



October 18, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
FASB
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Re: File Reference 2019-730

The Financial Reporting Executive Committee (FinREC) of the American Institute of Certified Public Accountants appreciates the opportunity to comment on the Financial Accounting Standards Board's (FASB or Board) July 31, 2019, Exposure Draft *Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)*.

FinREC supports the Board's continuing initiative to reduce complexity in accounting standards, while maintaining or improving the usefulness of the information provided to users of financial statements.

Overall, FinREC supports a single model approach to accounting for all convertible instruments that do not contain a conversion feature requiring bifurcation under ASC 815. However, we had mixed views on whether we support the proposed approach or would prefer an alternative approach. In addition, FinREC generally supports applying a threshold when determining whether certain features would preclude classification of a contract in an entity's own equity, but has substantial concerns about the operability of the proposed approach given the current lack of guidance related to application of the term *remote*.

Appendix A includes our detailed comments on the main provisions of the Exposure Draft, and further explains our positions as outlined above. Representatives of FinREC are available to discuss our comments with Board members or staff at their convenience.

Sincerely,

Angela Newell
Chair, FinREC

Appendix A

FinREC offers the following comments on the main provisions of the proposed ASU. Note, we have elected not to respond to individual questions, but rather to provide our overall views on each section. However, representatives of FinREC are available to discuss how any of the following comments should be considered in light of specific questions in the Exposure Draft.

Convertible Instruments

FinREC agrees that financial reporting would be improved and simplified by having only a single model to account for all convertible instruments that do not contain a conversion feature requiring bifurcation under ASC 815.

FinREC also fundamentally agrees with FASB's drive toward pragmatic and simplified solutions, and we support solutions that capture the economics of these instruments. However, FinREC observes that the proposed approach may not capture the economic substance for all scenarios, as acknowledged in the Basis for Conclusions. Some FinREC members accept the tradeoff of the proposed approach being a pragmatic overall solution, while other FinREC members do not. Those other members continue to support a single approach, but would prefer a different approach that more closely aligns with the underlying economics of convertible instruments, including the fact that the stated interest rate may not be reflective of the issuer's true borrowing rate.

Earnings per Share

FinREC supports the proposed amendments in the exposure draft, that is:

- Elimination of an entity's ability to overcome the assumption of share settlement when a contract may be settled in cash or stock and
- Application of the if-converted method to all convertible instruments.

The exposure draft proposes an exception to the guidance on contracts that may be settled in cash or stock for certain liability classified share-based payment awards. FinREC believes that there should be no exceptions in accounting for share-based payment arrangements because any exceptions would be inconsistent with the Board's objective of maximizing dilution, and therefore recommends that this exception be removed from the final standard.

Remote Threshold for Contracts in an Entity's Own Equity

FinREC offers conditional support for the proposal to disregard remote events for purposes of determining the classification of a contract in an entity's own equity. Specifically, we are concerned that introducing the notion of *remote* could increase complexity in the financial reporting system, and we believe that this complexity must be addressed if FASB moves forward with finalizing the proposal. To help alleviate our concerns, we suggest that FASB:

- Provide additional guidance to address the meaning of *remote* in this context. For example, FASB could attempt to provide factors an entity should consider when determining whether an event is remote of occurring.
- Engage with the PCAOB and Auditing Standards Board in developing this guidance as FinREC believes the accounting term *remote* may be intertwined with how the auditing community applies that term. (FinREC of course would be happy to facilitate a conversation with the ASB.) For example, the 200 series of AU-C sections uses the term in this context: “**Reasonably possible.** The chance of the future event or events occurring is more than *remote* but less than likely.”

If a final ASU includes the FASB’s proposed remote threshold, FinREC recommends that FASB:

1. Add the same remote threshold for contracts in an entity’s own equity that are in the scope of ASC 480-10-25-8 (e.g., a warrant that requires gross settlement but is also puttable for cash upon a remote event or a warrant on a share that is redeemable only upon a remote event), and
2. Engage with the U.S. Securities and Exchange Commission staff to clarify the requirements of ASC 480-10-S99-3A (that is, the SEC staff redeemable equity guidance that determines whether an equity-classified instrument should be presented in permanent or temporary equity) for
 - Freestanding option/forward contracts on an entity’s own equity. These instruments are currently scoped out the temporary equity guidance because any remote cash redemption feature would preclude equity classification under ASC 480 or ASC 815, and therefore 480-10-S99-3A is not applicable. If remote cash redemptions become a permitted exception under ASC 815 (and possibly ASC 480), are they also ignored under 480-10-S99-3A?
 - Shares that contain a settlement feature that provides the issuer a choice to settle in cash or shares. The current guidance requires an entity to evaluate those features under 815-40-25 (formerly EITF 00-19) to determine if the issue has the ability, in all possible scenarios, to settle in shares. If 815-40-25 permits net-cash settlement upon events deemed remote at inception, are they also permitted under 480-10-S99-3A, thus resulting in permanent equity classification for the instrument?

Reassessment

Overall, FinREC believes the threshold and frequency of reassessment depends on FASB’s success at providing guidance on the term *remote*. Our deliberations started with mixed views but ultimately coalesced around focusing on the importance of understanding the *remote* concept in determining the frequency of reassessment. We generally support more frequent reassessment to ensure that economic events are reflected in the financial statements in the appropriate periods.

However, we acknowledge that an increase in the frequency of reassessments will increase the complexity of complying with the standard, especially if the term *remote* is not well defined.

Regardless of our overall view, FinREC believes that the condition in proposed paragraph 815-40-35-8a should include an explicit requirement to reassess all features when an event deemed remote at inception occurs.

Likewise, FinREC also believes that the Board should add an explicit requirement to reassess all features if a contract is amended or otherwise modified.

Transition

FinREC supports the FASB's proposed transition requirements unrelated to EPS.

As it relates to EPS, FinREC conceptually supports requiring a full retrospective approach for all EPS-related aspects of the Exposure Draft, given the importance of comparability between periods for this metric. However, given our collective lack of experience having to prepare financial statements with these kinds of instruments, FinREC suggests that FASB do a targeted outreach to public company preparers that have historically issued such instruments in order to understand if there are unnecessary complexities with adopting the proposed guidance using a full retrospective approach.

Disclosures

FinREC generally agrees with the proposed disclosures as they would help users understand the instruments in the scope. However, FinREC does not support new fair value disclosures for public business entities for all equity-classified instruments, especially for PBEs whose stock does not trade on an exchange. In such instances, we do not believe the benefits to users outweigh the related costs to determine fair value.