

FASB Emerging Issues Task Force

Issue No. 05-1

Title: Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option

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Dates Previously Discussed: March 17, 2005; June 15, 2005; September 15, 2005; March 16, 2006

Previously Distributed EITF Materials: Issue Summary No. 1, dated March 1, 2005; Issue Summary No. 1, Supplement No. 1, dated May 27, 2005; Issue Summary No. 1, Supplement No. 2, dated September 1, 2005; Issue Summary No. 1, Supplement No. 3, dated March 3, 2006

References

FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* (FAS 15)

FASB Statement No. 84, *Induced Conversions of Convertible Debt* (FAS 84)

FASB Statement No. 128, *Earnings per Share* (FAS 128)

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity* (FAS 150)

* **The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

FASB Technical Bulletin No. 80-1, *Early Extinguishment of Debt through Exchange for Common or Preferred Stock* (TB 80-1)

FASB proposed revised Statement No. 128, *Earnings per Share* (proposed FAS 128(R))

APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14)

APB Opinion No. 26, *Early Extinguishment of Debt* (APB 26)

AICPA Accounting Interpretation No. 1, *Debt Tendered to Exercise Warrants*, of APB Opinion No. 26 (AIN-APB 26)

International Accounting Standard 32, *Financial Instruments: Disclosure and Presentation* (IAS 32)

EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion" (Issue 90-19)

EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" (Issue 98-5)

EITF Issue No. 02-15, "Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are within the Scope of FASB Statement No. 84" (Issue 02-15)

EITF Issue No. 03-7, "Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of Issue No. 90-19)" (Issue 03-7)

EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share" (Issue 04-8)

EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock'" (Issue 05-2)

EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues" (Issue 05-7)

EITF Abstracts, Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share" (Topic D-72)

Background

1. At the March 16, 2006 EITF meeting, the Task Force reached a tentative conclusion on this Issue and directed the staff to pursue the issuance of a draft abstract (Draft Abstract 05-1) for public comment. Additionally, the Task Force reached a tentative conclusion that Issue 03-7 should be amended to clarify that Issue 03-7 does not apply to settlements within the scope of this Issue and directed the staff to pursue the issuance of a draft abstract (Draft Abstract 03-7) for public comment. Draft Abstracts 05-1 and 03-7 were posted to the website on April 4, 2006, for 30-day comment periods that ended May 4, 2006.
2. Comment letters on Draft Abstract 05-1 have been distributed to members of the Task Force and have been analyzed by the FASB staff. At the June 15, 2006 EITF meeting, the Task Force will have the opportunity to consider those comment letters as it redeliberates the tentative conclusion in Draft Abstract 05-1 and addresses the issues raised in this Supplement. The Task Force will then be asked to affirm its tentative conclusion on this Issue as a consensus.
3. No comment letters were received on Draft Abstract 03-7. Accordingly, the Task Force will be asked to affirm its tentative conclusion regarding the clarifying amendment of Issue 03-7 as a consensus.

Summary of Comment Letters

4. Two comment letters were received on Draft Abstract 05-1. Both comment letters were from financial services firms. One of the respondents generally agreed with the scope and accounting model as proposed. The other respondent disagreed with the proposed accounting model.
5. The respondent who disagreed with the proposed model did agree, however, with certain aspects of the tentative conclusion, namely that the accounting treatment for a settlement within the scope of Issue 05-1 should be treated as a debt conversion or debt extinguishment based on whether a conversion feature other than one associated with the issuer's call option exists. However, the respondent disagreed with the Task Force's conclusion to evaluate the conversion feature as of the instrument's issuance date. The respondent believes that the likelihood that an instrument will become exercisable (that is, the likelihood that the holder will have the ability to

elect share settlement, irrespective of whether share settlement is economical) absent the issuer's exercise of its call option should be performed as of the date the call option is exercised; not as of the date the instrument is issued. The respondent remarked that evaluating the substance of a conversion feature as of an instrument's issuance date is not consistent with the model used to determine the accounting for the conversion of an instrument outside the scope of Issue 05-1 (that is, an instrument that is convertible at the discretion of the holder at the time an issuer exercises its call option).

