FINANCIAL ACCOUNTING SERIES

FASB ACCOUNTING STANDARDS UPDATE

No. 2017-11
July 2017

Earnings Per Share (Topic 260)
Distinguishing Liabilities from Equity (Topic 480)
Derivatives and Hedging (Topic 815)

I. Accounting for Certain Financial Instruments with Down Round Features

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

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.

For additional copies of this Accounting Standards Update and information on applicable prices and discount rates contact:

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

Please ask for our Product Code No. ASU2017-11.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly with the exception of May, July, September, and October by the Financial Accounting Foundation, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is $255 per year. POSTMASTER: Send address changes to Financial Accounting Series, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 455**

FASB

Accounting Standards Update

No. 2017-11
July 2017

Earnings Per Share (Topic 260)
Distinguishing Liabilities from Equity (Topic 480)
Derivatives and Hedging (Topic 815)

I. Accounting for Certain Financial Instruments with Down Round Features

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

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

Accounting Standards Update 2017-11

Earnings Per Share (Topic 260)
Distinguishing Liabilities from Equity (Topic 480)
Derivatives and Hedging (Topic 815)

I. Accounting for Certain Financial Instruments with Down Round Features
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

July 2017

CONTENTS

Summary

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

The Board decided to undertake this project to address narrow 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.

Part I of this Update addresses the complexity of accounting for certain financial instruments with down round features. Down round features are features of certain equity-linked instruments (or embedded features) that result in the strike price being reduced on the basis of the pricing of future equity offerings. Current accounting guidance creates cost and complexity for entities that issue financial instruments (such as warrants and convertible instruments) with down round features that require fair value measurement of the entire instrument or conversion option.

Stakeholders asserted that accounting for freestanding and embedded instruments with down round features as liabilities subject to fair value measurement on an ongoing basis creates a significant reporting burden and unnecessary income statement volatility associated with changes in value of an entity's own share price. Stakeholders also suggested that this accounting does not reflect the economics of the down round feature, which exists to protect certain investors from declines in the issuer's share price under certain circumstances. That is, current accounting guidance requires changes in fair value of an instrument with a down round feature to be recognized in earnings for both increases and decreases in share price, even though an increase in share price will not cause a down round feature to be triggered and a decrease will cause an adjustment to the strike price only if and when an entity engages in a subsequent equity offering.

Part II of this Update addresses the difficulty of navigating Topic 480, Distinguishing Liabilities from Equity, because of the existence of extensive pending content in the *FASB Accounting Standards Codification*®. This pending content is the result of the indefinite deferral of accounting requirements about mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests.

Who Is Affected by the Amendments in This Update?

The amendments in Part I of this Update that relate to liability or equity classification of financial instruments (or embedded features) affect all entities that issue financial instruments (for example, warrants or convertible instruments) that include down round features. The amendments in Part I of this Update that relate to the recognition, measurement, and earnings per share of certain freestanding equity-classified financial instruments that include down round features affect entities that present earnings per share in accordance with the guidance in Topic 260, Earnings Per Share. The amendments in Part II of this Update do not have an accounting effect.

What Are the Main Provisions?

The amendments in Part I of this Update change the classification analysis of certain equity-linked financial instruments (or embedded features) with down round features. When determining whether certain financial instruments should be classified as liabilities or equity instruments, a down round feature no longer precludes equity classification when assessing whether the instrument is indexed to an entity's own stock. The amendments also clarify existing disclosure requirements for equity-classified instruments.

As a result, a freestanding equity-linked financial instrument (or embedded conversion option) no longer would be accounted for as a derivative liability at fair value as a result of the existence of a down round feature. For freestanding equity-classified financial instruments, the amendments require entities that present earnings per share (EPS) in accordance with Topic 260 to 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.

Convertible instruments with embedded conversion options that have down round features are now subject to the specialized guidance for contingent beneficial conversion features (in Subtopic 470-20, Debt—Debt with Conversion and Other Options), including related EPS guidance (in Topic 260).

The amendments in Part II of this Update recharacterize the indefinite deferral of certain provisions of Topic 480 that now are presented as pending content in the Codification, to a scope exception. Those amendments do not have an accounting effect.

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

Under current GAAP, an equity-linked financial instrument with a down round feature that otherwise is not required to be classified as a liability under the guidance in Topic 480 is evaluated under the guidance in Topic 815, Derivatives and Hedging, to determine whether it meets the definition of a derivative. If it meets that definition, the instrument (or embedded feature) is evaluated to determine whether it is indexed to an entity's own stock as part of the analysis of whether it qualifies for a scope exception from derivative accounting. Generally, for warrants and conversion options embedded in financial instruments that are deemed to have a debt host (assuming the underlying shares are readily convertible to cash or the contract provides for net settlement such that the embedded conversion option meets the definition of a derivative), the existence of a down round feature results in an instrument not being considered indexed to an entity's own stock. This results in a reporting entity being required to classify the freestanding financial instrument or the bifurcated conversion option as a liability, which the entity must measure at fair value initially and at each subsequent reporting date.

The amendments in this Update revise the guidance for instruments with down round features in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity, which is considered in determining whether an equity-linked financial instrument qualifies for a scope exception from derivative accounting. An entity still is required to determine whether instruments would be classified in equity under the guidance in Subtopic 815-40 in determining whether they qualify for that scope exception. If they do qualify, freestanding instruments with down round features are no longer classified as liabilities and embedded conversion options with down round features are no longer bifurcated.

For entities that present EPS in accordance with Topic 260, and when the down round feature is included in an equity-classified freestanding financial instrument, the value of the effect of the down round feature is treated as a dividend when it is triggered and as a numerator adjustment in the basic EPS calculation. This reflects the occurrence of an economic transfer of value to the holder of the instrument, while alleviating the complexity and income statement volatility associated with fair value measurement on an ongoing basis. Convertible instruments are unaffected by the Topic 260 amendments in this Update.

Those amendments in Part 1 of this Update are a cost savings relative to current GAAP. This is because, assuming the required criteria for equity classification in Subtopic 815-40 are met, an entity that issued such an instrument no longer measures the instrument at fair value at each reporting period (in the case of warrants) or separately accounts for a bifurcated derivative (in the case of convertible instruments) on the basis of the existence of a down round feature.

For convertible instruments with embedded conversion options that have down round features, applying specialized guidance such as the model for contingent beneficial conversion features rather than bifurcating an embedded derivative also reduces cost and complexity. Under that specialized guidance, the issuer recognizes the intrinsic value of the feature only when the feature becomes beneficial instead of bifurcating the conversion option and measuring it at fair value each reporting period.

The amendments in Part II of this Update replace the indefinite deferral of certain guidance in Topic 480 with a scope exception. This has the benefit of improving the readability of the Codification and reducing the complexity associated with navigating the guidance in Topic 480.

When Will the Amendments Be Effective?

For public business entities, the amendments in Part I of this Update are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, the amendments in Part I of this Update are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted for all entities, including adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.

The amendments in Part 1 of this Update should be applied in either of the following ways:

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
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.

The amendments in Part II of this Update do not require any transition guidance because those amendments do not have an accounting effect.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 3–23. 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 <u>underlined</u>, and deleted text is ~~struck out~~.

2. The amendments in this Update are separated into two parts. Part I relates to the accounting for certain financial instruments with down round features. Part II relates to the indefinite deferral in Topic 480 for mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests.

Part I

Accounting for Certain Financial Instruments with Down Round Features

Amendments to Master Glossary

3. Add the new Master Glossary term *Down Round Feature*, with a link to transition paragraph 260-10-65-4, as follows:

<u>**Down Round Feature**</u>

<u>A feature in a **financial instrument** that reduces the strike price of an issued financial instrument if the issuer sells shares of its stock for an amount less than the currently stated strike price of the issued financial instrument or issues an equity-linked financial instrument with a strike price below the currently stated strike price of the issued financial instrument.</u>

<u>A down round feature may reduce the strike price of a financial instrument to the current issuance price, or the reduction may be limited by a floor or on the basis of a formula that results in a price that is at a discount to the original exercise price but above the new issuance price of the shares, or may reduce the strike price to below the current issuance price. A **standard antidilution provision** is not considered a down round feature.</u>

Amendments to Subtopic 260-10

4. Add paragraph 260-10-05-1A, with a link to transition paragraph 260-10-65-4, as follows:

Earnings Per Share—Overall

Overview and Background

260-10-05-1 The **Earnings Per Share** Topic contains only the Overall Subtopic. The Overall Subtopic specifies the computation, presentation, and disclosure requirements for earnings per share (EPS) for entities with publicly held **common stock** or **potential common stock**. Computation of EPS is included in Section 260-10-55.

<u>**260-10-05-1A** An entity may issue a freestanding **financial instrument** (for example, a warrant) with a **down round feature** that is classified in equity. This Subtopic provides guidance on earnings per share and recognition and measurement of the effect of a down round feature when it is triggered.</u>

5. Add Section 260-10-25, with a link to transition paragraph 260-10-65-4, as follows:

<u>Recognition</u>

<u>General</u>

<u>**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** (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.</u>

6. Add Section 260-10-30, with a link to transition paragraph 260-10-65-4, as follows:

<u>Initial Measurement</u>

<u>General</u>

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**, 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.

260-10-30-2 The fair values of the financial instruments in paragraph 260-10-30-1 shall be measured in accordance with the guidance in Topic 820 on fair value measurement. See paragraph 260-10-45-12B for related **earnings per share** guidance and paragraphs 505-10-50-3 through 50-3A for related disclosure guidance.

