



401 Merritt 7, PO Box 5116  
Norwalk, CT 06856-5116  
tel: 203.847.0700  
www.fasb.org

June 10, 2021

**TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE**

Included are the final minutes of the March 11, 2021 meeting of the FASB Emerging Issues Task Force (EITF).

At its March 24, 2021 meeting, the Board discussed the project direction of EITF Issue No. 19-B, "Revenue Recognition: Contract Modifications of Licenses of Intellectual Property," and with the EITF recommendation decided to remove the project from its technical agenda. The Board will consider the issue as part of the Post-Implementation Review (PIR) process of Topic 606, Revenue from Contracts with Customers.

Also, at its March 3, 2021 Agenda Prioritization meeting, the Board decided not to add two potential projects to its agenda or the EITF agenda ("Pushdown of Parent's Basis in a Common Control Transaction," and "Clarifying Applicable Guidance for Certain Asset Acquisition and Nonemployee Share-Based Payment Transactions").

With the issuance of EITF Issue No. 19-C, "Issuer's Accounting for Certain Modifications of Freestanding Equity-Classified Written Call Options," in early May, there are no outstanding Issues on the EITF agenda.

With these developments in mind, the staff has decided not to utilize the May 6, 2021 EITF "Extra" meeting date or the June 10, 2021 regular EITF meeting date.

Please call or email me if you have any questions.

Sincerely,

**David Yates**

*Practice Fellow*



Financial Accounting Standards Board  
401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856  
T: 203.956.5344  
[dyates@fasb.org](mailto:dyates@fasb.org)  
[www.fasb.org](http://www.fasb.org)

**Emerging Issues Task Force  
Meeting Minutes  
March 11, 2021**

	<b><u>Pages</u></b>
• <b>Attendees</b>	1
• <b>Administrative Matters</b>	2
• <b>Discussion of Agenda Technical Issues</b>	<b>3-16</b>
1. Issue No. 19-B, “Revenue Recognition—Contract Modifications of Licenses of Intellectual Property”	<b>3-9</b>
2. Issue No. 19-C, “Issuer’s Accounting for Certain Modifications of Freestanding Equity-Classified Written Call Options”	<b>10-16</b>

**MINUTES OF THE MARCH 11, 2021 MEETING  
OF THE FASB EMERGING ISSUES TASK FORCE**

Location: Virtual Meeting

Thursday, March 11, 2021

Starting Time: 10:00 a.m.

Concluding Time: 12:13 p.m.

**Task Force Members Present:**

Hillary H. Salo (EITF Chair)

Kimber K. Bascom

Paul A. Beswick

Terri Z. Campbell

Lawrence N. Dodyk

Kevin McBride

Liesl Nebel

Jeffrey Nickell

Dan Palomaki

Jeremy Perler

Matthew Schechter

Eric C. West

Aleks Zabreyko

\*Holly Neson (PCC Observer)

Angela Newell (FinRec Observer)

John Vanosdall (SEC Observer)

**Others at Meeting Table:**

Richard R. Jones, FASB Chair

James L. Kroeker, FASB Vice Chairman

Christine A. Botosan, FASB Board Member

Gary R. Buesser, FASB Board Member

Susan M. Cospers, FASB Board Member

Marsha L. Hunt, FASB Board Member

R. Harold Schroeder, FASB Board Member

David Yates, FASB Practice Fellow

Jay Seliber (incoming EITF member)

Alicia Posta, Executive Director, FASAC

Alex Casas, FASB Assistant Director

Mary Mazzella, FASB Assistant Director

Aarika Friend, FASB Supervising Project Manager

Bobbi S. Gwinn, FASB Project Manager

Amin Mohamed, FASB Project Manager

Jermaine Phua, FASB Postgraduate Technical Assistant

Katherine Sipple, FASB Postgraduate Technical Assistant

Steven Whitman, FASB Postgraduate Technical Assistant

\* For certain Issues only.