6. At the March 16, 2006 EITF meeting, the Task Force acknowledged the inconsistency in accounting treatment noted by the respondent but still supported a model based on evaluating the conversion feature as of the debt instrument's issuance date. The Task Force understood, for example, that an instrument with an extremely high conversion price could be accounted for as an extinguishment when it is converted into shares if it is within the scope of Issue 05-1 (that is, it was not otherwise convertible at the time the issuer exercised its call) and accounted for as a conversion if it is outside the scope of Issue 05-1 (that is, it was convertible at the discretion of the holder at the time the issuer exercised its call). Reasons cited by individual Task Force members as supportive of evaluating an embedded conversion feature as of the instrument's issuance date, despite the inconsistency in accounting models, included (a) a belief that instances like the one describe above (that is, instruments issued with extremely high conversion prices that are ultimately converted as a result of a rise in the underlying share price) would not be common and (b) a concern about the operationality of evaluating the conversion feature as of the date an issuer exercises its call.

7. The staff does not believe that there was any additional information presented by the respondent that was not considered by the Task Force as part of its previous deliberations. The staff does not believe that further deliberation of the issues raised by the respondent is necessary.

Scope

8. Issue Summary No. 1 and Issue Summary Supplement No. 1, which were previously distributed to the Task Force, indicated that the settlement of an instrument that would become exercisable due solely to the passage of time, such as an instrument containing an embedded European or Bermudan conversion option, was outside the scope of Issue 05-1. A European

option is an option that, by its terms, is convertible at the discretion of the holder on, but not before, its maturity date. For purposes of this discussion, a Bermudan option is an option that, by its terms, is convertible at the discretion of the holder on (a) a specified date or dates during the life of the option and (b) on the instrument's maturity date.

9. In preparation for the September 15, 2005 EITF meeting, the staff revised the proposed scope to include all instruments that were not currently convertible at the date the instrument was called by the issuer. Therefore, debt instruments that became convertible due solely to the passage of time were included in the proposed scope if the instrument was not convertible when the issuer exercised its call option. The staff believed that including such instruments in the scope of Issue 05-1 was important because it highlighted the notion that the likelihood that a conversion feature will become exercisable (assuming the issuer does not exercise its call option) is an attribute that impacts the value of an instrument relative to its conversion value.

10. The Task Force did not object to the revised scope at its March 16, 2006 meeting. However, at least one Task Force member has expressed concern about the revised scope subsequent to the March meeting. Accordingly, the staff believes it is appropriate for the Task Force to consider whether the scope of the tentative conclusion should include instruments with conversion options that will become exercisable due solely to the passage of time.

Accounting Issue and Alternatives

Issue 1: Whether the scope of Issue 05-1 should be revised to exclude the settlement of an instrument with an embedded conversion feature that will become exercisable solely due to the passage of time.

11. To illustrate the application of Issue 05-1, consider a debt instrument issued with an embedded European conversion option that is converted to equity shares of the issuer before its maturity date as a result of the issuer's exercise of its call option. In accordance with the current scope of Issue 05-1, because the embedded conversion feature is not exercisable at the time the issuer exercises its call option, accounting for the conversion should be determined by reference to the guidance in Issue 05-1. If, as of the instrument's issuance date, it was at least reasonably possible that the embedded conversion feature would be exercised absent the issuer's exercise of

its call option, the settlement of the instrument would qualify for conversion accounting. However, if as of the instrument's issuance date the embedded conversion feature was deemed not to be substantive (for example, because the price of the embedded conversion feature was extremely high), the conversion would be recognized as an extinguishment under Issue 05-1.

12. If the conversion feature had characteristics of an American option (that is, it is convertible at the discretion of the holder at any point in time during which the instrument is outstanding) it would be outside the scope of Issue 05-1 and would qualify for conversion accounting.

View A: The scope of Issue 05-1 should not be revised to exclude the settlement of instruments that contain embedded conversion features that will become exercisable solely due to the passage of time.

13. Proponents of View A believe that adding an exception to the scope of Issue 05-1 will add complexity without a significant improvement in financial reporting. On the other hand, they believe that a scope based on the principle of whether the instrument is convertible at the option of the holder at the date the issuer exercises its call will result in consistent application and interpretation.

