Notice for Recipients
of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) addresses an issuer's accounting for registration payment arrangements. This proposed FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, would be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*. The guidance in this proposed FSP would amend FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, to include scope exceptions for registration payment arrangements. This proposed FSP further clarifies that a financial instrument subject to a registration payment arrangement would be accounted for in accordance with other applicable generally accepted accounting principles without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement.

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues or specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

PROPOSED FASB STAFF POSITION

No. EITF 00-19-b

Title: Accounting for Registration Payment Arrangements

Comment Deadline: December 4, 2006

Introduction

1. This FASB Staff Position (FSP) addresses an issuer's accounting for registration payment arrangements. This FSP specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement, whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies*. The guidance in this FSP amends FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Other*s, to include scope exceptions for registration payment arrangements. This FSP further clarifies that a financial instrument subject to a registration payment arrangement should be accounted for in accordance with other applicable generally accepted accounting principles (GAAP) without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement.

Background

2. An entity may issue financial instruments (for example, equity shares, warrants, or debt instruments) that are subject to a *registration payment arrangement*. Under such arrangements, the issuer agrees to endeavor (a) to file a registration statement for the resale of specified financial instruments and/or for the resale of equity shares that are issuable upon exercise or conversion of those financial instruments and (b) for the registration statement to be declared effective by the Securities and Exchange Commission (SEC) within a specified grace period. In some registration payment

arrangements, the issuer may be required to endeavor to maintain the effectiveness of the registration statement for a specified period of time (or in perpetuity). Such arrangements frequently specify that the issuer is required to use its "best efforts" or to apply "commercially reasonable efforts" to undertake these actions. If the registration statement is not declared effective within the grace period or its effectiveness is not maintained for the specified period, the issuer must transfer consideration to the counterparty. That consideration may be payable in a lump sum or it may be payable periodically, and the form of the consideration may vary. For example, the consideration may be in the form of cash, equity instruments, or adjustments to the terms of the financial instrument or instruments that are subject to the registration payment arrangement (such as an increased interest rate on a debt instrument).

3. Because of the potential significance of the consideration that may become payable under registration payment arrangements, questions have arisen as to the accounting for those arrangements. Questions also have arisen about whether the existence of a registration payment arrangement affects the accounting for the financial instrument(s) subject to the registration payment arrangement, particularly when the financial instrument or instruments are accounted for in accordance with EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

FASB Staff Position

Scope

4. This FSP applies to the issuer of a registration payment arrangement. For purposes of this FSP, a *registration payment arrangement* is an arrangement with both of the following characteristics:

a. The arrangement specifies that the issuer will endeavor (1) to file a registration statement for the resale of specified financial instruments and/or for the resale of equity shares that are issuable upon exercise or conversion of specified financial instruments and for that registration statement to be declared effective by the SEC (or other applicable securities regulator if the registration statement will be filed in a foreign jurisdiction) within a specified grace period, and/or (2) to maintain the effectiveness of the registration statement for a specified period of time (or in perpetuity); and

b. The arrangement requires the issuer to transfer consideration to the counterparty if the registration statement for the resale of the financial instrument or instruments subject to the arrangement is not declared effective or if effectiveness of the registration statement is not maintained. That consideration may be payable in a lump sum or it may be payable periodically, and the form of the consideration may vary.

5. This FSP applies to a registration payment arrangement regardless of whether it is issued as a separate agreement or included as a provision of a financial instrument or other agreement. An arrangement that requires the issuer to obtain and/or maintain a listing on a stock exchange, instead of obtaining and/or maintaining an effective registration statement, is within the scope of this FSP if the remaining characteristics set forth in paragraph 4 are met.