## ADMINISTRATIVE MATTERS

- The EITF Coordinator noted that there were two active Issues on the EITF agenda to be discussed at the March 11, 2021 meeting.
- The EITF Coordinator announced that any consensus or consensus-for-exposure reached at this meeting would be considered by the Board for ratification at the March 24, 2021 Board meeting.
- The EITF Chair welcomed Mr. Dan Palomaki, Citigroup, Inc., as the newest member of the Task Force.
- An FASB staff member provided EITF members with an educational session regarding the Board's agenda consultation initiative. In May 2020, the FAF Trustees decided to embed the Post-Implementation Review (PIR) process in the standard-setting processes of the FASB and GASB. The announcement is available on the FASB website [here](#).
- The EITF chair announced that Messrs. Larry Dodyk, PwC LLP, and Jeff Nickell, Deloitte LLP, would be stepping down as members of the Task Force following the March 11, 2021 meeting. The EITF chair thanked both members for their contributions.
- The EITF chair also announced that Mr. Brett Dooley, formerly of JPMorganChase, Inc., has stepped down as a member of the Task Force, effective with the September 3, 2020 EITF meeting. The EITF chair thanked Mr. Dooley for his service.
- The EITF chair recognized Mr. Jay Seliber, PwC LLP, who observed this meeting in an unofficial capacity, as an incoming Task Force member effective with the next EITF meeting.

## DISCUSSION OF AGENDA TECHNICAL ISSUES

### Issue No. 19-B

**Title:** Revenue Recognition—Contract Modifications of Licenses of Intellectual Property

**Dates Discussed:** June 13, 2019; November 7, 2019; March 11, 2021

#### Background

1. The core principle for revenue recognition in Topic 606, Revenue from Contracts with Customers, is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring control of those goods or services. Topic 606 provides implementation guidance on revenue recognition for licenses of intellectual property (IP) because the nature of licensing arrangements can make it difficult to determine when control of the license has been transferred to a customer.

2. A license establishes a customer's rights to the IP (such as software, franchises, trademarks, and motion pictures) of an entity. Topic 606 includes implementation guidance for licensing arrangements in paragraphs 606-10-55-54 through 55-65B and provides that, depending on the nature of the IP to which the customer will have rights, the IP is either functional IP (a right to use) or symbolic IP (a right of access) as follows:

- a. Functional IP: IP that has significant standalone functionality (for example, the ability to process a transaction, perform a function or task, or be played or aired). Functional IP (such as software, motion pictures, or music) derives a substantial portion of its utility (that is, its ability to provide benefit or value) from its significant standalone functionality. A license to functional IP provides a customer with a right to use an entity's IP as it exists at the point in time when the license is granted and is satisfied at the point in time when the customer obtains the control of the license (point in time).
- b. Symbolic IP: IP that is not functional IP is symbolic IP (such as tradenames and franchise rights). Substantially all of the utility of symbolic IP is derived from its association with an entity's past or ongoing activities, including its ordinary business activities. An entity's promise to grant a customer a license to symbolic IP (that is, a right to access the entity's IP) includes supporting or maintaining that IP during the license period and, therefore, the nature of the entity's promise to the customer is to both (a) grant the customer rights to use and benefit from the entity's IP and make that underlying IP available for the customer's use and benefit and (b) support or maintain the IP during the license period (or over the remaining economic life of the IP, if shorter). Consequently, the customer will simultaneously receive and consume the benefit from the entity's performance as the performance occurs (over time).

3. In addition to the consideration of the guidance above, revenue from a license of IP cannot be recognized before (a) an entity provides (or otherwise makes available) a copy of the IP to the customer and (b) the beginning of the period during which the customer is able to use and benefit from its right to access or its right to use the IP. The guidance also specifies that an entity should recognize revenue from a license renewal no earlier than the beginning of the renewal period. That

is, the guidance specifies that the use and benefit guidance applies not only to the initial contract but also to renewals.

4. Topic 606 includes guidance on how to account for contract modifications. Prior to the issuance of Topic 606, U.S. Generally Accepted Accounting Principles (GAAP) did not include a comprehensive contract modifications framework. A contract modification is defined in Topic 606 as a change in the price or scope of the contract. Analysis of whether (a) the additional goods or services are distinct and (b) whether the pricing of the modification is consistent with the standalone selling price (SSP) of the additional goods or services determines how the modification should be accounted for. The guidance on modifications is identical in U.S. GAAP and International Financial Reporting Standards (IFRS).

5. Paragraph 606-10-25-12 requires a contract modification to be accounted for as a separate contract when both of the following criteria are met:

- a. The additional goods or services are distinct
- b. An increase in the price of the contract reflects the entity's SSP of those additional goods or services adjusted to reflect the circumstances of the contract.

6. If the modification does not result in a separate contract, paragraph 606-10-25-13 is applied to determine whether the modification is (a) the termination of the existing contract and the creation of a new contract, (b) a part of the existing contract, or (c) a combination of both.

7. On May 8, 2019, the Board added this narrow scope Issue to the EITF agenda to address revenue recognition for contract modifications of licenses of intellectual property, which will primarily affect licenses to functional IP.