7. Add Section 260-10-35, with a link to transition paragraph 260-10-65-4, as follows:

Subsequent Measurement

General

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** 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.

8. Supersede paragraph 260-10-45-12A and its related heading and add paragraphs 260-10-45-12B through 45-12C and their related headings, with a link to transition paragraph 260-10-65-4, as follows:

Other Presentation Matters

> Basic EPS

> > Income Available to Common Stockholders and Preferred Dividends

260-10-45-11 Income available to common stockholders shall be computed by deducting both the dividends declared in the period on **preferred stock** (whether or not paid) and the dividends accumulated for the period on cumulative preferred stock (whether or not earned) from income from continuing operations (if that amount appears in the income statement) and also from net income. If there is a loss from continuing operations or a net loss, the amount of the loss shall be increased by those preferred dividends. An adjustment to net income or loss for preferred stock dividends is required for all preferred stock dividends, regardless of the form of payment. Preferred dividends that are cumulative only if earned shall be deducted only to the extent that they are earned.

260-10-45-11A For purposes of computing EPS in **consolidated financial statements** (both basic and diluted), if one or more less-than-wholly-owned **subsidiaries** are included in the **consolidated group**, income from continuing operations and net income shall exclude the income attributable to the **noncontrolling interest** in subsidiaries. Example 7 (see paragraph 260-10-55-64) provides an example of calculating EPS when there is a noncontrolling interest in a subsidiary in the consolidated group.

260-10-45-12 Preferred stock dividends that an issuer has paid or intends to pay in its own common shares shall be deducted from net income (or added to the amount of a net loss) in computing income available to common stockholders. In certain cases, the dividends may be payable in common shares or cash at the issuer’s option. The adjustment to net income (or net loss) for preferred stock dividends payable in common stock in computing income available to common stockholders is consistent with the treatment of common stock issued for goods or services.

~~> > Treatment of Contingently Issuable Shares in Weighted-Average Shares Outstanding~~

260-10-45-12A <u>Paragraph superseded by Accounting Standards Update No. 2017-11.</u>~~Contractual agreements (usually associated with purchase business combinations) sometimes provide for the issuance of additional common shares contingent upon certain conditions being met. Consistent with the objective that basic EPS should represent a measure of the performance of an entity over a specific reporting period,~~ ~~**contingently issuable shares**~~ ~~should be included in basic EPS only when there is no circumstance under which those shares would not be issued and basic EPS should not be restated for changed circumstances.~~ **[Content moved to paragraph 260-10-45-12C]**

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

260-10-45-12B For a freestanding equity-classified **financial instrument** 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).

> > Treatment of Contingently Issuable Shares in Weighted-Average Shares Outstanding

260-10-45-12C Contractual agreements (usually associated with purchase business combinations) sometimes provide for the issuance of additional common shares contingent upon certain conditions being met. Consistent with the objective that basic EPS should represent a measure of the performance of an entity over a specific reporting period, **contingently issuable shares** should be included in basic EPS only when there is no circumstance under which those shares would not be issued and basic EPS should not be restated for changed circumstances. **[Content moved from paragraph 260-10-45-12A]**

9. Add paragraphs 260-10-55-95 through 55-97 and their related heading, with a link to transition paragraph 260-10-65-4, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 16: Equity-Classified Freestanding Financial Instruments That Include a Down Round Feature

260-10-55-95 Assume Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share and that Entity A presents EPS in accordance with the guidance in this Topic. The warrants have a 10-year term, are exercisable at any time, and contain a **down round feature**. The warrants are classified as equity by Entity A because they are indexed to the entity's own stock and meet the additional conditions necessary for equity classification in accordance with the guidance in Subtopic 815-40 on derivatives and hedging—contracts in entity's own equity (see paragraphs 815-40-55-33 through 55-34A for an illustration of the guidance in Subtopic 815-40 applied to a warrant with a down round feature). Because the warrants are an equity-classified freestanding **financial instrument**, they are within the scope of the recognition and measurement guidance in this Topic. The terms of the down round feature specify that if Entity A issues additional shares of its common stock for an amount less than $10 per share or issues an equity-classified financial instrument with a strike price below $10 per share, the strike price of the warrants would be reduced to the most recent issuance price or strike price, but the terms of the down round feature are such that the strike price cannot be reduced below $8 per share. After issuing the warrants, Entity A issues shares of its common stock at $7 per share. Because of the subsequent round of financing occurring at a share price below the strike price of the warrants, the down round feature in the warrants is triggered and the strike price of the warrants is reduced to $8 per share.~~Paragraph not used.~~

260-10-55-96 In accordance with the measurement guidance in paragraphs 260-10-30-1 through 30-2, Entity A determines that the fair value of the warrants (without the down round feature) with a strike price of $10 per share immediately before the down round feature is triggered is $600 and that the fair value of the warrants (without the down round feature) with a strike price of $8 per share immediately after the down round feature is triggered is $750. The increase in the value of $150 is the value of the effect of the triggering of the down round feature.~~Paragraph not used.~~

260-10-55-97 The $150 increase is the value of the effect of the down round feature to be recognized in equity in accordance with paragraph 260-10-25-1, as follows:

Retained earnings	$150	
Additional paid-in capital		$150

Additionally, Entity A reduces income available to common stockholders in its basic EPS calculation by $150 in accordance with the guidance in paragraph 260-10-45-12B. Entity A applies the treasury stock method in accordance with paragraphs 260-10-45-23 through 45-27 to calculate diluted EPS. Accordingly, the $150 is added back to income available to common stockholders when calculating diluted EPS. However, the treasury stock method would not be applied if the effect were to be antidilutive.~~Paragraph not used.~~

10. Add paragraph 260-10-65-4 and its related heading, as follows:

> 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.

Amendments to Subtopic 505-10

11. Amend paragraph 505-10-50-3 and add paragraph 505-10-50-3A, with a link to transition paragraph 260-10-65-4, as follows:

Equity—Overall

Disclosure

505-10-50-3 An entity shall explain, in summary form within its financial statements, the pertinent rights and privileges of the various securities outstanding. Examples of information that shall be disclosed are dividend and liquidation preferences, **participation rights**, call prices and dates, conversion or exercise prices or rates and pertinent dates, sinking-fund requirements, unusual voting rights, and significant terms of contracts to issue additional shares or terms that may change conversion or exercise prices (excluding **standard antidilution provisions**). An entity shall disclose within its financial statements the number of shares issued upon conversion, exercise, or satisfaction of required conditions during at least the most recent annual fiscal period and any subsequent interim period presented. An entity also shall disclose within the financial statements actual changes to conversion or exercise prices that occur during the reporting period (excluding changes due to standard antidilution provisions).

505-10-50-3A For a **financial instrument** with a **down round feature** that has been triggered during the reporting period and for which an entity has recognized the effect in accordance with paragraph 260-10-25-1, an entity shall disclose the following:

a. The fact that the feature has been triggered
b. The value of the effect of the down round feature that has been triggered.

12. Add paragraph 505-10-60-7, with a link to transition paragraph 260-10-65-4, as follows:

Relationships

> Financial Instruments

505-10-60-6 For guidance on the accounting for a **registration payment arrangement**, see Subtopic 825-20.

505-10-60-7 For guidance on the accounting for an equity-classified freestanding **financial instrument** with a **down round feature**, see Topic 260 on earnings per share.

Amendments to Subtopic 815-10

13. Add paragraph 815-10-15-75A, with a link to transition paragraph 260-10-65-4, 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
   2. Classified in stockholders' equity in its statement of financial position.
b. Contracts issued by the entity that are subject to Topic 718 or Subtopic 505-50. If any such contract ceases to be subject to Topic 718 or Subtopic 505-50 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 or Subtopic 505-50 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.

815-10-15-75 The scope exceptions in the preceding paragraph do not apply to either of the following:

a. The counterparty in those contracts. For example, the scope exception in (b) in the preceding paragraph related to stock-based compensation arrangements does not apply to equity instruments (including stock options) received by nonemployees as compensation for goods and services.
b. A contract that an entity either can or must settle by issuing its own equity instruments but that is indexed in part or in full to something other than its own stock. That contract can be a derivative instrument for the issuer under paragraphs 815-10-15-13 through 15-139, in which case it would be accounted for as a liability or an asset in accordance with the requirements of this Subtopic. For example, a forward contract that is indexed to both an entity's own stock and currency exchange rates does not qualify for the exception in (a) in the preceding paragraph with respect to that entity's accounting because the forward contract is indexed in part to something other than that entity's own stock (namely, currency exchange rates).

<u>**815-10-15-75A** For purposes of evaluating whether a financial instrument meets the scope exception in paragraph 815-10-15-74(a)(1), a **down round feature** shall be excluded from the consideration of whether the instrument is indexed to the entity's own stock.</u>

Amendments to Subtopic 815-40

14. Add paragraph 815-40-15-5D, with a link to transition paragraph 260-10-65-4, as follows:

Derivatives and Hedging—Contracts in Entity's Own Equity

Scope and Scope Exceptions

> Evaluating Whether an Instrument 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 freestanding financial instrument or embedded feature that has all the characteristics of a derivative instrument (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). 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.

815-40-15-5A The guidance in this paragraph through paragraph 815-40-15-8 does not apply to share-based payment awards within the scope of Topic 718 for purposes of determining whether instruments are classified as liability awards or equity awards under that Topic. Equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options are not within the scope of Topic 718 themselves. Consequently, the guidance in this paragraph through paragraph 815-40-15-8 applies to such market-based employee stock option valuation instruments for purposes of making the determinations described in the preceding paragraph.