6. Commercial arrangements with characteristics similar to registration payment arrangements are not within the scope of this FSP. For example, a building contract that includes a provision requiring the contractor to obtain a certificate of occupancy by a certain date or pay a penalty every month until the certificate of occupancy is obtained is not addressed by this FSP. This FSP does not apply to arrangements in which the amount of consideration transferred is determined by reference to (a) an observable market, other than the market for the issuer’s stock, or (b) an observable index. For example, this FSP does not apply if the consideration to be transferred if the issuer is unable to obtain an effective registration statement is determined by reference to the price of a commodity. Additionally, this FSP does not apply to arrangements in which the financial instrument or instruments subject to the arrangement are settled when the consideration is transferred. For example, this FSP does not apply to a warrant that is contingently puttable if an effective registration statement for the resale of the equity shares that are issuable upon exercise of the warrant is not declared effective by the SEC within a specified grace period.

Recognition and Measurement

7. The contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement shall be recognized and measured separately in accordance with Statement 5 and FASB Interpretation No. 14,

Reasonable Estimation of the Amount of a Loss.[1] The financial instrument(s) subject to the registration payment arrangement shall be recognized and measured in accordance with other applicable GAAP (for example, APB Opinion No. 21, *Interest on Receivables and Payables*, Statement 133, and Issue 00-19) without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement.

8. If the transfer of consideration under a registration payment arrangement is probable and can be reasonably estimated at inception, the contingent liability under the registration payment arrangement shall be included in the allocation of proceeds from the related financing transaction using the measurement guidance in Statement 5. The remaining proceeds shall be allocated to the financial instrument(s) issued in conjunction with the registration payment arrangement based on the provisions of other applicable GAAP. For example, if the financial instruments issued concurrently with the registration payment arrangement are a debt instrument and an equity-classified warrant, the remaining proceeds after recognizing and measuring a liability for the registration payment arrangement under Statement 5 would be allocated on a relative fair value basis between the debt and the warrant pursuant to paragraph 16 of APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*.

9. If the transfer of consideration under a registration payment arrangement becomes probable and can be reasonably estimated subsequent to the inception of the arrangement or if the measurement of a previously recognized contingent liability increases or decreases in a subsequent period, the initial recognition of the contingent liability or the change in the measurement of the previously recognized contingent liability shall be recognized in earnings.

Disclosures

10. The issuer of a registration payment arrangement shall disclose the following information about each registration payment arrangement or each group of similar arrangements. These disclosures are required even if the likelihood of the issuer having to make any payments under the arrangement is remote.

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[1]Interpretation 14 specifies the amount to be accrued if the reasonable estimate of the amount is a range. If some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount is accrued. However, if no amount within the range is a better estimate than any other amount, the minimum amount in the range is accrued.

a. The nature of the registration payment arrangement, including the approximate term of the arrangement, the financial instrument(s) subject to the arrangement, and the events or circumstances that would require the issuer to transfer consideration under the arrangement.
b. The maximum potential amount of consideration, undiscounted, that the issuer could be required to transfer under the registration payment arrangement. If the terms of the arrangement provide for no limitation to the maximum potential consideration to be transferred, that fact shall be disclosed.
c. The current carrying amount of the liability representing the issuer's obligations under the registration payment arrangement and the income statement classification of any gains or losses resulting from changes in the carrying amount of that liability.

Amendments to Statement 133 and Interpretation 45

11. Paragraph 10(j) of Statement 133 is added as follows: [Added text is underlined.]

> *Registration payment arrangements*. Registration payment arrangements within the scope of FSP EITF 00-19-b, "Accounting for Registration Payment Arrangements," are not subject to the requirements of this Statement. The exception in this subparagraph applies to both (a) the issuer that accounts for the arrangement pursuant to FSP EITF 00-19-b and (b) the counterparty.

12. Paragraph 6(g) of Interpretation 45 is added as follows:

> A registration payment arrangement within the scope of FSP EITF 00-19-b, "Accounting for Registration Payment Arrangements."

Effective Date and Transition

13. This FSP shall be effective immediately for registration payment arrangements and the financial instruments subject to those arrangements that are entered into or modified subsequent to the date of issuance of this FSP. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of this FSP, this guidance shall be effective for financial statements issued for fiscal years beginning after December 15, 2006, and interim periods within those fiscal years.