### **Issues**

8. The following issues were included in Issue Summary No. 1, dated May 30, 2019, and Issue Summary No. 1, Supplement No. 1, dated October 24, 2019, and were discussed at the June 13, 2019 and the November 7, 2019 EITF meetings:

- Issue 1: Accounting for contract modifications under which the contract term for existing rights is extended, while also adding rights
- Issue 2: Accounting for the revocation of licensing rights (including conversion of term software licenses to SaaS [software as a service] arrangements).

### **Prior EITF Discussion**

9. Issues 1 and 2 were discussed at the June 2019 meeting but no technical decisions were made.

### **Issue 1: Accounting for Contractual Modifications under Which the Contract Term for Existing Rights Is Extended, While Also Adding Rights**

10. This issue relates to the accounting for contract modifications involving licenses of IP that extend the original license term and grant additional rights. There is diversity in the application and interpretation of contract modification guidance and licensing guidance in cases in which a modification to a license arrangement involves extensions of the original license term and granting

additional rights to the licensee (that is, the renewal is not at the *same* terms and conditions as the original licenses). The diversity primarily results from different views about whether revenue resulting from the modification should be recognized at the date of the modification (because the modification is accounted for as the termination of the existing contract and the creation of a new contract) or at the start of the renewal period (because of the guidance on license renewals).

11. In discussing the potential alternatives in Issue Summary No. 1, one Task Force member noted that until the issuance of Accounting Standards Update No. 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*, which contained amendments that added the renewals guidance, the FASB's accounting guidance on revenue recognition was converged with the IASB's revenue recognition guidance. That Task Force member asked whether the FASB staff had considered removing the renewals guidance as an alternative, and the staff noted that removing the renewals guidance was not a potential alternative because the amendment in Update 2016-10 was intended to reduce diversity and therefore removing that guidance would reintroduce the diversity that existed prior to the issuance of that Update.

12. Another Task Force member requested that if a Working Group is formed, as recommended by the FASB staff, participants be given materials related to the Board's decisions that resulted in Update 2016-10. That Task Force member noted that those materials would help the Working Group as it discusses the potential alternatives. One Task Force member also indicated that the Working Group should include participants from industries outside the software industry. On July 16, 2019, the Issue 19-B Working Group met to gather feedback and further develop the alternatives for this issue.

## **Issue 2: Accounting for the Revocation of Licensing Rights (Including Conversion of Term Software Licenses to SaaS Arrangements)**

13. An emerging issue in the software industry is the existence of contracts that include, whether from inception or by subsequent modification, a feature that allows a customer to convert from an on-premise software license to a hosted software solution (such as SaaS arrangements). Revenue from a license to functional IP is recognized at a point in time when the entity provides a copy of the IP to the customer and the period in which the customer is able to use and benefit from the license has begun. Revenue from SaaS arrangements is typically recognized over time because the performance obligation likely would meet the criteria for over time recognition. Therefore, questions have arisen about how to account for the conversion of a point-in-time license to a service provided over time.

14. One Task Force member noted that similar situations exist in the healthcare and pharmaceutical industries. Specifically, these industries deal with chargebacks and returns that can be a significant portion of the reconciliation of gross sales to net sales. That Task Force member asked the staff to look at how this issue may affect those industries.

15. Some Task Force members noted that when developing the existing guidance on accounting for licenses and SaaS arrangements, there was an emphasis on consistency between the accounting

from the vendor's perspective and the customer's perspective. Those Task Force members suggested that the FASB staff consider the customer's perspective as it develops the alternatives.

16. One Task Force member encouraged the staff to consider the economics of the transaction (for example, pricing structures and options) and how the potential alternatives would reflect those economics.

17. A Task Force member suggested that the staff consider another potential alternative under which the term of the license is considered to be one day, so the entity would only recognize revenue for that day. That Task Force member stated that this alternative would remove many of the complexities associated with this issue.

18. At the November 7, 2019 EITF meeting, the Task Force discussed Issues 1 and 2. The Task Force was not able to reach a consensus-for-exposure on Issue 1 or Issue 2.

**Issue 1: Accounting for Contractual Modifications under Which the Contract Term for Existing Rights Is Extended, While Also Adding Rights**

19. The Task Force discussed the following four Alternatives for resolving Issue 1:

**Alternative 1:** The additional rights granted are a separate contract and the renewal guidance would apply to existing rights

**Alternative 2:** Modification implementation guidance for licenses – When a contract is considered terminated

**Alternative 3:** Modification implementation guidance for licenses – A license modification is always a termination of the existing contract

**Alternative 4:** Functionality and materiality is assessed to determine whether amendments are a renewal.

20. Several Task Force members asked the FASB staff to provide more examples to illustrate the application of the alternatives and their possible accounting outcomes. Additionally, Task Force members suggested that the staff should engage the Issue 19-B Working Group in gathering the example fact patterns.