14. Proponents of View A also believe that most instruments that will become exercisable solely due to the passage of time will also be considered substantive under Issue 05-1 and, therefore, only instruments issued without a substantive conversion option (for example, due to an extremely high conversion price) will result in extinguishment accounting, which they believe is the appropriate accounting treatment for such an instrument.

View B: The scope of Issue 05-1 should be revised to exclude the settlement of an instrument that, as of the date the issuer exercises its call option, contains an embedded conversion feature that will become exercisable solely due to the passage of time.

15. Proponents of View B do not believe that the settlement of otherwise identical instruments should be accounted for differently simply because the timing of when the conversion features are exercisable by the holders of the instruments is different. They believe that a conversion

feature that will become exercisable solely due to the passage of time effectively assures that the issuer's exercise of its call will not result in the transfer of incremental value to the holder. For example, if the value of the equity shares underlying an instrument that was issued with an embedded European conversion feature exceeds the debt-only value of the instrument, the instrument will trade at or above the value of the underlying shares and the issuer's call will not transfer incremental value to the holder. Because the issuer's call of such an instrument does not transfer incremental value, opponents of the current scope believe that any resulting conversion should be outside the scope of Issue 05-1.

16. If the Task Force decides to not modify its tentative conclusion in Draft Abstract 05-1 consistent with View A of Issue 1, the Task Force will be asked to affirm that tentative conclusion as a consensus. If the Task Force decides to modify its tentative conclusion in Draft Abstract 05-1 and reaches a tentative conclusion consistent with View B, the Task Force will be asked whether additional public exposure of Draft Abstract 05-1, revised to reflect the guidance in View B, is necessary. If the Task Force does not believe additional public exposure is necessary, the Task Force will be asked to affirm the tentative conclusion on this Issue with the required revisions to Draft Abstract 05-1 as a consensus with the intention of finalizing the required revisions through the EITF minutes process.

International Convergence

17. Paragraphs 28-32 of IAS 32 require that the issuer of a compound non-derivative that contains both a liability and equity component (such as a convertible debt instrument) separately classify the liability and equity components. In the event a convertible debt instrument is converted to equity shares prior to its maturity but the "original conversion privileges are unchanged," the value of the equity shares issued to settle the instrument is considered to be a component of the consideration paid to settle the instrument and is allocated between the separately classified liability and equity components. Any resulting gain or loss is treated in accordance with the accounting principles applicable to the related component (that is, gain or loss associated with settlement of the liability is recognized in profit or loss while settlement of the equity component is recognized in equity).

18. Because different models are used to account for the issuance and settlement of compound financial instruments under IAS and US GAAP, the Task Force's specific conclusions on this Issue do not impact international convergence to any significant degree.

Draft Abstracts 05-1 and 03-7

19. The staff has made certain editorial revisions to the draft abstracts that were posted for public comment. The staff believes that the revisions are consistent with the tentative conclusions reached by the Task Force at its March 16, 2006 meeting and that the revisions do not warrant specific consideration by the Task Force. Revised Draft Abstract 05-1 and Draft Abstract 03-7, marked for changes relative to the documents posted for public comment, are attached as Exhibits 05-1A and 05-1B, respectively.

EITF Abstracts (DRAFT)

Issue No. 05-1

Title: Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option

Dates Discussed: March 17, 2005; June 15–16, 2005; September 15, 2005; March 16, 2006; [June 15, 2006]

References: FASB Statement No. 49, *Accounting for Product Financing Arrangements*
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
FASB Statement No. 153, *Exchanges of Nonmonetary Assets*
AICPA Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing"
APB Opinion No. 29, *Accounting for Nonmonetary Transactions*
Statement 133 Implementation Issue No. K1, "Miscellaneous: Determining Whether Separate Transactions Should Be Viewed as a Unit"
Statement 133 Implementation Issue No. K3, "Miscellaneous: Determination of Whether Combinations of Options with the Same Terms Must be Viewed as Separate Option Contracts or as a Single Forward Contract"
AICPA Technical Practice Aids, Section 5100.46, "Nonmonetary Exchanges of Software (Part 1)"
AICPA Technical Practice Aids, Section 5100.47, "Nonmonetary Exchanges of Software (Part II)"