815-40-15-5B The guidance in paragraphs 815-40-15-5 through 15-8 shall be applied to the appropriate unit of accounting, as determined under other applicable U.S. generally accepted accounting principles. For example, if an entity issues two freestanding financial instruments and concludes that those two instruments are required to be accounted for separately, then the guidance in paragraphs 815-40-15-5 through 15-8 shall be applied separately to each instrument. In contrast, if an entity issues two freestanding financial instruments and concludes that those two instruments are required to be linked and accounted for on a combined basis as a single financial instrument (for example, pursuant to the guidance in paragraph 815-10-15-8), then the guidance in paragraphs 815-40-15-5 through 15-8 shall be applied to the combined financial instrument.

815-40-15-5C Freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary are not precluded from being considered indexed to the entity's own stock in the consolidated financial statements of the parent if the subsidiary is a substantive entity. If the subsidiary is not a substantive entity, the instrument or embedded feature shall not be considered indexed to the entity's own stock. If the subsidiary is considered to be a substantive entity, the guidance beginning in paragraph 815-40-15-5 shall be applied to determine whether the freestanding financial instrument (or an embedded feature) is indexed to the entity's own stock and shall be considered in conjunction with other applicable GAAP (for example, this Subtopic) in determining the classification of the freestanding financial instrument (or an embedded feature) in the financial statements of the entity. The guidance in this paragraph applies to those instruments (and embedded features) in the consolidated financial statements of the parent, whether the instrument was entered into by the parent or the subsidiary. The guidance in this paragraph does not affect the accounting for instruments (or embedded features) that would not otherwise qualify for the scope exception in paragraph 815-10-15-74(a). For example, freestanding instruments that are classified as liabilities (or assets) under Topic 480 and put and call options embedded in a noncontrolling interest that is accounted for as a financing arrangement under Topic 480 are not affected by this guidance. For guidance on presentation of an equity-classified instrument (including an embedded feature that is separately recorded in equity under applicable GAAP) within the scope of the guidance in this paragraph, see paragraph 810-10-45-17A.

815-40-15-5D When classifying a financial instrument with a **down round feature**, the feature is excluded from the consideration of whether the instrument is indexed to the entity's own stock for the purposes of applying paragraphs 815-40-15-7C through 15-7I (Step 2).

15. Amend paragraphs 815-40-55-33 through 55-34 and add paragraph 815-40-55-34A, with a link to transition paragraph 260-10-65-4, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Example 9: Variability Involving Future Equity Offerings and Issuance of Equity-Linked Financial Instruments

815-40-55-33 This Example illustrates the application of the guidance beginning in paragraph 815-40-15-5 for a financial instrument that includes a **down round feature**. Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify both of the following:

a. If the entity sells shares of its common stock for an amount less than $10 per share, the strike price of the warrants is reduced to equal the issuance price of those shares.
b. If the entity issues an equity-linked financial instrument with a strike price below $10 per share, the strike price of the warrants is reduced to equal the strike price of the newly issued equity-linked financial instrument.

815-40-55-34 The warrants are ~~not~~ considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. In accordance with paragraph 815-40-15-5D, when classifying a financial instrument with a down round feature, an entity shall exclude

that feature when considering whether the instrument is indexed to the entity's own stock for the purposes of applying paragraphs 815-40-15-7C through 15-7I (Step 2). The instrument does not contain any other features to be assessed under Step 2.~~The settlement amount would not equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price. The strike price would be adjusted if Entity A sells shares of its common stock for an amount less than $10 per share or if Entity A issues an equity-linked financial instrument with a strike price below $10 per share. Consequently, the settlement amount of the warrants can be affected by future equity offerings undertaken by Entity A at the then- current market price of the related shares or by the contractual terms of other equity-linked financial instruments issued in a subsequent period. The occurrence of a sale of common stock by the entity at market is not an input to the fair value of a fixed-for-fixed option on equity shares. Similarly, the occurrence of a sale of an equity-linked financial instrument is not an input to the fair value of a fixed-for-fixed option on equity shares, if the transaction was priced at market.~~

815-40-55-34A See paragraph 260-10-45-12B for earnings-per-share considerations, paragraph 260-10-25-1 for recognition considerations, and paragraphs 505-10-50-3 through 50-3A for disclosure considerations.

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

Amendments to Subtopic 480-10

16. Supersede paragraph 480-10-15-7, add paragraphs 480-10-15-7A through 15-7F and 480-10-15-8A and their related headings, and amend the heading preceding paragraph 480-10-15-8, with no link to a transition paragraph, as follows:

Distinguishing Liabilities from Equity—Overall

Scope and Scope Exceptions

> Overall Guidance

480-10-15-1 The Scope Section of the Overall Subtopic establishes the pervasive scope for the Distinguishing Liabilities from Equity Topic.

> Entities

480-10-15-2 The guidance in the Distinguishing Liabilities from Equity Topic applies to all entities.

> Instruments

480-10-15-3 The guidance in the Distinguishing Liabilities from Equity Topic applies to any **freestanding financial instrument**, including one that has any of the following attributes:

a. Comprises more than one option or forward contract
b. Has characteristics of both a liability and equity and, in some circumstances, also has characteristics of an asset (for example, a forward contract to purchase the **issuer's equity shares** that is to be net cash settled). Accordingly, this Topic does not address an instrument that has only characteristics of an asset.

480-10-15-4 For example, an instrument that consists of a written put option for an issuer's equity shares and a purchased call option and nothing else is a freestanding financial instrument (paragraphs 480-10-55-18 through 55-20 provide examples of such instruments). That freestanding financial instrument embodies an **obligation** to repurchase the issuer's equity shares and is subject to the requirements of this Topic.

480-10-15-5 Because paragraph 480-10-15-3 limits the scope of this Topic to freestanding instruments, this Topic does not apply to a feature embedded in a **financial instrument** that is not a derivative instrument in its entirety.

480-10-15-6 Paragraphs 480-10-55-53 through 55-58 apply to the specific circumstances described by those paragraphs in which a majority owner enters into a transaction in the **shares** of a consolidated subsidiary and a derivative instrument indexed to the **noncontrolling interest** in that subsidiary.

480-10-15-7 Paragraph superseded by Accounting Standards Update No. 2017-11.~~The guidance in this Topic does not apply to the following instruments:~~

~~a. **Registration payment arrangements** within the scope of Subtopic 825-20.~~ **[Content moved to paragraph 480-10-15-8A]**

> > Instruments Not within Scope of Certain Classification, Measurement, and Disclosure Provisions of This Subtopic

> > > Certain Mandatorily Redeemable Financial Instruments of Nonpublic Entities

480-10-15-7A ~~1. The effective date of~~ The classification, measurement, and disclosure guidance in this Subtopic does not apply to **mandatorily redeemable financial instruments** that meet both of the following: ~~is deferred for **mandatorily redeemable financial instruments**~~

a. They are issued by nonpublic entities that are not **Securities and Exchange Commission (SEC) registrants**. ~~**registrants**, as follows:~~

~~i.~~b. ~~For instruments that~~ They are mandatorily redeemable, but not on fixed dates or not for amounts that either are fixed or are determined by reference to an interest rate index, currency index, or another external index~~, the classification, measurement, and disclosure provisions of this Subtopic were effective for fiscal periods beginning after December 15, 2004~~.

~~ii. For all other **financial instruments** that are mandatorily redeemable, the classification, measurement, and disclosure provisions of this Subtopic are deferred indefinitely pending further Financial Accounting Standards Board (FASB) action. During that indefinite deferral, the FASB plans to reconsider implementation issues and, perhaps, classification or measurement guidance for those instruments in conjunction with the FASB's ongoing project on liabilities and equity.~~ **[Content amended as shown and moved from paragraph 480-10-65-1(a)(1)]**

480-10-15-7B ~~2.~~ Mandatorily redeemable financial instruments issued by an SEC registrant ~~SEC registrants~~ are not eligible for the scope exception in paragraph 480-10-15-7A ~~either of the deferrals in item (a)~~, even if the entity meets the definition of a **{add glossary link to 2nd definition}**nonpublic entity**{add glossary link to 2nd definition}** ~~in this Subtopic~~. ~~Those entities shall follow the effective dates required by this Subtopic and related guidance, including the deferral for certain mandatorily redeemable noncontrolling interests that follows, as appropriate.~~ **[Content amended as shown and moved from paragraph 480-10-65-1(a)(2)]**

480-10-15-7C ~~3.~~ Some entities have issued shares that are required to be redeemed under related agreements. If the shares are issued with ~~the~~ a redemption agreement and the required redemption relates to those specific underlying shares, the shares are mandatorily redeemable. If an entity with such shares and redemption agreement is a nonpublic entity that is not an SEC registrant, ~~the effective date for~~ those mandatorily redeemable shares ~~is deferred as stated~~ meet the scope exception in paragraph 480-10-15-7A if they meet the conditions specified in that paragraph ~~480-10-65-1(a)~~. **[Content amended as shown and moved from paragraph 480-10-65-1(a)(3)]**

480-10-15-7D ~~4.~~ Although the disclosure requirements of this Subtopic do not apply for those mandatorily redeemable instruments of certain nonpublic companies that meet the scope exception in paragraph 480-10-15-7A ~~while application of this Subtopic to those instruments is deferred~~, the requirements of Subtopic 505-10 still apply. In particular, paragraph 505-10-50-3 requires information about the pertinent rights and privileges of the various securities outstanding, which includes mandatory redemption requirements. Paragraph 505-10-50-11 also requires disclosure of the amount of redemption requirements for all issues of stock that are redeemable at fixed or determinable prices on fixed or determinable dates in each of the next five years. **[Content amended as shown and moved from paragraph 480-10-65-1(a)(4)]**