14. For registration payment arrangements and financial instruments subject to those arrangements that were entered into prior to the issuance of this FSP and that continue to be outstanding at the beginning of the period of adoption, transition shall be achieved by

reporting a change in accounting principle through a cumulative-effect adjustment to the opening balance of retained earnings, or other appropriate components of equity or net assets in the statement of financial position, as of the first interim period for the fiscal year in which this FSP is initially applied. However, an entity shall not apply the guidance in this FSP to registration payment arrangements that are no longer outstanding upon adoption of this FSP.

15. For purposes of measuring the component of the cumulative-effect adjustment relating to the recognition of a contingent liability under Statement 5, an entity shall evaluate whether the transfer of consideration under a registration payment arrangement is probable and can be reasonably estimated as of the adoption date of this FSP. If prior to adoption of this FSP a registration payment arrangement was separately recognized at its fair value, the cumulative-effect adjustment shall be the difference between (a) the carrying amount of the registration payment arrangement immediately prior to adoption of this FSP and (b) the measurement of the contingent liability, if any, that is required to be recognized under Statement 5 upon adoption. The carrying amounts of other instruments that were originally issued together with a registration payment arrangement that was separately recognized and measured at fair value prior to adoption of this FSP shall not be adjusted upon adoption.

16. In some cases, an entity may have accounted for a registration payment arrangement and a financial instrument subject to the provisions of that arrangement as one instrument classified as an asset or liability under other applicable GAAP (for example, Issue 00-19). If upon adoption of this FSP the entity determines that the financial instrument subject to the registration payment arrangement is required to be reclassified to equity under other applicable GAAP without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement, the fair value of that instrument at the date it would have originally met the criteria for equity classification under other applicable GAAP (which may have been its original issuance date) shall be reclassified to equity. The difference between the carrying amount of the instrument recorded as an asset or liability immediately prior to adoption of this FSP and the amount reclassified to equity upon adoption shall be recognized as a component of the cumulative-effect adjustment. The carrying amounts of other instruments that were

originally issued together with the instrument being reclassified to equity shall not be adjusted upon adoption of this FSP.

17. If upon adoption of this FSP the entity determines that the financial instrument subject to the registration payment arrangement contains an embedded derivative that will no longer be separately accounted for as a derivative instrument under other applicable GAAP without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement, the instrument shall be recombined and adjusted to the carrying amount that would have been recognized at the adoption date of this FSP if the embedded derivative were not previously separated (for example, the accreted value of a debt instrument). The difference between (a) the aggregate carrying amount of the embedded derivative and the host instrument immediately prior to adoption and (b) the carrying amount of the hybrid instrument upon adoption shall be recognized as a component of the cumulative-effect adjustment.

18. An entity shall separately disclose (a) the portion of the cumulative-effect adjustment resulting from the recognition of a Statement 5 liability and (b) the portion of the cumulative-effect adjustment resulting from the reclassification of a financial instrument subject to the registration payment arrangement to equity (or the recombination of an embedded derivative). Examples of the transition provisions of this FSP are provided in Appendix A.

19. Early adoption is permitted as of the beginning of the interim period of adoption. Retrospective application of the guidance in this FSP to financial statements for earlier interim or annual periods presented is not permitted.

Appendix A
Implementation Guidance

Introduction

A1. This appendix provides examples to illustrate the application of the accounting provisions of this FSP to various types of registration payment arrangements.