21. Three Task Force members asked the staff to conduct more research into the interplay between the use and benefit guidance and the modification and renewal guidance. These Task Force members asserted that, in conjunction with Alternative 2, the use and benefit guidance may allow for the manipulation of revenue recognition. One Task Force member suggested that the staff should consider a clarification in the use and benefit guidance that a contract modification is simply a modification of the attributes of an existing license.

22. Two Task Force members questioned why a fifth alternative was not included to address what they assert is the predominant view currently being applied in practice. That view is that the entity has, in substance, renewed the original license and, therefore, must defer revenue recognition of amounts allocated to the modified license until the beginning of the license renewal period regardless of whether the modification results in a renewal license with the same terms and

conditions as the original license. This view would require an entity to defer revenue recognition of the modified license. The staff clarified that the project was added because there is diversity in practice and that the staff's understanding is that there are different reasons for applying each view that depend on the facts and circumstances of the company and the auditor. The staff highlighted that the accounting outcomes under Alternative 1 are similar to what the outcome would be under this view.

## **Issue 2: Accounting for the Revocation of Licensing Rights (Including Conversion of Term Software Licenses to SaaS Arrangements)**

23. Task Force members disagreed with the FASB staff's recommendation to remove this issue from the scope of Issue 19-B. Task Force members noted that even for a simple fact pattern, there is diversity in practice. Task Force members were unable to reach a consensus-for-exposure on this issue and asked that the staff perform further research and that the issue be brought back for consideration at a future EITF meeting.

24. The Task Force discussed four alternatives for resolving Issue 2. The first two alternatives were included in Issue Summary No. 1. The other two alternatives were suggested by Task Force members during the discussion. The four alternatives that were discussed are:

**Alternative A:** A portion of the software license is deferred (as a returns reserve) and recognized over the SaaS period.

**Alternative B:** The SaaS conversion is accounted for prospectively.

**Alternative C:** Upon the SaaS conversion, the revenue previously recognized for the portion of the rights revoked should be reversed and recognized over the SaaS period. Consideration received for the term license is not deferred at the outset.

**Alternative D:** The potential SaaS conversion provides the customer with an option to "put" the term license back to the entity and the entity would consider whether the put option requires the license arrangement to be accounted for as a lease (according to the guidance on repurchase agreements in paragraph 606-10-55-72).

25. Many Task Force members noted that they did not agree with the Board's decisions in Accounting Standards Update No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which requires that revenue from some licenses be recognized over time and others at a point in time. Some Task Force members disagreed with the requirement to recognize revenue for functional IP at a point in time. A Task Force member noted that functional IP is one of the most difficult issues that users and preparers deal with when applying the guidance in Topic 606.

26. Task Force members and Board members discussed the overall economics of a transaction when a term license of IP is converted to a SaaS arrangement. There was disagreement among Task Force members and Board members about whether the conversion to a SaaS arrangement represents an overall change in the economics of the arrangement. There also was discussion regarding the point at which the conversion becomes a substantive economic event. A Task Force member noted that if a portion of the software license is deferred as a return reserve, it would be

important to have adequate disclosures to see how the return reserve is estimated and changes over time (such as a return reserve rollforward each period).

27. Task Force members and Board members asked the FASB staff to perform further research on this issue. Specifically, Task Force members asked the staff to further develop the four alternatives listed in paragraph 24 and to develop examples that illustrate the different accounting outcomes for different arrangements under each of the four alternatives, including consideration of the material rights guidance. One Board member requested that the staff perform user outreach so that users may better understand the implications of the various alternatives when providing their inputs. One Board member requested that the staff perform a cost-benefit analysis for each of the four alternatives and the staff noted that such an analysis will be included in the staff's analysis of the four alternatives when it is presented to the Task Force for discussion at a future EITF meeting. Additionally, the staff noted that the Issue 19-B Working Group will be utilized to help develop comprehensive realistic examples.

### **Current EITF Discussion**

28. In May 2020, the FAF Trustees decided to embed the Post-Implementation Review (PIR) process in the standard-setting processes of the FASB and GASB. Thus, the transition of the PIR process to the FASB (in 2020) occurred after this project had already been added to the EITF's agenda (in 2019). Actions resulting from a PIR are subject to the Board's normal due process. It is important to note that standard-setting activity during the PIR process does not have a stated timeline and is not dependent on the completion of PIR reporting. In preliminary PIR outreach for Topic 606, some stakeholders raised concerns about the cost and complexity of the licensing model, apart from this Issue.