> > Certain Mandatorily Redeemable Noncontrolling Interests

480-10-15-7E ~~b. Certain mandatorily redeemable noncontrolling interests.~~

~~1. The effective date of~~The guidance in this Subtopic does not apply to ~~is deferred for certain~~ mandatorily redeemable noncontrolling interests (of all entities, public and nonpublic) as follows:

- ~~i.~~a. ~~For~~The classification and measurement provisions of this Subtopic do not apply to mandatorily redeemable noncontrolling interests that would not have to be classified as liabilities by the subsidiary, under the only upon liquidation exception in paragraphs 480-10-25-4 and 480-10-25-6, but would be classified as liabilities by the parent in consolidated financial statements~~, the classification and measurement provisions of this Subtopic are deferred indefinitely pending further FASB action~~.
- ~~ii.~~b. ~~For other mandatorily redeemable noncontrolling interests that were issued before November 5, 2003, the~~ The measurement provisions of this Subtopic do not apply to other mandatorily redeemable noncontrolling interests that were issued before November 5, 2003 ~~are deferred indefinitely~~, both for the parent in consolidated financial statements and for the subsidiary that issued the instruments that result in the mandatorily redeemable noncontrolling interest~~, pending further FASB action~~. For those instruments, the measurement guidance for redeemable shares and noncontrolling interests in other predecessor literature (for example,

in <u>paragraph 480-10-S99-3A</u>~~EITF Abstracts Topic No. D-98, "Classification and Measurement of Redeemable Securities"~~) continues to apply~~ during the deferral period. However, the classification provisions of this Subtopic are not deferred~~. **[Content amended as shown and moved from paragraph 480-10-65-1(b)(1)]**

<u>480-10-15-7F</u> ~~3. During the deferral period for certain mandatorily redeemable noncontrolling interests, all~~ <u>All</u> public entities as well as nonpublic entities that are SEC registrants <u>with mandatorily redeemable noncontrolling interests subject to the classification and measurement scope exception in paragraph 480-10-15-7E</u> are required to follow the disclosure requirements in paragraphs 480-10-50-1 through 50-3 as well as disclosures required by other applicable guidance. **[Content amended as shown and moved from paragraph 480-10-65-1(b)(3)]**

> <u>Topics and Subtopics Not within Scope</u> ~~Other Considerations~~

> > Share-Based Compensation

480-10-15-8 The guidance in the Distinguishing Liabilities from Equity Topic does not apply to an obligation under share-based compensation arrangements if that obligation is accounted for under Topic 718 or Subtopic 505-50. For example, **employee stock ownership plan** shares or freestanding agreements to repurchase those shares are not within the scope of this Topic because those shares are accounted for under Subtopic 718-40 through the point of redemption. However, this Topic does apply to a freestanding financial instrument that was issued under a share-based compensation arrangement but is no longer subject to Topic 718 or Subtopic 505-50. For example, this Topic applies to a mandatorily redeemable share issued upon an employee's exercise of an employee share option. (Topic 718 and Subtopic 505-50 provide accounting guidance for dividends on allocated shares, redemption of shares, recognition of expense, and computing earnings per share [EPS].) However, employee stock ownership plan shares that are mandatorily redeemable or freestanding agreements to repurchase those shares continue to be subject to other applicable guidance related to Subtopic 718-40.

<u>> > Registration Payment Arrangements</u>

<u>480-10-15-8A</u> The guidance in this Topic does not apply to the following instruments:

a. **Registration payment arrangements** within the scope of Subtopic 825-20. **[Content moved from paragraph 480-10-15-7]**

17. Supersede paragraphs 480-10-55-6 through 55-9 and their related heading, with no link to a transition paragraph, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Mandatorily Redeemable Financial Instruments

~~**> > > Trust-Preferred Securities**~~

480-10-55-6 <u>Paragraph superseded by Accounting Standards Update No. 2017-11.</u>~~Mandatorily redeemable preferred stock and trust-preferred securities may be issued in many forms, including those referred to as monthly-income-preferred securities, trust-preferred securities, and trust-originated-preferred securities. Many trust-preferred securities are issued in the following manner:~~

- ~~a. A financial institution establishes a trust or other entity that the financial institution consolidates.~~
- ~~b. The trust issues preferred securities to outside investors and uses the proceeds of the issuance of those securities to purchase from the financial institution an equivalent amount of junior subordinated debentures or other loans having stated maturities.~~
- ~~c. The debentures or other loans are the only assets of the trust.~~
- ~~d. When the financial institution makes its payments of interest on the debentures or other loans, the trust distributes the cash to the holders of the trust-preferred securities.~~
- ~~e. The trust-preferred securities must be redeemed upon maturity of the debentures or other loans.~~

480-10-55-7 <u>Paragraph superseded by Accounting Standards Update No. 2017-11.</u>~~In this example, assume that the trust is required to be consolidated under the provisions of the Variable Interest Entities Subsections of Subtopic 810–10. However, if it were determined that the trust or other variable interest entity (VIE) is not consolidated by the financial institution, the financial statements would reflect the liability owed to the VIE.~~

480-10-55-8 <u>Paragraph superseded by Accounting Standards Update No. 2017-11.</u>~~In the preceding example, because the trust-preferred securities are mandatorily redeemable and represent obligations to transfer assets to redeem the shares:~~

- ~~a. Those instruments are classified as liabilities in the consolidated financial statements of the financial institution.~~

b. ~~Payments or accruals of dividends and other amounts to be paid to holders are reported as interest cost.~~

480-10-55-9 <u>Paragraph superseded by Accounting Standards Update No. 2017-11.</u>~~If redemption is required only upon liquidation or termination of the trust, this Subtopic does not require the securities to be reported as liabilities in the trust's standalone financial statements. However, this Subtopic does require the obligation to be reported as a liability in the consolidated financial statements of the financial institution because redemption is required to occur before the liquidation or termination of the reporting entity, that is, of the financial institution.~~

18. Supersede paragraph 480-10-65-1 and its related heading, with no link to a transition paragraph, as follows:

[Note: As a result of this change, the pending content that links to paragraph 480-10-65-1 will become current content.]

~~**> Transition Related to FASB Staff Position FAS 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests Under FASB Statement No. 150***~~

480-10-65-1 <u>Paragraph superseded by Accounting Standards Update No. 2017-11.</u>~~The effective date of the pending content that links to this paragraph is as follows for mandatorily redeemable financial instruments of certain nonpublic entities and for certain mandatorily redeemable noncontrolling interests:~~

- a. ~~Mandatorily redeemable financial instruments of certain nonpublic entities.~~
  - 1. ~~The effective date of this Subtopic is deferred for **mandatorily redeemable financial instruments** issued by nonpublic entities that are not **Securities and Exchange Commission (SEC) registrants**, as follows:~~
    - i. ~~For instruments that are mandatorily redeemable on fixed dates for amounts that either are fixed or are determined by reference to an interest rate index, currency index, or another external index, the classification, measurement, and disclosure provisions of this Subtopic were effective for fiscal periods beginning after December 15, 2004.~~
    - ii. ~~For all other **financial instruments** that are mandatorily redeemable, the classification, measurement, and disclosure provisions of this Subtopic are deferred indefinitely pending further Financial Accounting Standards Board (FASB) action. During that indefinite deferral, the FASB plans to reconsider implementation issues and, perhaps, classification or~~

~~measurement guidance for those instruments in conjunction with the FASB's ongoing project on liabilities and equity.~~ **[Content amended and moved to paragraph 480-10-15-7A]**

~~2. Mandatorily redeemable financial instruments issued by SEC registrants are not eligible for either of the deferrals in item (a), even if the entity meets the definition of a nonpublic entity in this Subtopic. Those entities shall follow the effective dates required by this Subtopic and related guidance, including the deferral for certain mandatorily redeemable noncontrolling interests that follows, as appropriate.~~ **[Content amended and moved to paragraph 480-10-15-7B]**

~~3. Some entities have issued shares that are required to be redeemed under related agreements. If the shares are issued with the redemption agreement and the required redemption relates to those specific underlying shares, the shares are mandatorily redeemable. If an entity with such shares and redemption agreement is a nonpublic entity that is not an SEC registrant, the effective date for those mandatorily redeemable shares is deferred as stated in paragraph 480-10-65-1(a).~~ **[Content amended and moved to paragraph 480-10-15-7C]**

~~4. Although the disclosure requirements of this Subtopic do not apply for those mandatorily redeemable instruments of certain nonpublic companies while application of this Subtopic to those instruments is deferred, the requirements of Subtopic 505-10 still apply. In particular, paragraph 505-10-50-3 requires information about the pertinent rights and privileges of the various securities outstanding, which includes mandatory redemption requirements. Paragraph 505-10-50-11 also requires disclosure of the amount of redemption requirements for all issues of stock that are redeemable at fixed or determinable prices on fixed or determinable dates in each of the next five years.~~ **[Content amended and moved to paragraph 480-10-15-7D]**

~~b. Certain mandatorily redeemable noncontrolling interests.~~

~~1. The effective date of this Subtopic is deferred for certain mandatorily redeemable noncontrolling interests (of all entities, public and nonpublic) as follows:~~

