the operability concerns about applying the remote threshold and the number and variety of potential settlement features may lead to complexity in management judgments, which could, in turn, give rise to complexity in auditing those judgments and related management controls. Additionally, some stakeholders noted that the length of time to which the assessment relates (the term of the contract) may add to the difficulty of the assessment.

BC77. On the basis of feedback, the Board had significant open questions regarding whether the remote likelihood threshold would be operable, auditable, or both without introducing significant additional cost or complexity. The remote

likelihood threshold was originally included within the scope of the project to improve the derivatives scope exception guidance in an attempt to reduce frequent financial statement restatements. On the basis of the mixed feedback, the Board could not determine that the proposed amendments related to the remote threshold and reassessment would achieve the project's objective. Therefore, the Board decided to remove from the scope of the project the proposed amendments that would have added a remote threshold to existing guidance in Section 815-40-15 and changed the reassessment frequency and disclosures. Instead of finalizing those amendments, the Board decided to add a separate project to its technical agenda, Distinguishing Liabilities from Equity Phase 2, to explore improvements to aspects of the derivatives scope exception guidance in Subtopic 815-40. The objective and scope of that separate project will be determined at a future date.

Settlement Criterion (Section 815-40-25)

BC78. Section 815-40-25 requires that an entity determine whether a contract meets specific conditions to be classified as equity. Analyzing whether a contract meets the settlement criterion involves evaluating the contract's settlement optionality and conditions necessary for share settlement. The theory behind the settlement criterion is that a contract that will settle in an entity's own equity shares meets the criterion, whereas a contract that may or will settle in cash does not. To evaluate a contract for provisions that could require net cash settlement, each contract must be evaluated against a list of conditions (included in paragraph 815-40-25-10) and if any condition is not met, the contract fails the derivatives scope exception and must be accounted for as an asset or a liability. Additionally, the current guidance explicitly precludes considering the likelihood that an event would trigger cash settlement.

BC79. To reduce cost and complexity, the amendments in this Update include simplifications to the settlement guidance in Subtopic 815-40. The amendments clarify that penalty payments do not preclude equity classification under the timely filing condition in paragraph 815-40-25-10(d) because they do not result in settlement of a contract, and the amendments remove the following three additional conditions for equity classification:

- a. Settlement in unregistered shares condition in paragraph 815-40-25-10(a)
- b. Collateral condition in paragraph 815-40-25-10(g)
- c. Shareholder rights condition in paragraph 815-40-25-10(f).

BC80. The Board considered adding a remote threshold to the settlement criterion as it relates to contingent events outside the counterparty's control that could require net cash settlement. However, the Board decided to remove this from the scope of the project for the reasons described in the Indexation Criterion section above.

BC81. The Board had considered an alternative approach that would have fundamentally replaced the current guidance with a simple principle. The evaluation under this approach would have been to contemplate only the contractual terms and would not have required analysis of extraneous factors, such as considering an entity's overall ability to settle in shares across all its contracts. Under this approach, if a contract requires that an entity settle in shares, there would be a presumption that the settlement aspect of the derivatives scope exception is met. The presumption about share settlement would be rebuttable when the entity has a history of cash-settling instruments that are contractually written to be share settled. The Board considered this type of approach because of stakeholders' feedback that evaluating provisions in a contract that theoretically could result in cash settlement, even though the contractual terms provide for share settlement, is cumbersome. This type of guidance may have been easier to apply than the current guidance with a list of conditions, but the Board had concerns that an entity might abuse this approach by issuing a limitless number of contracts with share-settled terms to obtain equity classification. The Board also had concerns that while this approach appears simple, it may subsequently require interpretive guidance, which could create complexities and prescriptive guidance. Therefore, the Board dismissed this approach and decided that it is more beneficial to amend the current guidance rather than create entirely new settlement guidance.

BC82. Stakeholders observed that an entity may be required to net cash settle a contract but often does not intend or is unable to settle the contract in cash. As a result, stakeholders questioned whether an entity should be able to use its own nonperformance to pay cash to qualify for share settlement under the settlement criterion. For example, can the entity claim that a contract qualifies for share settlement under the settlement criterion because it does not have cash to settle the contract in cash? In the Board's view, an entity should not be able to assert that a contract will be settled in shares because it would not have the cash to settle the contract and an entity's nonperformance to cash settle the contract should not be considered under the settlement criterion.