29. At the March 11, 2021 EITF meeting, the Task Force discussed two alternatives for the path forward for this project:

**Alternative 1:** Board to consider the Issue as part of the PIR of Topic 606. The Task Force could refer this Issue back to the Board and recommend that the Board consider the underlying issues as part of its PIR of Topic 606. This alternative will not lead to the immediate addition of an active project to the Board's technical agenda related to the licensing model. Rather, the Board would continue with the ongoing PIR of Topic 606 and consider whether changes to the existing licensing guidance are necessary as part of that review.

**Alternative 2:** Task Force to continue toward Issue resolution. The Task Force could continue to work toward the resolution of this Issue by providing implementation guidance within the framework of existing GAAP. Under this alternative, the Task Force may consider whether it wants to continue resolving both Issues 1 and 2.

30. Task Force members discussed exploring the fundamental licensing model to address these issues more holistically. Other Task Force members agreed with the staff recommendation to consider the Issue as part of the PIR process, mentioning that it would be difficult to come to a resolution with the diverse views on the topics.

31. However, other Task Force members expressed concerns about the timing and uncertainty of the PIR process.

32. The Task Force recommended moving this project back to the Board for consideration. Based on the Task Force recommendation, the Board will decide whether to take on this Issue directly through standard setting or through the PIR process. Additionally, while there were many alternatives discussed by the staff, the Task Force, and the Working Group, that does not necessarily suggest that any or all are appropriate interpretations of current guidance.

**Status**

33. At its March 24, 2021 meeting, the Board discussed the project direction of this Issue and with the EITF recommendation described above decided to remove the project from the FASB technical agenda. The Board will consider the issue as part of the FASB PIR process of Topic 606.

34. No further EITF discussion is planned.

## **Issue No. 19-C**

**Title:** Issuer's Accounting for Certain Modifications of Freestanding Equity-Classified Written Call Options

**Dates Discussed:** September 3, 2020; March 11, 2021

### **Background**

1. Stakeholders have asserted that there is diversity in an issuer's accounting for economically similar modifications or exchanges of freestanding equity-classified written call options due to a lack of explicit guidance in the Codification. Stakeholders requested that the Board provide guidance that would clarify whether an issuer would account for a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as (a) an adjustment to equity and, if so, the related earnings per share (EPS) effects, if any, or (b) an expense and, if so, the manner and pattern of recognition.
2. On September 18, 2019, the Board added a narrow scope project to the EITF agenda with the objective of providing authoritative guidance to clarify and reduce the diversity in an issuer's accounting for modifications or exchanges of freestanding equity-classified warrants that remain equity classified after modification.

### **Prior EITF Discussion**

3. At its September 3, 2020 meeting, the Task Force deliberated this Issue. One Task Force member noted the similarities between warrant modifications and an issuer's considerations in accounting for modifications or exchanges of other freestanding equity-classified derivative instruments (such as forwards) that remain equity classified after modification or exchange because there is a lack of explicit guidance in the Codification. That Task Force member suggested that the scope of this Issue should be expanded to address forwards and options. The Task Force reached a consensus-for-exposure to expand the scope of this Issue to include modifications or exchanges of freestanding equity-classified forwards and options that remain equity classified after modification or exchange.
4. The Task Force reached a consensus-for-exposure that an entity would treat a modification of the terms or conditions or an exchange of a freestanding equity-classified forward or option that remains equity classified after modification or exchange as an exchange of the original instrument for a new instrument. The Task Force noted that the amendments in the proposed Accounting Standards Update resulting from this Issue would be applicable regardless of whether a modification is executed through a modification to an existing instrument or the replacement of an existing instrument with a new instrument.
5. The Task Force reached a consensus-for-exposure that an entity would measure the effect of a modification or an exchange of a freestanding equity-classified forward or option that remains equity classified after modification or exchange as the excess, if any, of the fair value of the modified or exchanged instrument over the fair value of the original instrument immediately before it is modified or exchanged. The Task Force noted that the measurement approach taken in the consensus-for-exposure is similar to the share-based payment model in Topic 718 on stock

compensation, which does not result in accounting by the issuer for modifications that result in a reduction in the value of an instrument.