Example 1—Common Stock and Warrants

A2. Company A issues 10 million shares of common stock and 2 million freestanding warrants to purchase additional shares of common stock for total proceeds of $100 million in a private placement transaction. In connection with the offering, Company A enters into a registration payment arrangement that requires Company A to use its best efforts (a) to file a registration statement with the SEC for the resale of 12 million shares of common stock and for that registration statement to be declared effective within 180 days of the offering's closing date and (b) once the registration statement is effective, to maintain its effectiveness for three years. If the registration statement is not declared effective within 180 days, or if it ceases to be effective during the three-year period in which Company A is required to maintain its effectiveness, the investors are entitled to "liquidated damages" in the form of monthly cash payments computed as 1.5 percent per month of the $100 million total offering proceeds. At closing, Company A concludes that it is **not** probable that it will be required to remit any payments to the investors for failing to obtain an effective registration statement or failing to maintain its effectiveness.

A3. Company A files a registration statement for the resale of the shares that is declared effective within the 180-day grace period. One year after the effective date of the registration statement, circumstances have changed such that Company A concludes that it is probable that the effectiveness of the registration statement will not be maintained for some portion of the remaining two-year period. Although Company A is unable to estimate the exact amount of time that the registration statement will cease to be effective, its reasonable estimate at the reporting date is a period of time ranging between 9 and 18 months. Accordingly, the range of loss is between $13.5 million ($100 million × 1.5 percent × 9 months) and $27 million ($100 million × 1.5 percent × 18 months). At the reporting date, no amount within that range appears to be a better estimate than any other amount.

A4. The common stock and warrants subject to the registration payment arrangement must be recognized and measured in accordance with other applicable GAAP without regard to the contingent obligation to make payments pursuant to the registration payment arrangement. Therefore, that contingent obligation does not affect Company A's analysis of whether the warrants are classified as liabilities or equity instruments under Issue 00-19, regardless of whether the transfer of consideration under the registration payment arrangement is probable. In the period in which (a) it became probable that Company A will be required to remit payments to the investors for failing to maintain an effective registration statement and (b) a range of payments can be reasonably estimated, a contingent liability must be accrued by a charge to earnings. Because no amount within the range of payments is a better estimate than any other amount, the $13.5 million minimum amount in the range must be accrued.

Example 2—Common Stock and Warrants

A5. Assume the same facts as in Example 1. However, at closing, Company A concludes that it is probable that it will be required to remit payments to the investors for failing to obtain an effective registration statement within the 180-day grace period. Based on the relevant facts and circumstances, Company A can reasonably estimate that (a) the registration statement will become effective six months **after** the grace period expires and (b) once effective, registration will be maintained for the three-year required period of effectiveness.

A6. The common stock and warrants subject to the registration payment arrangement must be recognized and measured in accordance with other applicable GAAP without regard to the contingent obligation to make payments pursuant to the registration payment arrangement. Therefore, that contingent obligation does not affect Company A's analysis of whether the warrants are classified as liabilities or equity instruments under Issue 00-19, regardless of whether the transfer of consideration under the registration payment arrangement is probable. Because a transfer of consideration under the registration payment arrangement is probable and can be reasonably estimated at inception, the $9 million ($100 million × 1.5 percent × 6 months) contingent liability under the registration payment arrangement must be included in the allocation of proceeds from the offering. The $91 million of remaining proceeds should be allocated between the common stock and warrants based on the guidance in other applicable GAAP.

Example 3—Debt

A7. Company A issues notes with an aggregate principal amount of $100 million in a private placement transaction. The notes were issued at par, bear interest at 8 percent per annum, and are not convertible into equity shares of the issuer. In connection with the offering, Company A enters into a registration payment arrangement that requires Company A to use its best efforts (a) to file a registration statement with the SEC for the resale of the notes and for that registration statement to be declared effective within 180 days of the offering's closing date and (b) once the registration statement is effective, to maintain its effectiveness for two years. If the registration statement is not declared effective within 180 days, or if it ceases to be effective during the two-year period in which Company A is required to maintain its effectiveness, the investors are entitled to "liquidated damages" in the form of an increase to the interest coupon of 50 basis points per annum. At closing, Company A concludes that it is **not** probable that it will be required to remit any payments to the investors for failing to obtain an effective registration statement or failing to maintain its effectiveness.