ISSUE

1. At the September 29–30, 2004 EITF meeting, a consensus was reached on Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share." The contingently convertible instruments (CoCos) addressed in Issue 04-8 also may contain an embedded issuer call option that, upon exercise, permits conversion of an instrument by the holder even when the instrument's market price trigger has not been met. Although this Issue was raised in the context of CoCos with market price triggers, it also extends beyond market price triggers to any situation in which a call option permits conversion of an instrument by the holder that is not otherwise currently convertible. These call options provide the issuer with the ability to call the debt at any time (excluding lock-out periods). Upon exercise of the call option, the holder has the ability to receive cash for the call price or a defined number of equity shares or, in some cases, a combination of cash and shares. However, the holder typically will choose to receive equity if the value of the equity exceeds the cash call price of the debt.

2. To illustrate the underlying issue, consider the following example:

An entity issues a CoCo on January 1, 2006, with a market price trigger, a \$1,000 par amount, and a maturity date of December 31, 2020. The debt instrument is convertible at the option of the holder if the share price of the issuer exceeds a specified amount. The issuer can call the debt at any time between 2009 and the maturity date of the debt. If the issuer calls the debt, the holder has the option to receive cash for the call amount or a fixed number of shares as specified in the terms of the instrument upon issuance, regardless of whether the market price trigger has been met. In 2010, the issuer calls the debt prior to the market price trigger being met and the holder elects to receive a fixed number of shares (as specified in the terms of the instrument).

3. The issue is how the conversion of an instrument that became convertible upon the issuer's exercise of a call option should be accounted for.

Scope

4. This Issue applies to the issuance of equity securities to settle a debt instrument that was not otherwise currently convertible but became convertible upon the issuer's exercise of a call option when the issuance of equity securities is pursuant to the instrument's original conversion terms. Statement 84 provides guidance about conversions pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance to induce conversion and Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," provides guidance about modifications to embedded conversion options.

EITF DISCUSSION

5. The Task Force reached a [consensus] that the issuance of equity securities to settle a debt instrument (pursuant to the instrument's original conversion terms) that became convertible upon the issuer's exercise of a call option should be accounted for as a conversion if the debt instrument contained a substantive conversion feature as of its issuance date, as defined herein. That is, no gain or loss should be recognized related to the equity securities issued to settle the instrument. The issuance of equity securities to settle a debt instrument that became convertible upon the issuer's exercise of a call option should be accounted for as a debt extinguishment if the debt instrument did not contain a substantive conversion feature as of its issuance date. That is, the fair value of the equity securities issued should be considered a component of the reacquisition price of the debt.

6. For purposes of this Issue, the issuance date of an instrument is the instrument's commitment date, as defined in Issue 4 of Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments." The assessment of whether the conversion feature is substantive may be performed after the issuance date but should be based only on assumptions, considerations, and/or marketplace information available as of the issuance date.

7. For purposes of applying this [consensus], a substantive conversion feature is a conversion feature that is at least reasonably possible of being ~~coming~~ exercised ~~able~~ in the future absent the issuer's exercise of a call option. (The term *reasonably possible* has the same meaning that it has in Statement 5.)

8. For purposes of this Issue, the Task Force observed that if the conversion price of an instrument at issuance is extremely high so that conversion of the instrument is not deemed at least reasonably possible as of its issuance date then the conversion feature would not be considered substantive. The Task Force referred to footnote 15 of paragraph A9 of Statement 150 in making that determination. Therefore, even if such an instrument included a conversion feature that provided for conversion due solely to the passage of time (for example, the instrument will become convertible at a date prior to its maturity date), it would be inappropriate to conclude that the conversion feature at issuance was at least reasonably possible of being coming-exercised able in the future. The Task Force also observed that an instrument that can only become convertible upon the issuer's exercise of its call option does not possess a substantive conversion feature.

9. The Task Force observed that the following methods may be helpful in assessing whether a conversion feature is substantive (that is, a conversion feature is at least reasonably possible of being coming-exercised able in the future). This list is not intended to be all-inclusive.

