AICPA® PCPS
Private Companies Practice Section

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January 24, 2017

Susan M. Cosper, CPA
Technical Director
FASB
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Norwalk, CT 06856-5116

Re: FASB December 7, 2016 Proposed Accounting Standards Update *Distinguishing Liabilities from Equity 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* [File Reference No. 2016-370]

Dear Ms. Cosper:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the Proposed Accounting Standards Update, *Distinguishing Liabilities from Equity 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* (ED) and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC agrees with the objectives of this ED, which are mainly aimed at addressing the complexity of accounting for certain financial instruments with down round features. In prior meetings with the Board and in TIC's comment letter dated October 17, 2016 on the Agenda Consultation ITC, TIC expressed the need for some simplification to the accounting for equity-linked financial instruments containing "downround" features (such as convertible debt with warrants). TIC is pleased that the FASB has undertaken this proposal to help alleviate some of those concerns.

In addition, Part II of this ED recharacterizes the indefinite deferral of certain provisions of Subtopic 480-10, that are currently presented as pending content in the Codification, to a scope exception. TIC believes this is a welcome change and will make the Codification easier to navigate and apply the scope exception.

SPECIFIC COMMENTS

Question 1: *Do you agree that when classifying certain financial instruments with down round features, the down round feature should be excluded from the assessment of whether an instrument is indexed to an entity's own stock (in accordance with the guidance in Subtopic 815-40)? If not, please explain why and suggest alternatives.*

Yes, TIC agrees that when classifying certain financial instruments with down round features, the down round feature should be excluded from the assessment of whether an instrument is indexed to an entity's own stock. Otherwise, as acknowledged in the proposed ASU, these instruments are generally recorded as liabilities with fair value measurement each reporting period (and, thus, create income statement volatility) which creates a reporting burden and also results in accounting that is not reflective of the economics of such features in some cases. TIC believes that excluding the down round feature from the assessment should generally result in more of these instruments classified as equity, which addresses both of these concerns.

Question 2: *Do you agree that for certain financial instruments with down round features, the effect of the down round feature should be recognized when it is triggered and that the approach for recognition should follow the classification (liability or equity) of the instrument? If not, please explain why and suggest alternatives.*

TIC agrees that for certain financial instruments with down round features, the effect of the down round feature should be recognized when it is triggered, and the recognition should follow the classification. TIC could not think of an alternative approach that would better reflect the substance and economics of the transaction.

Question 3: *The proposed amendments in paragraphs 480-20-30-1 through 30-2 describe how to measure the effect of the down round trigger. Do you agree with that approach? If not, please explain why and suggest alternatives.*

TIC thinks these measurement principles outlined in 480-20-30-1 through 30-2 seem reasonable. Because the measurement specifies the instrument is measured without consideration of the down round, TIC believes a Black-Scholes model could be used to estimate the fair value; whereas if the down round had to be considered, a more complex binomial or lattice model would generally be required. Assuming Black-Scholes can be used, this measurement should not be difficult to perform. While TIC acknowledges that the FASB did not want to be prescriptive with regards to which valuation model to use, perhaps, some implementation guidance could be added to the codification that specifically allows for this type of model to be used.

Question 4: *Do you agree that for certain financial instruments with down round features that have been triggered during the reporting period, an entity should disclose the fact that the feature has been triggered, the value of the effect of the down round being triggered, and the financial statement line item in which that effect has been recorded? If not, please explain why and suggest alternatives.*

TIC agrees with the proposed requirement for an entity to disclose the fact that the down round feature has been triggered when this occurs, along with the value of the effect of the down round being triggered, and the financial statement line item where this effect was recorded. TIC believes these proposed disclosures seem minimal and straight-forward and, therefore, should be fairly easy for entities to adopt.

Question 5: *Do you agree that entities should apply the proposed guidance to outstanding instruments as of the effective date of the change, with no adjustments to prior periods presented, with the cumulative effect of the change recognized as an adjustment of the opening balance of retained earnings in the fiscal year or interim period of adoption? If not, please explain why and suggest alternatives.*

TIC agrees with a cumulative effect approach for outstanding instruments as of the effective date of the change. If the objectives of this ED are to reduce the accounting burden and reduce income statement volatility, TIC did not see any value in requiring retrospective application. Further, prospective application wouldn't address outstanding instruments currently classified as liabilities. Therefore, a cumulative effect approach seems reasonable.

Question 6: *How much time would be necessary to adopt the amendments in this proposed Update? Should early adoption be permitted? Would the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?*

TIC does not believe that adoption of this guidance would require much time to implement. TIC believes entities that have these types of instruments with down round features generally know they have them and know how they need to be accounted for under current U.S. GAAP. Because this is a simplification standard, TIC does not believe the effective date should be different for private entities than it would be for public business entities. TIC believes that private companies should be able to adopt this standard just as quickly as public business entities.

EDITORIAL COMMENT

TIC noted a minor drafting issue in the proposed 480-20-15-3. The paragraph currently goes from a, b, c, d, to b. TIC believes that the guidance currently marked at 480-20-15-3(b) should be renumbered as 480-20-15(e).

ADDITIONAL COMMENT

While TIC appreciates this simplification for certain instruments with downround features, we do believe that there are additional simplifications that should be looked at in ASC 480. This opinion also was expressed by two Board members in the Basis for Conclusions of the ED.

As noted in TIC's comment letter dated October 17, 2016 on the FASB Agenda Consultation ITC, most TIC members agree that distinguishing liabilities from equity should be a top priority for the FASB. This is an area where the guidance could use some clarification and there is some diversity in practice on how this guidance is interpreted. TIC also had a representative attend the agenda consultation ITC roundtable in Norwalk in December where this issue was discussed further and several constituents seemed to agree that further review and possible simplification of ASC 480 is needed and ideas were shared on how to provide relief.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Michael A. Westervelt

Michael A. Westervelt, Chair
PCPS Technical Issues Committee
cc: PCPS Executive and Technical Issues Committees