A8. Company A files a registration statement for the resale of the notes that is declared effective within the 180-day grace period. One year after the effective date of the registration statement, circumstances have changed such that Company A concludes that it is probable that the effectiveness of the registration statement will not be maintained for some portion of the remaining one-year period. Although Company A is unable to estimate the exact amount of time that the registration statement will cease to be effective, its reasonable estimate at the reporting date is a period of time ranging between three and six months. Accordingly, the range of loss is between $1.5 million ($100 million × 0.5 percent × 3 months) and $3 million ($100 million × 0.5 percent × 6 months). At the reporting date, no amount within that range appears to be a better estimate than any other amount.

A9. In the period in which (a) it became probable that Company A will be required to remit payments to the investors for failing to maintain an effective registration statement and (b) a range of payments can be reasonably estimated, a contingent liability must be accrued by a charge to earnings. Because no amount within the range of payments is a better estimate than any other amount, the $1.5 million minimum amount in the range must be accrued.

Examples of Transition Provisions

A10. The following examples are provided to illustrate the transition provisions of this FSP. The application of the transition provisions depends on how the issuer was accounting for the registration payment arrangement prior to application of the FSP.

Example 4—Transfer of Consideration Is Not Probable; Financial Instrument Subject to Registration Payment Arrangement Is Not Reclassified

A11. A registration payment arrangement is entered into in conjunction with the issuance of a warrant to purchase the issuer's shares. Prior to the adoption of this FSP, the issuer accounted for the warrant and the registration payment arrangement as one instrument and classified the entire arrangement as an equity instrument. The fair value of the entire arrangement at inception was $100. Immediately prior to adopting this FSP, the entire arrangement (the warrant and the registration payment arrangement) continues to be classified as an equity instrument and is carried at $100. At that date, the issuer determines that a payment under the registration payment arrangement is not probable. Further, the issuer determines that without regard to the registration payment arrangement, the warrant would continue to be classified as an equity instrument in accordance with other applicable GAAP. No transition adjustment would be recorded.

Example 5—Transfer of Consideration Is Not Probable; Financial Instrument Subject to Registration Payment Arrangement Is Not Reclassified

A12. A registration payment arrangement is entered into in conjunction with the issuance of a warrant to purchase the issuer's shares. Prior to the adoption of this FSP, the issuer's accounting policy was (a) to measure the contingent obligation to transfer consideration under a registration payment arrangement at fair value and (b) to recognize and measure instruments subject to a registration payment arrangement without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. At inception, the issuer concluded that the warrant is classified as an equity instrument in accordance with other applicable GAAP, and the $100 transaction proceeds were allocated as follows: $98 to the equity-classified warrant and $2 to the liability-classified registration payment arrangement. Immediately prior to adopting this FSP, the warrant continues to be classified as an equity instrument and is carried at $98, and the liability for the registration payment arrangement is measured at its current fair value of $4. At that date, the issuer determines that a payment under the registration payment arrangement is not probable. The following journal entry illustrates the transition adjustment, before tax considerations, that would be recorded upon adoption of this FSP.

Liability—registration payment arrangement	4	
Beginning retained earnings		4

To eliminate the liability for the contingent obligation to transfer consideration under the registration payment arrangement that was previously measured at fair value.

Example 6—Transfer of Consideration Is Probable and Can Be Reasonably Estimated; Financial Instrument Subject to Registration Payment Arrangement Is Not Reclassified

A13. A registration payment arrangement is entered into in conjunction with the issuance of a warrant to purchase the issuer's shares. Prior to the adoption of this FSP, the issuer accounted for the warrant and the registration payment arrangement as one instrument and classified the entire arrangement as an equity instrument. The issuer's policy prior to adoption of this FSP was to accrue payments under a registration payment arrangement in the period they are triggered. The fair value of the entire arrangement at inception was $100. Immediately prior to adopting this FSP, the entire arrangement (the warrant and the registration payment arrangement) continues to be classified as an equity instrument and is carried at $100. At that date, the issuer determines that a $10 payment under the registration payment arrangement is probable. Further, the issuer determines that without regard to the registration payment arrangement, the warrant would be classified as an equity instrument in accordance with other applicable GAAP. The following journal entry illustrates the transition adjustment, before tax considerations, that would be recorded upon adoption of this FSP.