~~i. For mandatorily redeemable noncontrolling interests that would not have to be classified as liabilities by the subsidiary, under the only upon liquidation exception in paragraphs 480-10-25-4 and 480-10-25-6, but would be classified as liabilities by the parent in consolidated financial statements, the classification and measurement provisions of this Subtopic are deferred indefinitely pending further FASB action.~~ **[Content amended and moved to paragraph 480-10-15-7E(a)]**

~~ii. For other mandatorily redeemable noncontrolling interests that were issued before November 5, 2003, the measurement~~

~~provisions of this Subtopic are deferred indefinitely, both for the parent in consolidated financial statements and for the subsidiary that issued the instruments that result in the mandatorily redeemable noncontrolling interest, pending further FASB action. For those instruments, the measurement guidance for redeemable shares and noncontrolling interests in other predecessor literature (for example, in EITF Abstracts Topic No. D-98, "Classification and Measurement of Redeemable Securities") continues to apply during the deferral period. However, the classification provisions of this Subtopic are not deferred.~~ **[Content amended and moved to paragraph 480-10-15-7E(b)]**

~~2. The FASB plans to reconsider implementation issues and, perhaps, classification or measurement guidance for those noncontrolling interests during the deferral period, in conjunction with the FASB's ongoing projects.~~

~~3. During the deferral period for certain mandatorily redeemable noncontrolling interests, all public entities as well as nonpublic entities that are SEC registrants are required to follow the disclosure requirements in paragraphs 480-10-50-1 through 50-3 as well as disclosures required by other applicable guidance.~~ **[Content amended and moved to paragraph 480-10-15-7F]**

Amendments to Status Sections

19. 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**
Down Round Feature	Added	2017-11	07/13/2017
Equity Restructuring	Added	2017-11	07/13/2017
Financial Instrument	Added	2017-11	07/13/2017
Not-for-Profit Entity	Added	2017-11	07/13/2017
Public Business Entity	Added	2017-11	07/13/2017

Paragraph	Action	Accounting Standards Update	Date
Standard Antidilution Provisions	Added	2017-11	07/13/2017
260-10-05-1A	Added	2017-11	07/13/2017
260-10-25-1	Added	2017-11	07/13/2017
260-10-30-1	Added	2017-11	07/13/2017
260-10-30-2	Added	2017-11	07/13/2017
260-10-35-1	Added	2017-11	07/13/2017
260-10-45-12A	Superseded	2017-11	07/13/2017
260-10-45-12B	Added	2017-11	07/13/2017
260-10-45-12C	Added	2017-11	07/13/2017
260-10-55-95 through 55-97	Added	2017-11	07/13/2017
260-10-65-4	Added	2017-11	07/13/2017

20. Amend paragraph 480-10-00-1, by adding the following items to the table, as follows:

480-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Nonpublic Entity	Added	2017-11	07/13/2017
480-10-15-7	Superseded	2017-11	07/13/2017
480-10-15-7A through 15-7F	Added	2017-11	07/13/2017
480-10-15-8	Amended	2017-11	07/13/2017
480-10-15-8A	Added	2017-11	07/13/2017
480-10-55-6 through 55-9	Superseded	2017-11	07/13/2017
480-10-65-1	Superseded	2017-11	07/13/2017

21. 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
Down Round Feature	Added	2017-11	07/13/2017
Equity Restructuring	Added	2017-11	07/13/2017
Financial Instrument	Added	2017-11	07/13/2017
Standard Antidilution Provisions	Added	2017-11	07/13/2017
505-10-50-3	Amended	2017-11	07/13/2017
505-10-50-3A	Added	2017-11	07/13/2017
505-10-60-7	Added	2017-11	07/13/2017

22. 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
Down Round Feature	Added	2017-11	07/13/2017
Equity Restructuring	Added	2017-11	07/13/2017
Standard Antidilution Provisions	Added	2017-11	07/13/2017
815-10-15-75A	Added	2017-11	07/13/2017

23. 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
Down Round Feature	Added	2017-11	07/13/2017

Paragraph	Action	Accounting Standards Update	Date
815-40-15-5D	Added	2017-11	07/13/2017
815-40-55-33	Amended	2017-11	07/13/2017
815-40-55-34	Amended	2017-11	07/13/2017
815-40-55-34A	Added	2017-11	07/13/2017

The amendments in this Update were adopted by the affirmative vote of four members of the Financial Accounting Standards Board. Ms. Botosan and Messrs. Schroeder and Siegel dissented.

Ms. Botosan and Messrs. Schroeder and Siegel dissent from the issuance of Part I of this Update because it fails to meet the primary objective set forth at the beginning of the project. That objective is to make targeted improvements that simplify the accounting guidance for financial instruments with characteristics of liabilities and equity. The amendments in this Update pertain only to entities that present earnings per share in accordance with the guidance in Topic 260, Earnings Per Share, and that also issue certain equity-linked instruments that include down round features. As a result, entities that present earnings per share under Topic 260 will recognize the value transfer (albeit on a delayed basis relative to previous GAAP). However, because of the narrowly defined scope, entities that do not report earnings per share will not recognize in the balance sheet the clear economic value transferred between certain classes of shareholders. Ms. Botosan and Messrs. Schroeder and Siegel are concerned because this latter group represents the dominant portion of all entities that issue instruments with down round features. In other words, Ms. Botosan and Messrs. Schroeder and Siegel believe that the entities most likely to issue those instruments (namely private companies) are exempt from faithfully representing the economics of down round features.

Ms. Botosan and Messrs. Schroeder and Siegel are concerned that the amendments fail to simplify, and instead add to, the complexity of accounting guidance for financial instruments with characteristics of liabilities and equity. They believe that financial reporting is not improved by accounting for down round features differently depending on whether an entity reports earnings per share under Topic 260. They believe that the economics of down round features warrant recognition regardless of whether an entity presents earnings-per-share data. Thus, they believe that the Update perpetuates further the path-dependent, rules-based nature of current accounting guidance for financial instruments with characteristics of liabilities and equity.

As noted in paragraph BC19, "Much of the cost and complexity associated with determining and applying the accounting requirements to those instruments results from the complexity of the underlying arrangement. Nonetheless, cost and complexity do arise from the requirement to measure those instruments. . . ."

Ms. Botosan and Messrs. Schroeder and Siegel agree that the instruments with down round features, as well as the current accounting, can be complex. However, they believe that this does not provide an adequate or appropriate basis for failing to consider the clear economic consequences of those features in both the classification and measurement of down round features.

Ms. Botosan and Messrs. Schroeder and Siegel believe that the issues that prevented the Board from requiring that the amendments in this Update be applied to all financial instruments with down round features highlight that making targeted improvements is not a viable solution to simplifying and improving the complicated guidance for financial instruments with characteristics of liabilities and equity.

An approach that focuses on targeted improvements might seem appealing because many of the stakeholders' issues focus on discrete accounting outcomes relating to specific instruments or features. Therefore, targeting those specific issues might appear to provide an effective and more timely response to stakeholders' concerns. However, because the guidance on classifying financial instruments with characteristics of liabilities and equity is significantly interconnected, Ms. Botosan and Messrs. Schroeder and Siegel believe that it is nearly impossible to amend one area of the guidance without introducing unintended effects and further complications elsewhere. Consequently, further attempts at targeted improvements likely will lead to inevitable compromises similar to ones made by the Board in this Update, increasing inconsistency and complexity and often necessitating the development of additional "rules."

Ms. Botosan and Messrs. Schroeder and Siegel believe that it is unsustainable to attempt to address the existing issues by developing accounting outcomes that "make sense" for individual instruments in isolation. Instead, they believe that the only way to simplify the accounting guidance for classifying financial instruments with characteristics of liabilities and equity is to take a holistic approach that begins with developing a revised liabilities definition in the conceptual framework. They believe that without first establishing an agreed-upon definition of a liability at the conceptual level, the development of standards in this area will continue to be a patchwork effort driven by desired outcomes. Furthermore, they view a holistic approach based on a conceptual foundation to be critical because it would provide a consistent basis for determining the accounting for all instruments with characteristics of liabilities and equity. Consistent classification of financial instruments with similar characteristics as either liabilities or equity is important because it also affects how the instruments would be measured, which ultimately determines an entity's comprehensive income.

Ms. Botosan and Messrs. Schroeder and Siegel believe that a holistic approach would eliminate the need for the myriad set of narrow, inconsistent, and complex rules that currently prescribe the classification and measurement of financial instruments with characteristics of liabilities and equity. They believe that only by eliminating the patchwork of current guidance and holistically replacing it with new guidance based on a revised liabilities definition will the Board be able to address most, if not all, of the problems most commonly cited by stakeholders with this area of accounting, namely (1) inconsistent reporting outcomes for instruments that are economically similar, which hinders the decision usefulness of reported information, (2) difficulties in applying and interpreting overly complex accounting guidance that often leads to unintentional misapplications and accounting restatements, and (3) additional costs to audit and regulate that information.

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

Messrs. Schroeder and Siegel dissent from the issuance of Part II of this Update because it implies that the Board has resolved the underlying issues that predicated the Update's publication. On the contrary, in August 2016, the Board issued an Invitation to Comment, *Agenda Consultation,* that discusses a broader project on distinguishing between liabilities and equity. This broader project potentially would include efforts to resolve the issues that previously were brought to the Board's attention and necessitated the indefinite deferral. Messrs. Schroeder and Siegel believe that it is not in stakeholders' best interest to provide a permanent scope exception for those instruments while concurrently considering a project to make broad changes to guidance that could affect accounting for those same instruments. While they understand the majority view that these amendments have an objective of improving the readability of the Codification, they are concerned that a scope exception runs the risk of creating confusion among stakeholders because it implies that deliberations for those instruments are complete notwithstanding the explanation provided in paragraph BC54. The indefinite deferral has existed in the Codification for many years and communicates to stakeholders that the Board is contemplating a solution to the accounting for the instruments within its scope, and Messrs. Schroeder and Siegel believe that, in fact, is the Board's current intent. Therefore, they would prefer to leave the deferral in place until the Board decides how to proceed with the broader, more holistic project on liabilities and equity.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Harold L. Monk
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

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 amendments in this Update simplify the accounting for financial instruments with characteristics of liabilities and equity, particularly as it relates to the area of equity-linked financial instruments (or embedded features) with down round features.