6. The Task Force deliberated whether the issuer's recognition of modifications or exchanges of freestanding equity-classified forwards and options should be based on the substance of the transaction and noted that an issuer should recognize those modifications or exchanges in the same manner as if cash were paid instead of modifying or exchanging those instruments. That is, an issuer should not reach a different accounting conclusion depending on the form of the consideration (cash or noncash). Additionally, the Task Force considered that while the facts and circumstances of those modifications or exchanges may differ and, thus, justify differences in recognition, sufficient guidance or accounting principles exist in the Codification to address those fact patterns. Therefore, the Task Force decided to provide a principles-based recognition framework that leverages existing guidance and specifies its application according to the substance of the modification or exchange transaction.

7. The Task Force reached a consensus-for-exposure that an entity would recognize the effect of a modification or an exchange of a freestanding equity-classified forward or option that remains equity classified after modification or exchange and is not within the scope of another Topic on the basis of the substance of the transaction, in the same manner as if cash had been paid as consideration, as follows:

- a. If the modification or exchange is executed in a financing transaction to raise equity, the effect would be recognized as an equity issuance cost in accordance with the guidance in Topic 340 on other assets and deferred costs.
- b. If the modification or exchange is executed in a financing transaction to raise new debt or modify existing debt, the effect would be recognized as a cost in accordance with the guidance in Topic 470 on debt and Topic 835 on interest.
- c. For other modifications that are not related to financings or compensation for goods or services or other exchange transactions addressed by other Topics, the effect would be recognized as a dividend. For entities that present EPS in accordance with Topic 260, that dividend would be an adjustment to net income (or net loss) in the basic EPS calculation.

If the modification or exchange is executed to compensate for a transfer of goods or services, the effect would be recognized in accordance with the guidance in Topic 718.

8. The Task Force discussed that in a multiple-element transaction (for example, one that includes both debt financing and equity financing), the total effect of the modification or exchange would be allocated to the respective elements in the transaction.

9. Additionally, the Task Force noted that to determine the substance of a modification or an exchange, an entity would analyze all relevant facts and circumstances of the modification such as reasons for the modification, relationship of the holder of the freestanding equity-classified forward or option to the entity, other relationships affecting the transaction, other transactions consummated with or entered into in contemplation of the modification, and other rights and privileges obtained or obligations incurred.

10. The Task Force considered whether the substance of a modification or an exchange executed in a financing transaction to raise equity, such as that described in proposed paragraphs 815-40-55-49 through 55-51, Example 22, Case A (see the proposed Codification amendments in Appendix C of Issue Summary No. 1), might be viewed as a dividend because the modification is not made available to all common stockholders, and the proposed recognition of the modification as equity issuance cost is not consistent with the accounting for the inducement of conversion of convertible preferred stock. However, the Task Force noted that had the issuer paid cash to the holder (instead of modifying the warrants) to raise equity in that Example, the issuer would recognize it as an equity issuance cost. The Task Force considered that the issuer should not reach a different accounting conclusion depending on the form of the consideration and concluded that the issuer's recognition of the effect of the warrant modification as an equity issuance cost is appropriate in that Example.

11. While the Task Force noted that modifications or exchanges that are not related to financings or compensation for goods or services (as discussed in proposed paragraph 815-40-35-17(d) in Appendix C of Issue Summary No. 1) are not prevalent in practice, the Task Force concluded that a transaction that does not represent costs of financing and is not within the scope of other Topics (for example, compensation cost under Topic 718) should be recognized as a dividend by the issuer. Some Task Force members disagreed with including that category in the recognition framework because they do not believe that that type of modification or exchange is common in practice. Some Task Force members disagreed with dividend treatment for the modifications or exchanges in that category because their preferred recognition approach for that category was either (a) as an expense or (b) as a dividend or an expense based on the facts and circumstances of the transaction.

12. The Task Force rejected alternatives that would have required that an entity recognize the effects of all modifications or exchanges within the scope of this Issue as an expense or a dividend because the Task Force decided that the accounting outcome under those alternatives would not necessarily represent the substance of the transaction.

13. The Task Force decided not to require incremental recurring disclosures for this Issue because appropriate disclosure requirements exist in Topic 260 on EPS, Topic 505 on equity, Subtopic 815-40 on contracts in an entity's own equity, and Topic 850 on related party disclosures.

14. The Task Force reached a consensus-for-exposure to provide an entity with the option to apply the amendments in the proposed Update resulting from this Issue either retrospectively to all prior periods or prospectively to all new modifications or exchanges occurring after the effective date of the final guidance. Early adoption would be permitted. If early adoption is elected in an interim period, the guidance would be effective as of the beginning of the fiscal year that includes that interim period.