Clarify the timely filing condition

BC83. The amendments in this Update clarify that penalty payments do not preclude equity classification under the timely filing condition in paragraph 815-40-25-10(d) because they do not result in settlement of a contract. Some stakeholders observed that there is diversity in practice about whether a penalty payment constitutes the cash payment in paragraph 815-40-25-10(d). Many have interpreted the guidance in a way that penalty payments do not preclude equity classification because they do not result in settlement of a contract. The Board decided to clarify this condition because this interpretation is consistent with the guidance on registration payment arrangements under which the cash payment is considered a separate unit of account from the host instrument.

BC84. A few comment letter respondents asked the Board to clarify whether other cash payments, such as cash-settled top-off, make-whole provisions, or a cash payment to compensate the holder for the difference in value between registered and unregistered shares, would preclude equity classification if they do not represent a net cash settlement. The Board notes that these other situations are clearly related to settlement of a contract and are not considered the same as penalty payments.

Remove the unregistered shares condition

BC85. The amendments in this Update align the guidance on registered shares in Topic 815 with the guidance on registered shares in Topic 718. First, the amendments remove the condition in paragraph 815-40-25-10(a) on settlement in unregistered shares. Second, the amendments in paragraph 815-40-25-10A(a) add guidance that a requirement for a contract to be settled in registered shares does not imply that an entity does not have the ability to deliver shares and does not preclude equity classification, which is similar to the guidance in paragraph 718-10-25-15. Third, the amendments clarify that an entity must consider the ability to settle in registered shares if the contract explicitly states that an entity must settle in cash if registered shares are unavailable. The Board does not intend that in applying paragraph 815-40-25-10A(a) that an entity should look beyond the contract terms to evaluate whether there is an implicit requirement to cash settle for accounting purposes.

BC86. The unregistered shares condition links back to the concept of whether share settlement is within an entity's control. Stakeholders told the Board that this condition is the most difficult aspect of the settlement guidance to apply when determining an entity's ability to settle in shares. To evaluate this condition, an entity typically must engage legal counsel to determine whether a contract can be settled with unregistered shares. Stakeholders have told the Board that lawyers and accountants often disagree about conclusions, especially considering that likelihood cannot be currently factored into this evaluation for accounting purposes but generally is factored into this evaluation for legal purposes.

BC87. Comment letter respondents supported removing the unregistered shares condition because the guidance is costly and time consuming to apply. Some respondents noted that contracts in an entity's own equity rarely settle in cash when registered shares are unavailable because those contracts often include a provision that precludes cash settlement in the event that the entity is unable to deliver registered shares.

BC88. Paragraph 815-40-25-10 also includes the following conditions that require an entity to assess its ability to share settle instruments in the future and that currently preclude equity classification:

- a. Entity has sufficient authorized and unissued shares (paragraph 815-40-25-10(b)).
- b. Contract contains an explicit share limit (paragraph 815-40-25-10(c)).

BC89. During initial deliberations, the Board considered whether condition (a), condition (b), or both should be amended or removed because those conditions also link back to the concept of whether share settlement is within an entity's control. Stakeholders informed the Board that these conditions are fairly straightforward and not the cause of cost and complexity in the guidance, mainly because an entity can objectively calculate how many shares are outstanding and compare that number with the number of shares that would be required to settle all outstanding instruments. Stakeholders told the Board that entities have this information readily available. Therefore, the Board decided to retain conditions (a) and (b).

Remove the collateral condition

BC90. The amendments in this Update remove the collateral condition because it is inconsistent with the concept of settlement. The Board acknowledges that removing the guidance may permit entities to issue contracts that require collateral because a collateral requirement no longer precludes equity classification.

BC91. This condition was originally included in the guidance because of a view that a requirement to post collateral is inconsistent with the concept of equity and, therefore, should preclude equity classification of a contract. Although posting collateral requires using assets in the short term, the Board observes that the nature of collateral is that it may be returned, so it may not be considered cash settlement.

BC92. Comment letter respondents supported removing the collateral condition because a requirement to post collateral is unrelated to the concept of settlement and, therefore, should not affect classification. A few respondents and one Board member disagreed with the removal because they disagree with the Board's rationale for the removal (that this condition is unrelated to settlement) and they stated that form of settlement and the nature of the counterparty's rights should affect classification (not just form of settlement).

Remove the shareholder rights condition

BC93. The amendments in this Update remove the shareholder rights condition because it is unrelated to the concept of settlement (that is, cash versus share settlement), its inclusion as a condition is not justified by any other areas of GAAP, and it is difficult to apply in practice.