- a. **The fair value of the conversion feature relative to the fair value of the debt instrument.** Comparing the fair value of a conversion feature to the fair value of the debt instrument (that is, the complete instrument as issued) may provide evidence that the conversion feature is substantive.
- b. **The effective annual interest rate per the terms of the debt instrument relative to the estimated effective annual rate of a nonconvertible debt instrument with an equivalent expected term and credit risk.** Comparing the effective annual interest rate per the terms of the debt instrument to the effective annual rate the issuer estimates it could obtain on a similar non-convertible instrument may provide evidence that a conversion feature is substantive.
- c. **The fair value of the debt instrument relative to an identical instrument for which conversion is not contingent.** Comparing the fair value of the debt instrument to the fair value of an identical instrument for which conversion is not contingent isolates the impact of the contingencies and may provide evidence about the substance of a conversion feature. If the fair value of the debt instrument is similar to the fair value of an identical convertible debt instrument for which conversion is not contingent, then it may indicate that the conversion feature is substantive. However, this approach may not be appropriate unless it is clear that the conversion feature, not considering the contingencies, is substantive.
- d. **Qualitative evaluation of the conversion provisions.** The nature of the conditions under which the instrument may become convertible may provide evidence that the conversion feature is substantive. For example, if an instrument may become convertible upon the occurrence of a specified contingent event, the likelihood that the contingent event will occur prior to the instrument's maturity date may indicate that the conversion feature is substantive. However, this approach may not be appropriate unless it is clear that the conversion feature, not considering the contingencies, is substantive.

10. Upon the settlement (that is within the scope of this Issue) of an instrument with the characteristics of Instrument C in Issue No. 90-19, "Convertible Bonds with Issuer Option to

Settle for Cash upon Conversion," by payment of the accreted value of the obligation in cash and settlement of the conversion spread with stock, the cash payment should be considered in the computation of gain or loss on extinguishment of the recognized liability. The treatment of the shares transferred should be determined by reference to the guidance in this Issue.

11. The Task Force also observed that this Issue does not affect the treatment of an instrument for purposes of applying Statement 128 and related interpretive guidance, including Issue 04-8.

Transition

12. This Issue applies to all conversions within the scope of this Issue that result from the exercise of call options in interim or annual reporting periods beginning after Board ratification of the [consensus], irrespective of whether the instrument was entered into prior or subsequent to Board ratification of this Issue. For instruments issued prior to the effective date of this [consensus], the assessment as to whether a substantive conversion feature exists at issuance should be based only on assumptions, considerations and/or marketplace information available as of the issuance date.

13. Early application of this Issue is permitted in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.

Board Ratification

14. At its [June 28, 2006] meeting, the Board ratified the [consensuses] reached by the Task Force in this Issue.

STATUS

15. No further EITF discussion is planned.

Title: Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of Issue No. 90-19)

Dates Discussed: July 31, 2003; March 16, 2006; [June 15, 2006]

References: FASB Statement No. 84, *Induced Conversions of Convertible Debt*
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*
FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*
FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*
FASB Technical Bulletin No. 80-1, *Early Extinguishment of Debt through Exchange for Common or Preferred Stock*
FASB Concepts Statement No. 6, *Elements of Financial Statements*
APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*
APB Opinion No. 26, *Early Extinguishment of Debt*
AICPA Accounting Interpretation 1, "Early Extinguishment of Debt," of APB Opinion No. 26

ISSUE

1. Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion," addresses the accounting for all convertible bonds with characteristics of Instruments A, B, or C as described in that Issue.¹ Specifically, the issues addressed in Issue 90-19 are:

¹ Instrument A: Upon conversion, the issuer must satisfy the obligation entirely in cash based on the fixed number of shares multiplied by the stock price on the date of conversion (the conversion value).
Instrument B: Upon conversion, the issuer may satisfy the entire obligation in either stock or cash equivalent to the conversion value.
Instrument C: Upon conversion, the issuer must satisfy the accreted value of the obligation (the amount accrued to the benefit of the holder exclusive of the conversion spread) in cash and may satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock.

Issue 1— Whether the initial balance sheet treatment by the issuer should provide for separate or combined accounting for the conversion feature and debt obligation

Issue 2— How the issuer should account for the excess conversion spread over the accreted value

Issue 3— How each instrument should be treated in earnings-per-share computations.