BC3. The FASB issued a proposed Update, *Distinguishing Liabilities from Equity (Topic 480): I. Accounting for Certain Financial Instruments with Down Round Features and 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,* on December 7, 2016, with a 60-day comment period. The Board received 18 comment letters. Overall, respondents supported the proposed amendments, citing reduced cost and complexity in applying the guidance.

Background Information—Part I

BC4. A down round feature is a provision in an equity-linked financial instrument (or embedded feature), such as a warrant or a conversion option, that provides a downward adjustment of the current exercise price on the basis of the price of future equity offerings. Down round features are most common in warrants, convertible preferred shares, and convertible debt instruments issued by private companies and development-stage public companies.

BC5. Current GAAP contains extensive guidance for financial instruments with characteristics of liabilities and equity. Both freestanding financial instruments (such as warrants) and convertible instruments, comprising a debt or equity contract and an embedded conversion option, can contain down round features. The analysis of those financial instruments under current GAAP follows a particular navigation to determine the appropriate accounting.

BC6. The first step in the analysis for warrants and convertible preferred shares is to determine whether the equity-form instrument would be required to be classified as a liability under Topic 480. For freestanding financial instruments with down round features that are not required to be classified as liabilities based on the guidance in Topic 480 and for hybrid financial instruments containing embedded conversion options with down round features, an analysis under other Topics or Subtopics is required to determine the appropriate accounting for the entire freestanding instrument or embedded conversion option.

BC7. Subtopic 815-40 provides guidance on determining whether an equity-linked financial instrument (or an embedded feature) should be classified as an asset, liability, or as an equity instrument of the issuer. There are two components to this guidance: (a) guidance for determining whether an instrument is considered indexed to an entity's own stock and (b) guidance on the classification, recognition, and measurement of equity-linked financial instruments that are considered indexed to an entity's own stock depending on the form of settlement of the instrument. Under this guidance, if an instrument is considered indexed to an entity's own stock (and can be settled in shares), the instrument is classified as equity. However, if the instrument does not meet the criteria to be considered indexed to an entity's own stock, it must be classified as a liability or an asset.

BC8. Subtopic 815-40 provides guidance on evaluating whether an equity-indexed instrument can be considered indexed to an entity's own stock in two instances:

a. To evaluate whether a freestanding equity-linked financial instrument or embedded feature that meets the definition of a derivative in Topic 815 is indexed to, and potentially settled in, an entity's own shares for the purposes of determining whether the instrument or embedded feature qualifies for a scope exception from derivative accounting. (For an embedded feature, this needs to be considered only if both of the other criteria for bifurcation are met—that the embedded feature is not clearly and closely related to the host contract and that the hybrid instrument is not measured at fair value in its entirety.)
b. To evaluate whether a freestanding equity-linked financial instrument that potentially is settled in an entity's own stock and that does not meet the definition of a derivative instrument in Topic 815 is considered indexed to its own stock.

BC9. Regarding (a) above, if a freestanding equity-linked financial instrument (or an embedded feature) meets the definition of a derivative in Topic 815, an entity must analyze the contract to determine whether it qualifies for a scope exception from derivative accounting. Paragraph 815-10-15-74 specifies that a contract that otherwise meets the definition of a derivative that is both (a) indexed to its own stock and (b) classified in stockholders' equity in an entity's statement of financial position is not a derivative financial instrument. Subtopic 815-40 provides guidance on evaluating whether the contract is indexed to the entity's own stock. If the entire financial instrument meets the definition of a derivative and does not qualify for the scope exception, it must be measured at fair value with changes in fair value recognized in earnings. Likewise, if the embedded feature meets the definition of a derivative and does not qualify for the scope exception, it must be bifurcated and measured at fair value with changes in fair value recognized in earnings.

BC10. Regarding (b) above, the guidance in Subtopic 815-40 still applies if a freestanding equity-linked financial instrument does not meet the definition of a derivative under Topic 815. The contract must be evaluated under that guidance to determine whether it is indexed to an entity's own shares. If it is not indexed to the entity's own shares, the contract must be accounted for as a liability and initially measured at fair value in accordance with paragraph 815-40-15-8A.

BC11. The guidance in Subtopic 815-40 on whether the instrument is indexed to an entity's own stock requires a two-step evaluation of exercise contingencies and settlement adjustments on the basis of the terms of the contract. Step 1 is to evaluate the instrument's contingent exercise provisions, if any. If the evaluation does not preclude an instrument from being considered indexed to an entity's own stock, the entity would proceed to Step 2, which is to evaluate the instrument's settlement provisions. In accordance with paragraph 815-40-15-7C, an instrument (or embedded feature) is considered indexed to an entity's own stock if its settlement amount equals 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.

However, a contract is considered indexed to the entity's own stock even if the strike price or number of shares used to calculate the settlement amount is not fixed if the only variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares.

BC12. Under current GAAP, Step 2 in this analysis may result in the instrument being required to be classified as a liability because a down round feature exists. This is because the settlement of a financial instrument with a down round feature can be affected by future equity offerings undertaken by the issuer at the then-current market price of the related shares or by the contractual terms of other equity-linked financial instruments issued in a subsequent period. When analyzed under Step 2, the adjustment of the strike price that occurs upon a sale of common stock by the issuer at market is not an input to the fair value of a fixed-for-fixed option on equity shares. Similarly, the adjustment of the strike price that occurs upon a sale of an equity-linked financial instrument is not an input to the fair value of a fixed-for-fixed option on equity shares.

BC13. Under the amendments in this Update, a financial instrument with a down round feature no longer is classified as a liability solely because of the guidance in Subtopic 815-40 on down round features. However, the instrument may still be required to be classified as a liability if it contains terms or features other than the down round feature that would cause liability classification on the basis of the guidance in Topic 480 or Subtopic 815-40 (such as features that cause the instrument not to meet the additional criteria for equity classification in Subtopic 815-40 or other features that cause the instrument not to be considered indexed to the entity's own stock).

BC14. Although equity-linked features embedded in convertible instruments with down round features no longer require bifurcation and liability classification as a result of the guidance in Subtopic 815-40, an entity should consider whether the instrument is subject to other specialized accounting models (such as the guidance in Subtopic 470-20) on the basis of the navigation followed under current GAAP.

BC15. Accordingly, the amendments in this Update change the navigation under current GAAP for specific types of financial instruments with down round features as follows:

a. The amendments alter the navigation under GAAP for freestanding instruments that meet the definition of a derivative by changing the effect of a down round feature on the analysis under the scope exception in Topic 815 about whether the instrument is indexed to an entity's own stock. The amendments continue to require an entity to analyze whether the second part of the scope exception is met (that is, whether the instrument should be classified in stockholders' equity) under Subtopic 815-40. If the second part of the scope exception is met, the instrument is classified as equity.
b. The amendments alter the navigation under GAAP for convertible preferred shares deemed to be a debt host by changing the effect of a down round feature on the analysis under the scope exception in Topic 815 about whether the embedded conversion option is indexed to the entity's own stock. The amendments continue to require that the entity analyze whether the second part of the scope exception is met (that is, whether the embedded conversion option should be classified in stockholders' equity) under Subtopic 815-40. If the second part of the scope exception is met, the entity is not required to bifurcate the conversion option under Topic 815. In this case, the entity must determine whether a specialized accounting model for convertible instruments applies. If the convertible preferred share has a down round

feature, the current accounting guidance for contingent beneficial conversion features in Subtopic 470-20 applies.

c. The amendments alter the navigation for convertible debt instruments under GAAP by changing the effect of a down round feature on the analysis under the scope exception in Topic 815 about whether the embedded conversion option is indexed to the entity's own stock. Under the amendments in this Update, the entity is still required to analyze whether the second part of the scope exception is met (that is, whether the embedded conversion option should be classified in stockholders' equity) under Subtopic 815-40. If the second part of the scope exception is met, the entity is not required to bifurcate the conversion option under Topic 815. In this case, the entity must determine whether a specialized accounting model for convertible instruments applies. If a convertible debt instrument has both a down round feature and a cash conversion feature within the scope of Subtopic 470-20, the accounting guidance for cash conversion features applies. If not, the specialized guidance for contingent beneficial conversion features in Subtopic 470-20 applies.

BC16. The amendments in this Update do not change the accounting for liability-classified financial instruments that (a) meet the definition of a derivative and are not indexed to or settled in an issuer's own stock because of a term or feature other than a down round feature or (b) do not meet the definition of derivative (for example, private company shares that are gross share settled) and are not indexed to an entity's own stock because of a term or feature other than a down round feature. That is, if a feature, other than the down round feature, results in liability classification of the instrument, an entity should apply other existing GAAP. Those instruments are not captured by the guidance in this Update related to the EPS adjustment and related recognition in equity of the effect of a down round feature upon trigger because that guidance applies only to equity-classified instruments.