BC94. This condition was originally included in the guidance because of a view that to be classified as equity, a contract cannot give the counterparty any of the rights of a creditor in the event of an entity's bankruptcy. The Board observed that including this condition in the guidance is unrelated to whether the contract will be cash settled or share settled. The Board also observed that the notion of shareholders' rights is not defined in the Master Glossary (other than as described in Section 815-40-25), which makes this condition difficult to apply in practice.

BC95. Comment letter respondents supported removing the shareholder rights condition because counterparty rights are unrelated to the concept of settlement and, therefore, should not affect classification. A few respondents and one Board member disagreed with the removal because they disagree with the Board's rationale for the removal (that this condition is unrelated to settlement) and stated that form of settlement and the nature of the counterparty's rights should affect classification (not just form of settlement).

Disclosures for Contracts in an Entity's Own Equity (Section 815-40-50)

BC96. According to outreach with financial statement users, disclosure of the terms and features of contracts in an entity's own equity is useful in projecting cash flows, determining dilutive effects on shareholders, and understanding the subordination structure in bankruptcy proceedings, depending on a user's perspective. Most users noted that disclosures about the terms and features of contracts are more important than disclosures about fair value for their analyses. On the basis of this feedback and a review of the current disclosure requirements for contracts in an entity's own equity, the Board concluded that currently there are no significant gaps between users' needs and disclosure requirements for contracts in an entity's own equity. Therefore, as part of the amendments in this Update, the Board considered whether there may be any informational gaps created by the amendments related to the derivatives scope exception.

BC97. The Board observed that a population of contracts that were previously accounted for as derivatives (measured at fair value through net income each period) will now be accounted for as equity (not remeasured) as a result of the amendments in this Update. Therefore, for that population of contracts, financial statement users are no longer able to receive fair value information and derivative disclosures. The Board observed that this population of contracts mainly consists of contracts that were previously accounted for as derivatives because of their form and not because of their substance.

BC98. The main difference between disclosures for equity-classified contracts and asset- or liability-classified derivative instruments is fair value information. That is because fair value information is not required for equity-classified contracts. To close the informational gap caused by the amendments in this Update, the Board considered, for public business entities, whether fair value information should be

required for those contracts that currently fail the derivatives scope exception but would meet it and be classified as equity under the amendments (that is, only those contracts that financial statement users currently receive fair value information for) or whether fair value information should be required for all contracts in an entity's own equity that qualify for the derivatives scope exception. The Board decided that it would not be operable to require the former of this fair value information requirement because it would not be possible to identify every affected contract to develop a clear scope for stakeholders to apply. Therefore, the Board observed that the only operable scope for such a fair value disclosure would be to require fair value for all equity-classified contracts under Subtopic 815-40. However, the Board observed that to require fair value for all equity-classified contracts in an entity's own equity would come at a substantial cost because entities currently are not required to provide (and, in most circumstances, currently are not calculating) this information. The Board decided not to require fair value disclosures for equity-classified contracts in an entity's own equity because this disclosure requirement would not be cost beneficial. In response to a question included in the proposed Update, almost all those who answered the question did not support including new fair value disclosures because such a requirement would be too burdensome and would not provide any additional useful information beyond what is already disclosed.

BC99. The amendments in this Update add a disclosure objective for Section 815-40-50. The Board observed that a disclosure objective often is included for complex accounting areas. The Board decided that disclosure objectives are important for stakeholders to understand the set of the disclosure requirements and provide insight on why the Board deemed those disclosure requirements to be broadly relevant to all entities. The disclosure objective is not intended to represent additional disclosure requirements for entities.

BC100. The amendments in this Update clarify that Subtopic 815-40 includes disclosure requirements that are applicable for freestanding instruments, regardless of whether the contract meets the criteria in Sections 815-40-15 and 815-40-25. Because a contract may be analyzed under multiple Topics before an entity determines the correct accounting for that contract, the Board acknowledges that it can be confusing to identify what disclosures must be provided, especially because there is no specific guidance that provides the scope of the disclosure requirements under each Topic. The Board decided that the scope for the disclosure requirements in Subtopic 815-40 should be clarified so that stakeholders can better understand whether a contract is subject to the disclosure requirements.