Beginning retained earnings	10	
Contingent liability		10

To recognize the contingent liability to make payments under the registration payment arrangement.

Example 7—Transfer of Consideration Is Not Probable; Financial Instrument Subject to Registration Payment Arrangement Is Reclassified

A14. A registration payment arrangement is issued in conjunction with a warrant to purchase the issuer's shares. Prior to the adoption of this FSP, the issuer accounted for the warrant and the registration payment arrangement as one instrument and classified the entire arrangement as a liability. The fair value of the entire arrangement at inception was $100. Immediately prior to adopting this FSP, the entire arrangement is recorded at its current fair value of $110. At that date, the issuer determines that a payment under the registration payment arrangement is not probable. Further, the issuer determines that without regard to the registration payment arrangement, the warrant would have been classified as an equity instrument in accordance with other applicable GAAP for all periods. The following journal entry illustrates the transition adjustment, before tax considerations, that would be recorded upon adoption of this FSP.

Warrant liability	110	
Beginning retained earnings		10
Warrant (equity)		100

To reclassify the warrant to equity at its fair value as of the date it would have originally met the criteria for equity classification under other GAAP without regard to the contingent obligation to transfer consideration under the registration payment arrangement.

Example 8—Transfer of Consideration Is Probable and Can Be Reasonably Estimated; Financial Instrument Subject to Registration Payment Arrangement Is Reclassified

A15. A registration payment arrangement is issued in conjunction with a warrant to purchase the issuer's shares. Prior to the adoption of this FSP, the issuer accounted for the warrant and the registration payment arrangement as one instrument and classified the entire arrangement as a liability. The fair value of the entire arrangement at inception was $100. Immediately prior to adopting this FSP, the entire arrangement is recorded at its current fair value of $115. At that date, the issuer determines that a $20 payment under the registration payment arrangement is probable. Further, the issuer determines that without regard to the registration payment arrangement, the warrant would have been classified as an equity instrument in accordance with other applicable GAAP for all periods. The following journal entry illustrates the transition adjustment, before tax considerations, that would be recorded upon adoption of this FSP.

Warrant liability	115	
Beginning retained earnings	5	
Contingent liability		20
Warrant (equity)		100

To reclassify the warrant to equity at its fair value as of the date it would have originally met the criteria for equity classification under other GAAP without regard to the contingent obligation to transfer consideration under the registration payment arrangement and to recognize the contingent liability to make payments under the registration payment arrangement.

Example 9—Transfer of Consideration Is Probable and Can Be Reasonably Estimated; Conversion Option Embedded in Financial Instrument Subject to the Registration Payment Arrangement Is No Longer Separately Accounted for as a Derivative

A16. A registration payment arrangement is issued in conjunction with a convertible debt instrument. The total proceeds from the offering are equal to the $1,000 principal amount of the debt. Prior to the adoption of this FSP, the issuer accounted for the embedded conversion option and the registration payment arrangement as a single embedded derivative and separately accounted for that embedded derivative at fair value under Statement 133. At issuance, the embedded conversion option (including the contingent obligation to transfer consideration under the registration payment arrangement) was measured at its fair value of $200, and the remaining proceeds of $800 were allocated to the debt host. Immediately prior to adopting this FSP, the embedded conversion option (including contingent obligation to transfer consideration under the registration payment arrangement) is recorded at its current fair value of $350, and the debt host is recorded at its accreted value of $900. At that date, the issuer determines that a $20 payment under the registration payment arrangement is probable. Further, the issuer determines that without regard to the registration payment arrangement, the embedded conversion option would not have been separately accounted for as a derivative instrument in accordance with other applicable GAAP for all periods. The following journal entry illustrates the transition adjustment, before tax considerations, that would be recorded upon adoption of this FSP.[2]

Derivative liability—conversion option	350	
Beginning retained earnings		230
Convertible debt instrument		100
Contingent liability		20

To adjust the carrying amount of the convertible debt instrument to the amount that would have been recognized if the embedded conversion option had not been separately accounted for as a derivative under Statement 133 and to recognize the contingent liability to make payments under the registration payment arrangement.

