

MINUTES



MEMORANDUM

To: Board Members

From: Distinguishing Liabilities from Equity Team (Olcott x443)

Subject: Minutes of April 3, 2019 Board Meeting on Distinguishing Liabilities and Equity (Including Convertible Debt) **Date:** April 8, 2019

cc: Tosches

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

Topic: Distinguishing Liabilities from Equity (Including Convertible Debt)

Basis for Discussion:

- FASB Memo 21 — *Cover Memo*
- FASB Memo 22 — *Convertible Instruments—Gaps, Practice Issues, and Technical Corrections*
- FASB Memo 23 — *Derivatives Scope Exception—Gaps and Consequential Amendments*
- FASB Memo 24 — *Other Consequential Amendments*
- FASB Memo 25 — *Transition*

Length of Discussion: 10:31 a.m. to 11:03 a.m. EDT

Attendance:

- Board members present: Golden, Kroeker, Botosan, Buesser, Hunt, and Schroeder
- Staff in charge of topic: Mazzella
- Other staff at Board table: Cospers, Kuhaneck, Friend, Cheng, Olcott, and Cole

Type of Document and Timing Based on the Technical Plan:

The Board met to discuss issues relating to the development of an Exposure Draft addressing the accounting for instruments with characteristics of liabilities and equity (including convertible debt).

Tentative Board Decisions:

The Board deliberated consequential amendments and technical corrections for convertible instruments and decided to:

1. Clarify the difference between a convertible debt and a debt instrument that could be converted to a variable number of shares with an aggregate fair value equal to a fixed monetary amount (such as share-settled debt) to improve application of the guidance.

(Vote: 6-0)

2. Define or redefine the scope of the guidance on convertible debt instruments in Subtopic 470-20, Debt—Debt with Conversion and Other Options, and on convertible preferred shares in Topic 505, Equity.

(Vote: 6-0)

3. Remove the word *conventional* from the term *conventional convertible debt* instrument used in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity.

(Vote: 6-0)

4. Amend paragraph 470-20-25-2 to clarify that an entity should consider the guidance in Topic 480, Distinguishing Liabilities from Equity, and Topic 815 for the classification of the detachable stock purchase warrant.

(Vote: 6-0)

The Board deliberated consequential amendments and technical corrections for the derivatives scope exception and decided to:

1. Expand the scope of the subsequent fair value measurement guidance in paragraph 815-40-35-4 to include instruments that failed the indexation criterion under the scope and scope exception Section of Subtopic 815-40 and do not meet the definition of a derivative.

(Vote: 6-0)

2. Modify the disclosure requirement in paragraph 815-40-50-5(d) about the fair value of settlement alternatives to parallel the disclosure requirement in paragraph 480-10-50-2(a) through (b).

(Vote: 6-0)

3. Retain the disclosure requirement in paragraph 815-40-15-5(e), which requires that an entity provide certain disclosures if an instrument within the scope of Subtopic 815-40 is classified as temporary equity.

(Vote: 6-0)

4. Remove the embedded written put options and forward purchase contracts table in paragraph 815-40-55-11 (and the related paragraphs 815-40-55-8 through 55-10).

(Vote: 6-0)

5. Modify the reassessment guidance in the subsequent measurement Section of Subtopic 815-40 as follows:

- a. Clarify that the reassessment guidance in paragraph 815-40-35-8 applies to the same scope as the indexation and settlement criterion. That is, the reassessment requirement of the derivatives scope exception applies to both freestanding instruments and embedded features (similar to the scope as written in paragraph 815-40-15-5).

- b. Add a cross-reference in Section 815-40-35 to the guidance in Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, on the accounting for embedded features upon a change in assessment of the derivatives scope exception.

(Vote: 5-1)

The Board deliberated other consequential amendments and decided to:

1. Expand the scope of the down rounds EPS adjustment in Topic 260, Earnings Per Share, to include equity-classified convertible preferred shares.

(Vote: 5-1)

2. Exclude liability-classified stock-based payment arrangements from the Board's February 2019 decision about the diluted EPS calculation for contracts that may be settled in cash or shares, resulting in no change in the diluted EPS calculation for those instruments.

(Vote: 6-0)

3. Align the post-vesting classification of convertible instrument awards with other financial instrument awards under Topic 718, Compensation—Stock Compensation, by requiring that convertible instrument awards continue to be accounted for under Topic 718 after they are fully vested rather than being accounted for under guidance in other Topics.

(Vote: 6-0)

The Board deliberated transition and decided to:

1. Require the modified retrospective transition approach, and allow an option for full retrospective approach, for the derivatives scope exception and convertible instrument amendments. Under the modified retrospective approach, an entity would apply the proposed guidance to transactions outstanding as of the beginning of the year in which the standard is adopted and record a cumulative-effect adjustment to the opening balance of retained earnings at the date of adoption.

(Vote: 5-1)

2. Provide a transition expedient for an entity to assess at the date of adoption whether the adjustment, or settlement, features are remote rather than requiring an entity to assess likelihood and reassessments from the contract inception to the date of adoption.

(Vote: 6-0)

3. Require full retrospective transition for the amendments to EPS guidance on cash versus share settlement and require that an entity apply the if-converted method as of the date of adoption for the amendments to the EPS guidance on convertible instruments, unless the entity chooses the full retrospective option for transition for the convertible instrument amendments.

(Vote: 6-0)

4. Require disclosures in Topic 250, Accounting Changes and Error Corrections (except for the disclosures in paragraph 250-10-50-1(b)(2), which would be required only for an entity that elects full retrospective transition, and paragraph 250-10-50-3).

(Vote: 6-0)

5. Require an entity to apply any transition expedients consistently to all contracts within all reporting periods presented and to require an entity to disclose the following information:

- a. The expedients that have been used

- b. To the extent reasonably possible, a qualitative assessment of the estimated effect of applying each of those expedients.

(Vote: 6-0)

The Board also decided to allow entities that have not yet adopted the amendments in Accounting Standards Update No. 2017-11, *Earnings per Share (Topic 260)*, *Distinguishing Liabilities from Equity (Topic 480)*, *Derivatives and Hedging (Topic 815): (Part I) Accounting for Certain Financing Instruments with Down Round Features*, *(Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*, to early adopt the amendments to the convertible instruments guidance for a convertible instrument that includes a down round feature.

(Vote: 6-0)

Next Steps

The Board directed the staff to draft a proposed Accounting Standards Update and distribute that staff draft for external review. Following external review, the staff will bring back any additional issues and an analysis of costs and benefits.

General Announcements: None