Basis for Conclusions—Part I

Benefits and Costs

BC17. The amendments in an Update should provide information that is useful in making business and economic decisions, and the benefits should justify the costs. Providing useful information means producing economically "neutral" information that permits users to make their own decisions on the basis of the financial information. Neutral information faithfully reports the economics of a transaction, regardless of any perceived positive or negative effect of reporting that information.

BC18. 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, state 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.]

BC19. Considering the objective of general purpose financial reporting, the Board determined that the objective of Part I of this Update is to reduce cost and complexity associated with the accounting for certain financial instruments with down round features. Much of the cost and complexity associated with determining and applying the accounting requirements to those instruments results from the complexity of the underlying arrangement. Nonetheless, cost and complexity do arise from the requirement to measure those instruments at fair value at each reporting date on the basis of the requirement to account for instruments (or embedded options) containing those features as derivatives. The issue on accounting for down round features in financial instruments was raised by members of the Private Company Council (PCC) and the AICPA Private Companies Practice Section Technical Issues Committee (TIC). In accordance with the FASB's process of reassessing existing accounting standards when stakeholders raise concerns or practice issues arise, the Board undertook research and outreach to obtain information about the nature of instruments for which the accounting is asserted to be overly complex and potential alternatives for improving the decision usefulness of financial reporting for those instruments. The Board solicited input from two large international banks that are dealers in convertible instruments to obtain an understanding of the nature of equity-indexed financial instruments prevalent in the marketplace. In addition, the Board conducted outreach with public and private company auditors, preparers, and a regulator.

BC20. Stakeholders asserted that the requirement under current GAAP to account for certain freestanding and embedded instruments with down round features as liabilities creates undue complexity. They indicated that measuring the fair value of those instruments on an ongoing basis creates a significant reporting burden and unnecessary income statement volatility associated with changes in value of an entity's own share price that is inconsistent with the economics of the transaction in a variety of cases. That is, stakeholders also asserted that the current accounting model for certain financial instruments with down round features does not reflect the economics of the down round feature, which exists only to protect investors from declines in the issuer's share price. This is because current accounting guidance requires that changes in fair value of an instrument with a down round feature be recognized in earnings for both increases and decreases in share price, even though an increase in share price does not cause a down round feature to be triggered. The Board determined that the complexity associated with the current accounting model for financial instruments with down round features should be addressed.

BC21. Present and potential investors, creditors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by the entity and, by extension, present investors. The Board's assessment of the costs and benefits likely to result from issuing a new standard is unavoidably more qualitative than quantitative because there is not an identified method to objectively quantify the costs to implement the new guidance or to quantify the value of expected, improved information on financial statements.

BC22. On the basis of due process and input received from stakeholders, the Board concluded that the amendments increase the decision usefulness of information provided about financial instruments with down round features and provide users with more relevant information about those instruments in a more cost-efficient manner for preparers. The amendments result in the following benefits:

a. Reduced cost and complexity associated with determining the fair value of the instrument or embedded feature at each reporting date because of eliminating the requirement to measure certain financial instruments or embedded features with down round features at fair value initially and subsequently under derivatives guidance
b. Financial statements that better reflect the nature of the financial instrument with a down round feature because the existence of the down round feature no longer drives the classification of the entire financial instrument
c. Improved disclosures that provide transparency into changes in exercise prices and the value transfer between shareholders
d. For entities that present earnings per share, reporting of incremental information about additional equity value that has been transferred to holders of freestanding equity-classified financial instruments with down round features through the recognition of the effect of the down round feature in equity and improved EPS reporting when the down round feature is triggered.

BC23. The Board understands that certain reporting entities will incur additional costs because of the amendments in this Update. The expected costs of the amendments could include the following:

a. Initial costs to educate employees about how to apply the amendments as well as how to explain the effects of the changes on the entity's financial statements to users of financial statements
b. For entities that present EPS, incremental costs to provide the EPS adjustment and related equity entry and disclosure about financial instruments with down round features that have been triggered.

BC24. The Board considered the potential effects of the amendments on complexity in financial reporting. The Board acknowledges that amending the classification guidance for financial instruments with down round features will affect how certain instruments are accounted for because of the existing navigation of the guidance and the application of other existing GAAP in this area. However, the Board notes that this represents a cost savings relative to current GAAP because the issuer no longer has to remeasure the instrument at each reporting period (in the case of warrants) or separately account for a bifurcated derivative (in the case of convertible instruments) when the only reason for this outcome is the existence of a down round feature. The Board concluded that the expected reduction in cost and complexity of application as a result of eliminating the requirement to measure financial instruments with down round features at fair value on an ongoing basis sufficiently mitigates the potential concerns about making targeted amendments to the guidance in this area.

BC25. The Board concluded that the amendments in this Update will reduce the cost and complexity of accounting for financial instruments that include down round features. While the approach requires an EPS adjustment and measurement of the value of the effect of the down round feature, that measurement is limited to situations in which the feature is triggered. Thus, the Board concluded that this alleviates much of the measurement complexity and income statement volatility associated with fair value measurement on an ongoing basis, as is currently required. The Board also expects that the amendments will reduce the cost burden that exists under current GAAP because many entities may engage third-party valuation experts to determine the fair value of those instruments.

BC26. Additionally, the Board concluded that the amendments in this Update better reflect the economics of the transaction than does current GAAP. While current GAAP requires that changes in fair value of an instrument with a down round feature be recognized in earnings for both increases and decreases in share price, under the amendments, the down round feature has no effect on the income statement. The Board decided that measuring the entire instrument or embedded conversion option at fair value as a result of the existence of a down round feature does not provide useful financial reporting information.

BC27. Overall, the Board concluded that entities will not incur significant incremental costs as a result of the amendments in this Update because the amendments simplify how current GAAP is applied. Although cost and complexity may be reduced for some entities and increased for others, the expected benefits of the amendments justify the perceived costs.

Down Round Features

BC28. Current GAAP includes an example of a warrant with a down round feature in paragraphs 815-40-55-33 through 55-34. In this example, an entity issues warrants that permit a holder to buy a fixed number of shares for a specified price, and the terms of the warrants specify that the price would be reduced to reflect the current issuance price of the entity’s shares if it either (a) sells shares of its common stock for an amount less than the specified price in the contract or (b) issues an equity-linked financial instrument with a strike price below the specified share price in the contract.

BC29. The Board decided to define the term *down round feature* so that applying the guidance on classification in Subtopic 815-40 and the EPS guidance in Topic 260 is clear. The definition is not limited to situations in which the strike price is reduced to equal the current issuance price of shares issued or to equal the current strike price in a newly issued equity-linked financial instrument. Rather, the new definition applies to down round features that result in any reduction of the current strike price. For example, a down round feature may reduce the strike price of a warrant or option to the current issuance price, with the amount of the reduction limited by a floor, or the down round feature may reduce the strike price of a warrant or option on the basis of a formula that considers a ratio of shares outstanding before and after an issuance, resulting in a price that is below the original exercise price but above the new issuance price of the shares, or may reduce the strike price to below the current issuance price.

BC30. The amendments in this Update related to classification (that is, the amendments to Subtopic 815-40) have the same effect as the amendments included in the proposed Update. Comment letter respondents broadly supported the classification changes. The recognition and measurement requirements for equity classified instruments are the same as those in the proposed Update. However, the scope of instruments captured by the recognition and measurement requirements in this Update is different from the proposed amendments because those requirements do not apply to liability-classified instruments and do not apply to entities that do not present EPS.

BC31. Comment letter respondents questioned the existence of liability-classified instruments that would have been captured by the scope of the down round feature recognition and measurement model because the recognition and measurement model in the proposed Update excluded convertible debt and instruments measured at fair value (for example, instruments measured at fair value for a reason other than the existence of the down round feature). Additionally, comment letter respondents questioned the usefulness of the subsequent accounting of amortizing the adjustment of the carrying amount of the liability-classified instrument arising from recognition of the value of the effect of the down round feature using the effective interest method. Accordingly, the Board decided to simplify the amendments by excluding those instruments from the scope of the recognition and measurement model.

Equity-Classified Freestanding Financial Instruments and Earnings per Share

BC32. The guidance in Topic 260 requires that all entities that have issued common stock or potential common stock (that is, securities such as options, warrants, convertible securities, or contingent stock agreements) present EPS if those securities trade in a public market either on a stock exchange (domestic or foreign) or in the over-the-counter market, including securities quoted only locally or regionally. Entities that are not within the scope of the guidance in Topic 260 are unaffected by the amendments to Topic 260, unless they voluntarily choose to present EPS in their financial statements.

BC33. Under current GAAP, equity-classified warrants to purchase common shares have no effect for the computation of basic EPS. Because there is no earnings effect, there is no effect on the EPS numerator. Options and warrants will have a dilutive effect under the treasury stock method only when the average market price of the common stock during the period exceeds the exercise price of the options or warrants (that is, they are in the money). For computation of diluted EPS related to equity-classified warrants to purchase common shares, the treasury stock method is applied to outstanding warrants on common shares as follows:

a. Exercise of options and warrants is assumed at the beginning of the period (or at time of issuance, if later) and common shares are assumed to be issued.
b. The proceeds from exercise are assumed to be used to purchase common stock at the average market price during the period.
c. The incremental shares (the difference between the number of shares assumed issued and the number of shares assumed purchased) are included in the denominator of the diluted EPS computation.

BC34. The Board decided to provide guidance on the effect of EPS on the trigger of a down round feature to reduce the potential for diversity arising because comment letter respondents raised questions about the EPS effect. The Board also decided to limit the applicability of the recognition and measurement model to those entities that present EPS. Because entities that have not issued common stock or potential common stock traded in a public market are not required to present EPS, the Board concluded that the benefits to financial statement users from requiring those entities to recognize the effect of the down round trigger would not justify the costs.