[2] This journal entry assumes that the convertible debt instrument did not contain a beneficial conversion feature that would have been accounted for under EITF 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," if the embedded conversion option had not been separately accounted for as a derivative under Statement 133.

Appendix B
Basis for Conclusions

Background Information

B1. If a contract within the scope of Issue 00-19 permits the issuer to net-share settle or physically settle the contract **only by delivering registered shares**, paragraph 14 of that Issue specifies that it is assumed that the issuer will be required to net-cash settle the contract and, as a result, it must be classified as an asset or a liability. In many cases, contracts within the scope of Issue 00-19 require the issuer to use its "best efforts" or "commercially reasonable efforts" to register the shares underlying the contract, but do not prohibit net-share settlement or physical settlement by delivery of unregistered shares if the issuer is unable to do so. However, such arrangements typically provide for penalty payments to the counterparty if a registration statement for the shares that would be delivered upon physical or net-share settlement is not declared effective within a specified grace period and/or its effectiveness is not maintained for a specified period of time. At the June 15–16, 2005 EITF meeting, the Task Force discussed Issue No. 05-4, "The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to Issue No. 00-19." Issue 05-4 was added to the EITF agenda to address the diversity in practice related to the issuer's accounting for registration rights agreements that contain contingent payment provisions and the financial instruments subject to those registration rights agreements. Specifically, practice is diverse about whether a registration rights agreement and the related financial instruments should be viewed as one combined instrument or as separate instruments for accounting purposes. Also, if the arrangement is viewed as a combined instrument, practice is diverse about the assessment of the combined instrument under Statement 133, Issue 00-19, and EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock.'"

B2. The Task Force postponed further deliberations on Issue 05-4 until after the Board addressed the accounting for separate registration rights agreements. This FSP is the result of those Board discussions and eliminates the need for Issue 05-4.

Scope

B3. The Board observed that *registration rights agreements* is a broad term referring generally to any agreement in which the registration of equity shares or other financial instruments is discussed. This FSP applies to only those arrangements that require a contingent transfer of consideration (payment) based on whether a registration statement is filed and declared effective and/or registration is maintained for a specified period (described herein as *registration payment arrangements*).

B4. The Board considered whether commercial arrangements with characteristics similar to registration payment arrangements should be subject to the guidance in this FSP. For example, a building contract may include a provision requiring that the contractor obtain a certificate of occupancy by a certain date or pay a penalty every month the certificate of occupancy is not obtained. The Board decided not to address such commercial arrangements in this project; therefore, the scope of this FSP is limited to registration payment arrangements as described in paragraph 4.

B5. The Board concluded that the form of consideration that the issuer is contingently obligated to transfer under a registration payment arrangement should not affect the classification or measurement of that contingent obligation. The Board observed that a contingent obligation to transfer equity shares under a registration payment arrangement should be subject to the provisions of this FSP in the same manner as a contingent obligation to pay cash under a registration payment arrangement. In reaching this conclusion, the Board observed that liability classification is required by paragraph 12 of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, for certain share-settled obligations with similar characteristics. However, for the reasons described below, the Board decided not to require that share-settled contingent obligations under a registration payment arrangement be measured at fair value.