15. The Task Force reached a consensus-for-exposure to require that in accordance with Topic 250 on accounting changes and error corrections, an entity disclose in the period of adoption the nature of and reasons for the change in accounting principle, the transition method, and a qualitative description of the financial statement line items affected by the change. Additionally,

an entity that elects the retrospective transition method would be required to provide other disclosures required by Topic 250 excluding the disclosure requirements in paragraphs 250-10-50-1(b)(2) and 250-10-50-3, which require that an entity disclose the effect of the accounting change on certain financial statement line items. The Task Force noted that an entity would have to maintain two sets of accounting records during the period of adoption to provide the disclosures required in those paragraphs, which would thereby increase the cost of applying retrospective transition.

16. At its September 16, 2020 meeting, the Board ratified the consensus-for-exposure reached by the Task Force on this Issue and directed the FASB staff to draft a proposed Update reflecting the consensus-for-exposure for vote by written ballot.

17. At its October 14, 2020 meeting, the Board clarified the terminology used in describing the scope of the proposed Update resulting from this Issue (“freestanding equity-classified forwards and options” rather than “freestanding equity-classified derivative instruments”). As a result, the title of the project also was revised from Issue No. 19-C, “Warrant Modifications: Issuers’ Accounting for Modifications of Equity Classified Freestanding Call Options That Are Not within the Scope of Topic 718, Compensation—Stock Compensation, or Topic 815, Derivatives and Hedging.”

#### **Current EITF Discussion**

18. At its March 11, 2021 meeting, The Task Force reached a consensus that an entity should treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as an exchange of the original instrument for a new instrument. The Task Force noted that the amendments in the Update resulting from this Issue should be applicable regardless of whether a modification is executed through an amendment to an existing instrument or a replacement of an existing instrument with a new instrument. The Task Force also noted that the amendments in the Update resulting from this Issue provide guidance for a modification or an exchange of a freestanding equity-classified written call option that is not within the scope of another Topic.

19. The Task Force reached a consensus that an entity should measure the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as follows:

- a. For a modification or an exchange that is a part of or directly related to a modification or an exchange of an existing debt instrument, as the difference between the fair value of the modified or exchanged written call option and the fair value of that written call option immediately before it is modified or exchanged. Specifically, an entity should consider:
  - i. An increase or a decrease in the fair value of the modified or exchanged written call option in applying the 10 percent cash flow test and/or calculating the fees between debtor and creditor in accordance with Subtopic 470-50.
  - ii. An increase (but not a decrease) in the fair value of the modified or exchanged written call option in calculating the third-party costs in accordance with Subtopic 470-50.

- b. For all other modifications or exchanges, as the excess, if any, of the fair value of the modified or exchanged written call option over the fair value of that written call option immediately before it is modified or exchanged.

20. The Task Force noted that the measurement approach for modifications or exchanges of written call options that are related to a modification of existing debt is consistent with the requirements under Subtopic 470-50. For other modifications or exchanges of written call options within the scope of the amendments in the Update resulting from this Issue, the Task Force noted that the measurement approach in the Update resulting from this Issue is similar to the share-based payment model in Topic 718 on stock compensation, which does not result in accounting by the issuer for modifications that result in a reduction in the value of an instrument.

21. The Task Force deliberated whether an issuer's recognition of modifications or exchanges of freestanding equity-classified written call options should be based on the substance of the transaction. The Task Force noted that an issuer should recognize those modifications or exchanges in the same manner as if cash were paid instead of modifying or exchanging those instruments. That is, an issuer should not reach a different accounting conclusion depending on the form of the consideration (cash or noncash). Additionally, the Task Force considered that while the facts and circumstances of those modifications or exchanges may differ and, thus, justify differences in recognition, sufficient guidance or accounting principles exist in the Codification to address those fact patterns. Therefore, the Task Force decided to provide a principles-based recognition framework that leverages existing guidance and specifies its application according to the substance of a modification or an exchange transaction.

22. The Task Force reached a consensus that an entity should recognize the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange and is not within the scope of another Topic on the basis of the substance of the transaction, in the same manner as if cash had been paid as consideration, as follows:

- a. If the modification or exchange is executed in a financing transaction to raise equity, the effect should be recognized as an equity issuance cost in accordance with the guidance in Topic 340 on other assets and deferred costs.
- b. If the modification or exchange is executed in a financing transaction to raise new debt or modify existing debt, the effect should be recognized as a cost in accordance with the guidance in Topic 470 on debt and Topic 835 on interest.
- c. For other modifications that are not related to financings or compensation for goods or services or other exchange transactions addressed by other Topics, the effect should be recognized as a dividend. For entities that present EPS in accordance with Topic 260, that dividend should be an adjustment to net income (or net loss) in the basic EPS calculation.