Subsequent Measurement

BC101. The amendments in this Update require instruments that should be classified as an asset or liability under paragraph 815-40-15-8A to be measured subsequently at fair value, with changes reported in earnings and disclosed in the

financial statements. Measuring those instruments at fair value is consistent with the SEC staff's long-standing position that written options should be reported at fair value and subsequently marked to fair value through earnings and with the views in AICPA Issues Paper No. 86-2, *Accounting for Options* (March 6, 1986). Therefore, the Board concluded that most of these contracts are currently being measured at fair value and the amendments should not have a significant effect on current practice.

BC102. Subtopic 815-40 provides classification guidance for a freestanding instrument that does not meet the indexation criterion (classify as an asset or liability). However, before the issuance of the amendments in this Update, that Subtopic did not provide subsequent measurement guidance for instruments that do not meet the indexation criterion and do not meet the definition of a derivative (for example, whether to measure at cost or recurring fair value). Conversely, paragraph 815-40-35-4 requires instruments that do not meet the definition of a derivative and do meet the indexation criterion but do not meet the settlement criterion to be measured at fair value. Practitioners noted that they generally have applied the subsequent measurement guidance in paragraph 815-40-35-4 (recurring fair value through net income) for instruments that are required to be classified as an asset or liability under paragraph 815-40-15-8A, but they observed that this is an area of confusion that has created diversity in practice (with some entities currently measuring those instruments at cost).

BC103. Most comment letter respondents supported the Board addressing the gap in subsequent measurement. A few comment letter respondents observed that the fair value requirement may include contracts that were previously not measured at fair value. The Board acknowledges that because of a lack of guidance, there may be a population of these instruments that are currently being accounted for at cost and, therefore, an entity should transition to fair value measurement under the amendments in this Update. The Board concluded that this amendment mostly affects freestanding instruments issued by private companies. For example, a freestanding warrant on the share of a private company may not meet the definition of a derivative because it requires physical settlement or cannot be net settled because the underlying equity is not readily convertible to cash. In the Board's view, it would be impractical to attempt to remove certain contracts from the scope of this guidance, especially if the contracts are within the scope of Subtopic 815-40 and do not qualify for the derivatives scope exception. Although certain contracts may not be measured at fair value today, this is likely the most consistent treatment for those contracts if they have features similar to other contracts in an entity's own equity.

Technical Corrections

BC104. During the Board's development of the amendments in this Update, stakeholders provided suggestions for various technical corrections to Subtopic

815-40. As part of the amendments, the Board decided to make the various technical corrections, which comment letter respondents supported.

BC105. The amendments in this Update align the wording in paragraph 815-40-50-5(d) with the wording in paragraph 480-10-50-2 to clarify the disclosure requirement. The Board observed that the intent of the disclosure requirement in paragraph 815-40-50-5(d) is to obtain the same information that must be disclosed in paragraph 480-10-50-2, which requires that an entity disclose the amount that would be paid or the number of shares that would be issued and their fair value and how changes in the fair value of the issuer's equity shares would affect those settlement amounts.

BC106. The amendments in this Update remove the table previously included in paragraph 815-40-55-11 and related guidance because the Board concluded that the information in the table is not relevant for embedded features. That table illustrated how Subtopic 815-40 applies to embedded written put options and embedded forward purchase contracts. That table was originally included in Issue 00-19 to apply to freestanding written put options and forward purchase contracts. That table is now included in paragraph 480-10-55-63 to apply to freestanding written put options and forward purchase contracts. Subtopic 815-40 does not apply to hybrid contracts or embedded features except when an entity is analyzing whether an embedded feature must be bifurcated as an embedded derivative under paragraph 815-15-25-1(c). Therefore, Subtopic 815-40 does not provide classification or measurement guidance for hybrid contracts or embedded features. Because of this, stakeholders noted that the information in the table could be misleading.

BC107. The amendments in this Update clarify that the reassessment guidance in paragraphs 815-40-35-8 through 35-13 applies to all contracts evaluated under Subtopic 815-40, including both freestanding instruments and embedded features. Additionally, the amendments clarify that the reassessment guidance applies to both the indexation criterion and the settlement criterion. Those amendments are not expected to result in a significant change to current practice. Feedback from stakeholders is that this reassessment guidance is applied in practice to both freestanding instruments and embedded features because no explicit guidance exists for reassessing embedded features. Additionally, stakeholders noted that it is common for entities to analogize to the guidance for embedded conversion options that no longer meet the bifurcation criteria under paragraph 815-15-35-4 (which requires reclassification of the feature to equity).