2. The Task Force reached a consensus on Issue 1 that combined accounting for the conversion feature and debt obligation is appropriate for Instrument C. On Issue 2, the Task Force reached a consensus that Instrument C "should be accounted for *similarly to indexed debt obligations*" (emphasis added). That is, the issuer should adjust the carrying amount of the instrument in each reporting period to the higher of the current stock price or the accreted value of the instrument. The Task Force reconsidered that consensus guidance for Instrument C at the January 23–24, 2002 meeting to reflect the effect of the consensus guidance in Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." Issue 00-19 addresses how freestanding derivative financial instruments that are indexed to, and potentially settled in, a company's own stock should be classified and measured by the company.

3. At the January 23–24, 2002, meeting the Task Force revised the prior consensuses on Issues 1 and 2 of Issue 90-19 that Instrument C should be accounted for like convertible debt if the conversion spread meets the requirements of Issue 00-19 for classification within permanent equity. Paragraph 4 of Issue 00-19 discusses the Task Force consensus:

. . . for purposes of evaluating under Statement 133 whether an embedded derivative indexed to a company's own stock would be classified in stockholders' equity if freestanding, the requirements of paragraphs 12–32 of [Issue 00-19] do not apply if the hybrid contract is a conventional convertible debt instrument in which the holder may only realize the value of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of shares or the equivalent amount of cash (at the discretion of the issuer).

4. The Task Force also observed that the requirements of paragraphs 12–32 of Issue 00-19 apply when an issuer is evaluating whether any other embedded derivative instrument is an equity instrument and thereby excluded from the scope of Statement 133. The January 23–24, 2002 meeting minutes for Issue 90-19 explain that because the features of Instrument C are sufficiently different from *conventional* convertible debt, paragraphs 12–32 of Issue 00-19 should be applied in determining whether the conversion feature meets the criteria for classification as permanent equity. If the conversion feature does not meet those criteria, Instrument C should be bifurcated by the issuer and the bifurcated derivative (that is, the conversion feature) should be marked to market under the provisions of Statement 133.

5. While the Issue 90-19 consensus, as revised, provides guidance for the accounting for Instrument C at issuance, Issue 90-19 does not address the accounting at settlement for Instrument C, and questions have arisen in practice about the accounting for the excess of the conversion spread over the accreted value of the obligation at settlement. With the exception of Issue No. 05-1, "Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option," current accounting guidance for convertible debt

(for example, Opinion 14, Opinion 26, Statement 84, and Issues No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments") also does not specifically address the settlement accounting for Instrument C of Issue 90-19. Therefore, for settlement transactions other than those within the scope of Issue 05-1, this Issue addresses how the issuer should account at settlement for Instrument C in Issue 90-19 if the issuer settles the conversion spread in stock. If settled in cash, the issuer would record a gain or loss based on the total cash consideration compared with the carrying amount of the debt. This Issue assumes that the embedded conversion feature meets the criteria in paragraphs 12–32 of Issue 00-19 for classification within permanent equity. If it did not meet those criteria, this Issue would not arise because the embedded conversion feature would be bifurcated from the debt host as a separate liability and accounted for as a derivative.

6. The issue is how the issuer should account for the partial cash-based and partial stock-based settlement of a debt instrument structured in the form of Instrument C as described in Issue 90-19.

EITF DISCUSSION

7. The Task Force reached a consensus that upon settlement (other than within the scope of Issue 05-1) of a security (~~other than those instruments within the scope of Issue 05-1~~) with the characteristics of Instrument C in Issue 90-19 by payment of the accreted value of the obligation (recognized liability) in cash and settlement of the conversion spread (unrecognized equity instrument) with stock, only the cash payment should be considered in the computation of gain or loss on extinguishment of the recognized liability. That is, any shares transferred to settle the embedded equity instrument (referred to as the excess conversion spread in Issue 90-19) would not be considered in the settlement of the debt component.

Transition

8. This consensus is effective for settlement transactions entered into on or after the beginning of an entity's next reporting period beginning after August 13, 2003.

Board Ratification

9. At its August 13, 2003 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

STATUS

10. No further EITF discussion is planned.

11. Issue 05-1 was ratified by the Board on [June 28, 2006], and amends this Issue to clarify that the issuance of equity securities to settle a debt instrument that became convertible upon the issuer's exercise of a call option is not within the scope of this Issue. Issue 05-1 requires that such conversion be accounted for as a debt conversion or debt extinguishment based on whether the instrument contained a substantive conversion feature as of its issuance date.