BC35. For financial instruments with down round features that currently are accounted for as derivatives under Topic 815, the basic EPS adjustment in the amendments in this Update creates a different result compared with current GAAP. This is because when an instrument meets the definition of a derivative, it is measured at fair value with changes in value recognized in earnings each period. For basic EPS, under current GAAP, the numerator includes the earnings effect of remeasurement of the instrument as a derivative at fair value each period. The amendments in this Update also adjust the basic EPS numerator, but the amount of the adjustment is the effect of the trigger of the down round feature (rather than the change in fair value of the entire instrument).

BC36. For financial instruments within the scope of the amendments in this Update, the Board concluded that when determining whether a financial instrument is indexed to an entity's own stock, for purposes of determining liability or equity classification, a down round feature does not preclude equity classification. Therefore, a financial instrument or embedded feature that would have been a liability classified under current GAAP because a down round feature exists would now be equity-classified, assuming that applying other GAAP does not result in liability classification. For entities that present EPS, when the feature is triggered (that is, upon the occurrence of the triggering event that results in a reduction of the strike price), the entity treats the effect of the trigger like a dividend and deducts the effect of the trigger from the numerator in its basic EPS calculation.

BC37. The Board observed that the EPS effect upon the trigger of the down round feature for an equity-classified instrument is similar to the effect of EPS on convertible preferred stock that includes a beneficial conversion feature. In addition, the equity entry, which is illustrated in paragraph 260-10-55-97, is consistent with the effects of pro rata dividends to shareholders and the approach for recognizing stock dividends in Subtopic 505-20, Equity—Stock Dividends and Stock Splits.

BC38. In determining the appropriate method to establish the value attributed to the trigger of a down round feature, the Board selected a method that captures the rights existing in the down round feature without introducing significant measurement complexity. The Board decided to require a method that measures this adjustment on the basis of the difference between the fair values of two instruments that have terms consistent with the actual instrument but that do not have a down round feature, where one instrument has a strike price that corresponds to the current strike price of the actual instrument and the second instrument has a strike price that corresponds to the strike price of the instrument after the trigger date. Each of those fair value measurements is required to comply with the guidance in Topic 820, Fair Value Measurement. The Board concluded that this would be a practical way to assign a value to the down round feature that meets the objective of capturing the effect of the down round feature once it is triggered. The Board observed that it is inappropriate to analogize to the measurement method in this Update to instruments with features other than down round features.

Convertible Instruments

BC39. The amendments in this Update to the classification guidance in Subtopic 815-40 affect both freestanding instruments and convertible instruments. This effect is discussed in paragraph BC15. The amendments to the guidance on EPS in Topic 260 only apply to freestanding equity-classified financial instruments.

BC40. The Board concluded that the amendments to the guidance on EPS for financial instruments with down round features do not apply to convertible instruments. Under current GAAP, the dilutive effect of convertible securities is reflected in diluted EPS by applying the "if-converted" method. Under that method, if an entity has convertible preferred stock outstanding, the preferred dividends applicable to convertible preferred stock are added back to the numerator. The amount of preferred dividends added back is 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. The convertible preferred stock is assumed to have been converted at the beginning of the period (or at time of issuance, if later), and the resulting common shares are included in the denominator. Conversion is not assumed for purposes of computing diluted EPS if the effect would be antidilutive. Convertible preferred stock is antidilutive whenever the amount of add-back per incremental share for the current period exceeds basic EPS (for example, the dividend declared in or accumulated for the current period per common share obtainable on conversion exceeds basic EPS).

BC41. Convertible instruments already are captured by the specialized models in Subtopic 470-20 and by the if-converted method of calculating diluted EPS in Topic 260. In reaching the decision that the amendments to the guidance on EPS do not apply to convertible instruments, the Board decided not to override or amend the objectives of the current models that were established under prior accounting standards. The Board noted that each of those models was developed to achieve a specific objective for the particular type of convertible instrument and that those objectives remain valid and are unrelated to the Board's purpose for issuing the amendments in this Update.

Disclosures

BC42. The Board considered whether any additional disclosure requirements were needed for financial instruments that include down round features. Current GAAP contains guidance that is broadly applicable to issued debt and equity instruments. Subtopic 505-10, Equity—Overall, requires disclosure of information about an entity's capital structure. Entities must provide information about securities, specifically a summary explanation in their financial statements of the pertinent rights and privileges of their outstanding securities.

BC43. Paragraph 815-40-50-5 indicates that the disclosures required by Subtopic 505-10 apply to all contracts within the scope of Subtopic 815-40. The Board observed that although this guidance does not specifically mention down round features, it expects entities would include information about down round features in the disclosure. The Board decided to amend the existing disclosures in paragraph 505-10-50-3 to clarify the disclosure of changes to exercise or strike prices. This clarification applies to all changes in exercise or strike price, not only those related to down round features (for example, this captures contingent beneficial conversion features), except for changes due to standard antidilution provisions. For entities required to recognize the effect of the trigger of a down round feature, the Board decided to require new disclosures in Topic 505 about the fact that the feature has been triggered and the value of the effect of the down round feature that has been triggered. Although the new disclosures in Topic 505 are similar to the disclosure requirements in Topic 260, the Board concluded that the financial statements should provide users with the information that indicates that additional equity value has been transferred to holders of certain equity-linked financial instruments and the effect of that value transfer, to supplement the existing EPS disclosure.

BC44. Under existing disclosure requirements in Topic 260, the numerator and the denominator of the basic and diluted per-share computations for income from continuing operations must be reconciled. Accordingly, the basic EPS adjustment in paragraph 260-10-45-12B is inherently included in that reconciliation requirement. Therefore, the Board decided not to amend EPS disclosure requirements.

BC45. The Board observed that the disclosure requirements in Topic 820 do not apply to the down round feature because the value of the effect of that feature is determined on the basis of the fair values of other instruments.

Effective Date and Transition

BC46. The Board decided that the amendments in this Update should be effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. The Board decided that those effective dates will allow adequate time for entities to apply the amendments.

BC47. For all entities, the Board decided to permit early adoption, including early adoption in an interim period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. The amendments provide significant cost savings, and the Board did not want entities to have to wait for the mandatory adoption date to avail themselves of the improvements.

BC48. The Board decided to allow entities to choose one of the following methods of transition:

a. 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 amendments are effective. The cumulative effect of the change should be recognized as an adjustment of the opening balance of retained earnings in the fiscal year and interim period of adoption.
b. 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.

BC49. The proposed Update included only a modified retrospective transition method. The Board decided to allow an option for full retrospective transition (applied to outstanding financial instruments) because of requests from comment letter respondents who noted that the fair value accounting for the instruments affected by the amendments in this Update currently creates income statement volatility. Therefore, the transition option permits entities to restate their financial statements to improve comparability.

BC50. For a freestanding financial instrument with a down round feature that had been classified as a liability and measured at fair value under prior accounting guidance but that is classified in equity on the basis of the amendments in this Update, the amendments require that the difference in retained earnings that would have been reported as if this Update was in effect at the issuance and throughout the term of the financial instrument be recognized as a cumulative-effect adjustment of the opening balance of retained earnings upon adoption. In addition, the freestanding financial instrument should be reclassified from a liability to equity on the basis of the proceeds received at issuance or on the basis of relative fair value, when applicable.

BC51. 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 this Update is recombined at the date of adoption. The difference in retained earnings that would have been reported as if this Update was in effect at issuance of the convertible instrument is recognized as a cumulative-effect adjustment of the opening balance of retained earnings at adoption and as an adjustment of the recombined instrument, which should be classified as a liability or equity instrument in its entirety as provided by the amendments in this Update. If the convertible instrument has a cash conversion feature or a contingent beneficial conversion feature that had been triggered before the effective date, upon initial application, the convertible instrument is separated 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. Under the transition approach, when recombining the host contract and bifurcated conversion option, an entity does not establish that value as the carrying amount as of the date of adoption without any reversal of prior gains and losses on the derivative component.

Basis for Conclusions—Part II

BC52. In 2003, an FASB Staff Position FAS 150-1, *Issuer's Accounting for Freestanding Financial Instruments Composed of More Than One Option or Forward Contract Embodying Obligations under FASB Statement No. 150,* was issued to defer the effective date of applying the provisions of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity,* for mandatorily redeemable financial instruments of certain nonpublic entities and certain mandatorily redeemable noncontrolling interests. The current transition guidance in paragraph 480-10-65-1 explains the deferral. However, stakeholders indicated that the existence of the deferral creates pending content in Topic 480 that makes the Codification difficult to read and to navigate. For this reason, the Board decided to replace the indefinite deferral in Topic 480 with a scope exception to improve the readability of the Codification.

BC53. The Board concluded that the amendments in Part II of this Update improve the readability of the Codification and reduce the cost and complexity associated with navigating the guidance in Topic 480. The Board noted that these amendments do not result in any differences compared with existing practice because the amendments only move (but do not change) the guidance.

BC54. In addition, the Board observed that the decision to replace the indefinite deferral in the transition Section of Topic 480 with a scope exception is solely being done to improve the content in the Codification and is not the result of reconsidering the accounting for the instruments within the scope of Topic 480. Therefore, these amendments should not be interpreted (implicitly or explicitly) as an expression of the Board's view that the affected instruments conceptually should be considered equity instruments or that the Board has resolved the underlying issue that led to the indefinite deferral.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the 2018 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.