Earnings Per Share

BC108. In considering improvements to the guidance on EPS, the Board focused on the areas included in the overall project scope of (a) convertible instruments and (b) instruments that qualify for the derivatives scope exception for contracts in an entity's own equity in Subtopic 815-40; that is, the Board's objective was not to

perform a holistic review of the EPS guidance. The amendments in this Update relate to aligning the diluted EPS calculation for convertible instruments and simplifying the application of diluted EPS guidance for instruments that may be settled in cash or shares.

BC109. There are currently two methods of calculating diluted EPS—the if-converted method and the treasury stock method. The if-converted method assumes conversion of convertible securities at the beginning of the reporting period (or at time of issuance, if later). The denominator is adjusted to reflect the potential shares, and the numerator is adjusted to add back any interest and preferred dividends that were included in the income statement during the period. The treasury stock method considers the use of proceeds that could be obtained upon exercise of options and warrants in computing diluted EPS and assumes that the proceeds would be used to purchase common stock at the average market price during the period.

BC110. Because the Board decided to align the recognition and measurement guidance for convertible instruments to eliminate several accounting models, it also decided to align the diluted EPS calculation for convertible instruments. Currently, diluted EPS for many convertible instruments is calculated using the if-converted method. However, the treasury stock method is used for certain instruments, for example, convertible securities that permit or require the payment of cash to the holder of the security at conversion.

BC111. Current guidance on the if-converted method requires that interest charges applicable to the convertible debt be added back to the numerator. However, that calculation would provide a confusing diluted EPS result for an instrument for which the principal is required to be paid in cash because an entity would not have avoided the cash payment of interest because the principal and interest are required to be cash settled. That is, only the conversion premium is share settled. Therefore, as a practical matter, the Board decided to modify the existing if-converted method. The Board observes that the diluted EPS result under the if-converted method for a convertible instrument for which the principal is required to be cash settled will be similar to the diluted EPS result under current GAAP of applying the treasury stock method. That is because only the conversion premium affects diluted EPS under both approaches.

BC112. Current GAAP provides guidance on the effect to diluted EPS for instruments that may be settled in cash or shares. Under that guidance it should be presumed that the contract will be settled in common stock and the resulting potential common shares included in diluted EPS if the effect is more dilutive. However, the presumption that the contract will be settled in common stock may be overcome if past experience or a stated policy provides a reasonable basis to believe that the contract will be paid partially or wholly in cash.

BC113. The Board decided to simplify the guidance by removing an entity's ability to rebut the presumption about share settlement. The Board has concerns about an entity being able to classify an instrument in equity because it contractually may

be share settled but then exclude the shares from diluted EPS because of an assertion that the instrument would be cash settled. The Board observed that a disconnect exists between classification and EPS because the two areas of guidance do not depend on one another. However, the Board decided that it would not be feasible in this project to fully align classification and EPS guidance. Therefore, the Board decided to amend only the ability to rebut the presumption rather than making more extensive amendments to the guidance. The Board observed that this approach was previously exposed in 2003, 2005, and 2008 as part of a convergence project with the IASB that was not finalized. During that project, financial statement users supported this approach. Additionally, an added benefit is that this amendment aligns this aspect of the EPS guidance with International Financial Reporting Standards. The Board observed that taking this approach results in entities including the maximum potential dilution in EPS and that results in a lower diluted EPS for instruments that may be cash settled or share settled because the denominator is larger by assuming share settlement. The Board observes that this approach does not consider the likelihood of share settlement and it does not consider management's intent regarding the method of settlement. Additionally, the Board retained the existing guidance in paragraph 260-10-45-45 about when share settlement is "more dilutive." Because that guidance exists in current GAAP and was retained, the Board expects that that assessment would not change after adopting the amendments in this Update. The Board concluded that this is more consistent with the general interpretation of diluted EPS as a measure of EPS calculated on the assumption that all potentially dilutive securities are exercised because the instrument contractually may be share settled.

BC114. The classification guidance in Topic 718 is different from the classification guidance in Subtopic 815-40. Specifically, the guidance in paragraph 718-10-25-15 states that ". . . if an entity that nominally has the choice of settling awards by issuing stock predominantly settles in cash or if the entity usually settles in cash whenever a grantee asks for cash settlement, the entity is settling a substantive liability rather than repurchasing an equity instrument." Under current GAAP, a liability-classified stock-based compensation arrangement may not be included in diluted EPS because of the existing guidance on contracts that may be settled in cash or shares. The Board decided to retain the current guidance for calculating diluted EPS for stock-based compensation because those arrangements are not within the scope of this project.