Recognition and Measurement

B6. FASB Concepts Statement No. 6, *Elements of Financial Statements*, defines *liabilities* as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events." Probable is used with its usual general meaning, rather than in a specific accounting or technical sense (such as in Statement 5), and refers to that which can reasonably be expected or believed on the basis of available evidence or logic but is neither certain nor proved. Its inclusion in the definition of liabilities is intended to acknowledge that business and other economic activities occur in an environment characterized by uncertainty. Additionally, paragraph 36 of Concepts Statement 6 states that "…liabilities may not require an entity to pay cash but to convey other assets, to provide or **stand ready** to provide services, or to use assets" (emphasis added).

B7. The Board believes that a registration payment arrangement is consistent with the definition of a liability in Concepts Statement 6. A registration payment arrangement requires the issuer to provide consideration to the counterparty if the contractual event that calls for the payment of the consideration occurs. However, the amount paid to the issuer for taking on that stand-ready obligation usually is not determined separately from the consideration exchanged for the related financial instrument(s). Also, there currently do not appear to be similar arrangements being entered into on a standalone basis. As a result, some Board members had concerns about the relevance and reliability of using a fair value measurement attribute for registration payment arrangements. Those Board members questioned whether an entity would have the ability to reasonably estimate the price that would be paid to transfer the liability under a registration payment arrangement in an orderly transaction between market participants, considering that a key assumption is the entity's ability to obtain (and maintain) an effective registration statement. Some Board members also observed that the portion of the overall proceeds attributable to a registration payment arrangement is frequently expected to be small in relation to the total proceeds from an offering. Those Board members believe that, in many cases, the fair value of a registration payment arrangement will be minimal at inception and only increase significantly as payment becomes probable. Additionally, some Board members believe the difficulties (costs) in determining fair value outweigh the benefits of the measure, particularly in circumstances where the likelihood of payment is low and the value is immaterial.

B8. For the reasons described in paragraph B7, the Board decided that entities should recognize and measure the contingent obligation to transfer consideration under a registration payment arrangement using the guidance in Statement 5, instead of requiring that a liability always be recognized and measured at fair value.

B9. The Board decided that a registration payment arrangement should be recognized and measured as a separate unit of account from the financial instrument(s) subject to the registration payment arrangement. This treatment is intended to simplify the accounting for certain complex securities offerings. This treatment also is intended to limit accounting arbitrage opportunities by requiring consistent accounting treatment for all registration payment arrangements, regardless of how an arrangement is structured, the form of consideration that may be transferred to the counterparty, and the type of financial instrument subject to the registration payment arrangement. Further, the Board observed that regardless of whether consideration is transferred under a registration payment arrangement, the form of settlement of the financial instrument or instruments subject to the registration payment arrangement generally is not affected. For example, if a registration payment arrangement is issued in conjunction with a warrant settleable in shares (physical or net-share settlement), the warrant would be settled in shares regardless of whether consideration is transferred to the counterparty under the registration payment arrangement. However, for a contract accounted for under Issue 00-19 that permits the issuer to net-share settle or physically settle **only by delivering registered shares**, this FSP does not affect the guidance in paragraph 14 of that Issue, which requires that such contracts be classified as assets or liabilities.

Amendments to Statement 133 and Interpretation 45

B10. The Board's conclusion that entities should recognize and measure the contingent obligation to transfer consideration under a registration payment arrangement using the guidance in Statement 5, rather than using a fair value measurement attribute, obviated the need to decide whether such arrangements have all the characteristics of a derivative instrument, as set forth in paragraphs 6–9 of Statement 133. Accordingly, Statement 133 is amended to explicitly exclude registration payment arrangements subject to this FSP from its scope to clarify that an analysis of whether a registration payment arrangement within the scope of this FSP has all the characteristics of a derivative instrument is unnecessary.

B11. Registration payment arrangements within the scope of this FSP could have the characteristics of a guarantee contract as set forth in paragraph 3(c) of Interpretation 45. Due to the Board's decision that an entity should not measure the contingent obligation to transfer consideration under a registration payment arrangement at fair value, Interpretation 45 is amended to explicitly exclude registration payment arrangements subject to this FSP from its scope.