23. The Task Force noted that if a modification or exchange is executed to compensate for the transfer of goods or services, the effect should be recognized in accordance with the guidance in Topic 718.

24. Additionally, the Task Force noted that to determine the substance of a modification or an exchange, an entity should analyze all relevant facts and circumstances of the modification such as reasons for the modification, relationship of the holder of the freestanding equity-classified written call option to the entity, other relationships affecting the transaction, other transactions consummated with or entered into in contemplation of the modification, and other rights and privileges obtained or obligations incurred.

25. The Task Force considered whether the substance of a modification or an exchange executed in a financing transaction to raise equity, such as that described in Example 22, Case A, in paragraph 815-40-55-50 of Subtopic 815-40 on contracts in an entity's own equity, might be viewed as a dividend because the modification is not made available to all common stockholders and because recognizing the modification as an equity issuance cost is not consistent with the accounting for the inducement of the conversion of convertible preferred stock. The Task Force noted, however, that had the issuer paid cash to the holder (instead of modifying warrants) to raise equity in that Example, the issuer would recognize it as an equity issuance cost. The Task Force considered that the issuer should not reach a different accounting conclusion depending on the form of the consideration and concluded that recognizing the effect of the warrant modification as an equity issuance cost is appropriate in that Example. One Task Force member disagreed with the view that the effect of a modification or exchange executed in a financing transaction to raise equity should be recognized as an equity issuance cost and preferred recognizing the effect as a dividend. That member noted that a modification or an exchange made available disproportionately to some common stockholders is akin to a preferential distribution of dividends and should be reflected in EPS, consistent with the accounting for the inducement of conversion of convertible preferred stock.

26. While the Task Force noted that modifications or exchanges that are not related to financings or compensation for goods or services (as discussed in paragraph 815-40-35-17(d)) are not prevalent in practice, the Task Force concluded that a transaction that does not represent costs of financing and is not within the scope of other Topics (for example, compensation cost under Topic 718) should be recognized as a dividend by the issuer. Some Task Force members disagreed with including that category in the recognition framework because in their view that type of modification or exchange is not common in practice. Some Task Force members disagreed with dividend treatment for the modifications or exchanges in that category because their preferred recognition approach for that category was either (a) as an expense or (b) as a dividend or an expense based on the facts and circumstances of the transaction.

27. Additionally, the Task Force noted that if a modification or an exchange is executed in exchange for an agreement by the holder of the written call option to abandon certain acquisition plans, forgo other planned transactions, settle litigation, settle employment contracts, or voluntarily restrict its purchase of shares of the issuing entity or the issuing entity's affiliates within a stated time period, those rights and privileges obtained, both stated and unstated, or other elements of the transaction should be accounted for according to their substance (that is, as a cost to the issuing entity) rather than as a dividend distribution.

28. The Task Force rejected alternatives that would have required that an entity recognize the effects of all modifications or exchanges within the scope of the Update resulting from this Issue

as an expense or a dividend because the Task Force concluded that the accounting outcome under those alternatives would not necessarily represent the substance of the transaction.

29. In a multiple-element transaction (for example, one that includes both debt financing and equity financing), an entity should allocate the total effect of the modification or exchange to the respective elements in the transaction.

30. The Task Force decided to require incremental disclosures for an issuer to improve transparency about the nature and effects of the transactions within the scope of the amendments in the Update resulting from this Issue.

### **Effective Date and Transition**

31. The Task Force decided that the amendments in the Update resulting from this Issue should be effective for all entities for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years.

32. The Task Force reached a consensus that an entity should apply the amendments in the Update resulting from this Issue prospectively to all new modifications or exchanges occurring on or after the date at which the entity first applies the amendments in this Update.. Early adoption is permitted. If early adoption is elected in an interim period, the guidance will be effective as of the beginning of the fiscal year that includes that interim period.

33. The Task Force reached a consensus to require that in accordance with Topic 250, Accounting Changes and Error Corrections, an entity disclose in the period of adoption the nature of and reasons for the change in accounting principle, the transition method, and a qualitative description of the financial statement line items affected by the change.

### **Board Ratification**

34. At its March 24, 2021 meeting, the Board ratified the consensus reached by the Task Force on this Issue and directed the FASB staff to draft an Update reflecting the consensus for vote by written ballot.

### **Status**

35. FASB Accounting Standards Update No. 2021-04, *Earnings Per Share (Topic 260), Debt—Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging—Contracts in Entity’s Own Equity (Subtopic 815-40): Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*, was issued on May 3, 2021.

36. No further EITF discussion is planned.