BC115. The Board also decided to amend the diluted EPS guidance to clarify which share prices should be used in calculating the diluted EPS denominator for instruments for which (a) the exercise prices may change on the basis of an entity's share price or (b) changes in the entity's share price may affect the number of shares that may be used to settle a financial instrument. Stakeholders highlighted that currently there is diversity in how the denominator for those instruments is calculated. The Board understands that under current practice, an entity typically makes a policy election to use either the share price as of the end of the period

(because of analogy to contingently issuance share guidance) or the average share price during the reporting period (because Example 11 in Topic 260 includes the average share price in the diluted EPS calculation). The Board decided to reduce this diversity by clarifying that an average market price should be used. The Board observed that there already is existing implementation guidance in Topic 260 (paragraphs 260-10-55-4 through 55-5) on determining an average market price. The Board's view is that using an average price is most consistent with the existing requirements of the treasury stock method and provides the most consistent calculations for the if-converted method (for example, because an average price would be less volatile than a price determined at a point in time). The Board also observed that there is guidance on the share price to apply to contingently issuable shares in paragraphs 260-10-45-48 through 45-57. The addition of the guidance in paragraph 260-10-45-21A does not override that guidance.

BC116. The amendments in this Update also include a technical correction to paragraph 260-10-55-34 about year-to-date share calculation to correct an inconsistency between paragraphs 260-10-55-3 and 260-10-55-34. The current guidance in paragraph 260-10-55-3 requires that an entity use the weighted-average share count from each quarterly diluted EPS calculation to determine its year-to-date average share count. In contrast, the current guidance in paragraph 260-10-55-34 requires that an entity calculate an average for the year-to-date period (rather than averaging the quarters). The amendment clarifies that the weighted-average share count in each quarterly diluted EPS calculation should be used to determine the year-to-date weighted-average share count.

BC117. Some financial statement users requested improvements to the disclosures about the effect of hedging transactions on share count. Entities often have a strategy of issuing multiple instruments at or near the same time to manage the potential effects for dilution. For example, an entity will issue convertible debt with a purchased call option or other hedging strategies. In calculating diluted EPS, an entity includes the potential dilution from exercise of the conversion option but does not include the potential offset from the hedge because it is antidilutive. *Antidilution* is defined in the Master Glossary as an increase in EPS amounts or a decrease in loss per share amounts. Information about those instruments currently is required to be disclosed in accordance with guidance in Topics 505 and 815. The Board decided not to provide any new disclosure requirements because it deemed the existing requirements sufficient.

Private Company Considerations

BC118. The Private Company Decision Making Framework provides guidelines that assist the Board and the PCC in determining whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date, and transition guidance for private companies reporting under GAAP. The assessment of significant differential factors between private

companies and public companies is an important source of input when considering whether to provide accounting alternatives.

BC119. The amendments in this Update are expected to improve, simplify, and enhance the financial reporting requirements for convertible instruments and contracts in an entity's own equity for all entities, including private companies.

Effective Date and Transition

BC120. The amendments in this Update are effective for public business entities that meet the definition of an SEC filer, excluding entities eligible to be smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years.

BC121. The Board decided on an effective date for fiscal years beginning after December 15, 2021, for public business entities that meet the definition of an SEC filer, excluding entities eligible to be smaller reporting companies, because of the issuance date of this Update and the complexity of this area of guidance. The Board decided that at least one year should be provided for implementing the guidance. An effective date for fiscal years beginning after December 15, 2020, might not have provided entities with sufficient time to adopt the amendments.

BC122. In determining the effective date for all other entities, the Board considered its new effective date philosophy articulated in Accounting Standards Updates No. 2019-09, *Financial Services—Insurance (Topic 944): Effective Date*, and No. 2019-10, *Financial Instruments—Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*. Consistent with the new effective date philosophy and stakeholder feedback, the Board decided that providing all other entities, including those eligible to be smaller reporting companies, with an additional two years to adopt the amendments is appropriate because those entities have limited resources and this area of guidance is complex. The Board observed that this project may not be considered by some stakeholders to be a major standard-setting project to warrant a two-year deferral. However, the Board decided that including a two-year deferral would be a good test of the new philosophy. The Board also decided to permit early adoption so that companies are not required to wait to adopt the standard if they so choose.

BC123. Early adoption is permitted as of the fiscal years beginning after December 15, 2020, including interim periods within those fiscal years. Considering that the amendments are simplifying in nature, the Board decided that entities with the capabilities to implement the standard earlier should be able to do so. However, the Board specified the early adoption date because it decided that entities should adopt the guidance as of the beginning of its annual fiscal year (that is, an entity must adopt the guidance as of the beginning of the year and is not allowed to adopt the guidance in a subsequent interim period).

BC124. The Board decided to allow entities to adopt the guidance through either a modified retrospective method of transition or a fully retrospective method of transition. The Board also decided to align the transition methods for all of the amendments in this Update rather than allowing for different transition methods for different aspects of the amendments in this Update. Although the proposed amendments included different transition provisions for the EPS amendments, the Board decided to align the methods as a result of the comment letter feedback. Because entities are not required to apply a full retrospective method of transition, the Board decided to include an additional transition disclosure about EPS in the first reporting period that the Update is adopted.

BC125. In applying a modified retrospective method of transition, an entity should adjust the basis of an affected instrument (or feature) to what it would have been if the entity had applied the amendments from the inception of the instrument (or feature). The entity should record the offset of the basis adjustment as a cumulative catch-up adjustment in retained earnings at the date of adoption. By adjusting the instrument's basis as of the date of adoption, the entity should calculate consistently the income statement amounts in the period of adoption and future reporting periods (for example, interest and amortization) for both instruments outstanding at the date of adoption and for new instruments issued in periods after adoption.

BC126. In applying a full retrospective method of transition, an entity should apply the guidance retrospectively to all instruments outstanding as of the beginning of the first comparative period. The cumulative effect of the change in guidance should be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented. The offsetting adjustment should be made to the opening balance of retained earnings for the first period presented.

BC127. In applying the transition methods described above, in many cases an entity may need to recombine instruments that were previously bifurcated into separate units of account for accounting purposes. This recombination may be complex in scenarios in which there are multiple features in an instrument. However, the Board observed that this is expected to be a one-time cost of transition, rather than a recurring cost.

BC128. For convertible debt, conversion options that were previously bifurcated and recorded in equity (for example, under the cash conversion model or beneficial conversion feature model) should be recombined as a single instrument classified as a liability (or in the case of convertible preferred stock, as a single instrument classified as equity). The basis of that instrument should be determined by recalculating what the instrument's basis would be if the conversion option had not been bifurcated originally. This requires that an entity determine the amortized cost of the instrument at contract inception and then recalculate the amortization of the discount (or premium) until the date of the basis adjustment and recalculate the effective interest rate.

BC129. The following table includes examples of how the transition method(s) should be applied in common scenarios:

Instrument Type and Current GAAP Classification	Effect of Guidance (If Scope Exception Currently Failed, but Passed under the Amendments)
Freestanding instrument is classified as a liability.	Reclassify to equity and adjust basis of instrument to what would have been the value at initial measurement.
Embedded feature is classified as a liability, and the host is classified as a liability.	Recombine instruments into a single liability instrument. Determine what the basis of that instrument would have been originally if the embedded feature had not been bifurcated. This would include a recalculation of the effective interest rate and any amortization of a discount (or premium).
Embedded feature is classified as a liability, and the host is classified as equity.	Recombine instruments into a single equity instrument and recalculate basis. Determine what the basis of that instrument would have been originally if the embedded feature had not been bifurcated.
Multiple embedded features are bifurcated from the host and classified as liabilities (host is classified as equity).	Recombine instruments into a single equity instrument (except for features not affected by this guidance) and recalculate basis. Determine what the basis of that instrument would have been originally if the embedded feature(s) had not been bifurcated.
Multiple embedded features are bifurcated from the host and classified as liabilities (host is classified as a liability).	Recombine instruments into a single liability instrument (except for features not affected by this guidance) and recalculate basis. Determine what the basis of that instrument would have been originally if those embedded features had not been bifurcated. This would include a recalculation of the effective interest rate and any amortization of a discount (or premium).
Debt is issued with detachable warrants.	Recalculate Day 1 allocation between the debt and warrants. Reclassify the warrants to equity on the basis of original relative fair value. Recalculate the basis of the debt. This would include a recalculation of the effective interest rate and any amortization of a discount (or premium).

BC130. The effects of the basis adjustments described in the table above would be recognized in accordance with the transition requirements in paragraph 815-40-65-1(b).

Fair Value Option

BC131. The amendments in this Update affect the population of instruments that are eligible for the fair value option under Topic 825 because paragraph 825-10-15-5 prohibits election of the fair value option for financial instruments that are, in whole or in part, classified by the issuer as a component of shareholders' equity.

BC132. The election to record an instrument at fair value must be made as of the *election date* as described in paragraph 825-10-25-4. The Board observes that a change in an accounting standard is not an event that is considered an election date. Therefore, if an entity did not originally elect the fair value option for a convertible instrument, then the entity cannot subsequently make the election for that instrument.

BC133. As a result, the Board decided to provide entities with a one-time irrevocable election to apply the fair value option to liability-classified convertible instruments that are allowed by paragraph 825-10-15-5 as of the date of adoption of the amendments in this Update. The Board acknowledges that because this option applies to all convertible instruments that are liability classified (that is, it does not apply to convertible debt with a substantial premium accounted for in accordance with paragraph 470-20-25-13), the option also may be applied to convertible instruments whose eligibility for the fair value option would not have been affected by these amendments (for example the option also applies to convertible instruments with embedded derivatives). However, the Board concluded that the prevalence of these instruments does not warrant distinguishing the instruments whose eligibility for the fair value option would have been affected by these amendments from the instruments whose eligibility for the fair value option would not have been affected. Additionally, the Board observes that transition to the fair value method of accounting for these instruments would follow the transition method selected by an entity in accordance with paragraph 815-10-65-1(b).

Early Adoption for Convertible Instruments That Include Down Round Features

BC134. The amendments in Update 2017-11 affect the accounting for convertible instruments that include a down round feature. In applying that guidance, at the date of adoption of Update 2017-11, an entity should recombine a convertible instrument with a down round feature that had been bifurcated into a host contract and an embedded conversion option measured initially and subsequently at fair value with changes in fair value recognized in earnings under derivative accounting guidance but that is not bifurcated because of the amendments in that Update. If the convertible instrument has a cash conversion feature or a contingent beneficial conversion feature that had been triggered before the effective date of that Update, the entity should separate the convertible instrument into two components on the

basis of the appropriate model as if that model had been applied upon issuance or upon trigger, as appropriate, with any resulting difference in retained earnings recognized as a cumulative-effect adjustment of the opening balance of retained earnings.

BC135. The amendments in this Update affect the accounting for convertible instruments that include down round features by requiring that those conversion features no longer be bifurcated from the host instrument (unless the conversion features were required to be bifurcated as an embedded derivative). Therefore, an entity no longer is required to apply the cash conversion model or beneficial conversion feature model. However, this could result in multiple transitions for the same instrument; that is, in applying the guidance in Update 2017-11, a convertible instrument with a down round feature may transition from derivative accounting to beneficial conversion feature accounting if the down round feature meets the definition of a contingent beneficial conversion feature. Then, the convertible instrument may further transition from beneficial conversion feature accounting to traditional convertible debt accounting under the amendments in this Update. The Board decided that requiring multiple transitions for the same instrument would be costly for preparers with no benefit for financial statement users. Accordingly, the Board decided that an entity may early adopt the amendments in this Update for convertible instruments that include down round features if an entity has not yet adopted the amendments in Update 2017-11.

BC136. The Board decided that this aspect of adoption only applies to convertible instruments that include down round features. Other instruments affected by the amendments in this Update (such as other convertible instruments that do not include down round features, options, or warrants) should follow the overall effective date guidance. Accordingly, aspects of the amendments might be adopted on different dates. However, an entity must select the same transition method for early adoption and the other amendments. That is, if an entity elects to apply a full retrospective option for the early adoption, that method would apply to all amendments. Additionally, if an entity elects early adoption for convertible instruments with down round features, the transition disclosures in paragraph 815-40-65-1 would apply.

BC137. The Board decided that the disclosure and EPS amendments would not apply to the early adoption for convertible instruments that include down round features. The Board observed that partially adopting the disclosure amendments for a subset of instruments would be confusing for users. Additionally, the EPS amendments would not be applicable because the only population of entities that can early adopt for this subset of instruments are those entities that have not yet adopted the amendments in Update 2017-11, which would be nonpublic entities only and they are not required to present EPS.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*[®] in this Accounting Standards Update require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those improvements, which will be incorporated into the proposed 2021 Taxonomy, are available through Taxonomy Improvements provided at www.fasb.org, and finalized as part of the annual release process.