



Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

EITF-13G
Comment Letter No. 4
330 North Wabash, Suite 3200
Chicago, IL 60611

December 20, 2013

Via email to director@fasb.org

Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Proposed Accounting Standards Update, *Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity* (File Reference No. EITF-13G) ("the ED")

Dear Ms. Cospers:

We are pleased to provide comments on the ED. We understand that the "whole instrument" approach prescribed in the ED is the method predominantly used in practice for evaluating the nature of the host contract within a hybrid financial instrument issued in the form of a share. As such, we believe the guidance in the ED will codify current practice and promote consistency in the method applied for evaluating the host contract. Our responses to specific questions, including consideration of redemption features in the evaluation of the host contract, are provided in the appendix to this letter.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Adam Brown at (214) 665-0673 or Gautam Goswami at (312) 616-4631.

Very truly yours,

A handwritten signature in black ink that reads "BDO USA, LLP". The letters are written in a cursive, slightly slanted style.

BDO USA, LLP

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Appendix

Question 1: Should the scope of the proposed amendments be extended beyond hybrid financial instruments issued in the form of a share? If yes, please explain why and identify other hybrid instruments that should be considered by the Task Force.

We agree with the scope of the ED. We do not believe that it should be extended beyond hybrid financial instruments issued in the form of a share since the diversity in practice addressed in this project is focused on that type of instrument.

In the basis for conclusions, we also suggest prohibiting analogies to the final ASU. We note the ED contemplates certain redemption features being considered nonsubstantive, depending on the circumstances. This is evident in the proposed addition of 815-15-25-17A as well as paragraph BC15. In this context, some practitioners may attach little to no weight to a fixed-price, noncontingent redemption option because the entity may lack sufficient liquidity and/or be restricted by laws of the applicable jurisdiction from satisfying a redemption request. In the future, it is possible similar arguments may be made for convertible debt or mandatorily redeemable shares within the scope of Topic 480 issued by those same entities. While we agree with an approach that requires judgment to determine the nature of a host contract for preferred stock instruments, we do not believe this narrowly focused ED to be the appropriate forum to expand the notion of substance overrides for legal form redemption features in other parts of the debt/equity literature. For example, paragraph 480-10-25-6 precludes entities from reaching inappropriate conclusions as to whether a mandatorily redeemable share is classified as a liability based on contractual provisions that link the redemption to the issuer's maintenance of a sufficient level of liquidity. Prohibiting analogies to the final ASU would pre-empt any unintended consequences in other areas of US GAAP.

Question 2: Do you agree that a reporting entity should consider all terms and features—including the embedded derivative feature being evaluated for bifurcation—when determining whether the nature of a host contract is more akin to debt or to equity? If another method should be used, please explain that method and why it would be an improvement.

We agree that a reporting entity should consider all terms and features in the evaluation of the host contract, including the embedded derivative feature being evaluated for bifurcation. As indicated in our cover letter, our experience has been that this is the approach predominantly used in current practice.

Question 3: Do you agree that no single feature should be determinative in concluding whether the host contract is more akin to debt or to equity? Furthermore, do you agree that a fixed-price, noncontingent redemption option held by an investor embedded in a share is not, in and of itself, determinative in concluding that the nature of the host contract is more akin to debt? If not, please explain why.

We agree that no single feature generally should be determinative in concluding whether the host contract is more akin to debt or to equity. We note the forepart of paragraph 815-15-25-17A requires entities to consider all of the stated or implied *substantive* terms, and that some of those terms may be weighted more heavily. This is similar to the guidance for public entities in

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paragraph 815-10-S99-3, a concept that we agree should be applied to all entities. However, we are concerned that the example in paragraph 815-15-25-17A about the presence of a fixed-price, noncontingent redemption feature and related basis for conclusions may not reduce diversity in the application of the whole instrument approach.

The example in paragraph 815-15-25-17A, read together with paragraphs BC13 through BC15, highlights the issuer's future liquidity and state laws in the evaluation of a fixed-price, noncontingent redemption option. That is, some may perceive a requirement in the ED to evaluate the probability of maintaining sufficient liquidity in future periods and/or completing a liquidity event at a later date to determine the nature of the host contract in the current period. Our experience is that many reporting entities are not performing such forward-looking analyses under current practice pursuant to 815-10-S99-3.

Therefore, we believe the Board should consider removing the last two sentences proposed in 815-15-25-17A or otherwise clarify in the basis that a forward-looking analysis is not required. Rather, entities would continue exercising judgment based on current conditions to determine the nature of the host contract. We believe that the requirement in the first four sentences of paragraph 815-15-25-17A to consider each *substantive* term would provide adequate guidance, without potentially introducing more subjective factors such as the entity's future liquidity.

We acknowledge some may conclude that the presence of a negotiated term with the *potential* to provide downside protection is substantive on its face, and therefore determines the nature of the host contract. Conversely, others may believe the protection provided by state laws in case of potential liquidity issues causes the redemption to be *contingent*, leading them to weight it less heavily in determining the nature of the host contract. Additionally, the evaluation of redemption features in identical instruments may vary between early stage companies and established profitable companies. However, we believe potentially different judgments reached in good faith are a natural outcome of the whole instrument approach and do not view that as a concern.

However, as it relates to counterparties in the same contract, we suggest that the Board indicate in the basis for conclusions whether it expects the issuer and the investor to arrive at different conclusions regarding the nature of the host. Further, because the liquidity profile of a company and an investor's incentive to redeem may both change over time, we suggest clarifying whether the evaluation of the host contract should be a one-time determination or needs to be updated every reporting period.

Question 4: Will the proposed amendments help reduce diversity in practice with respect to determining the nature of the host contract within hybrid financial instruments issued in the form of a share? If not, please explain why.

As indicated in our cover letter, our experience has been that the approach prescribed in the ED is the method predominantly used in current practice. As such, the proposed amendments will help reduce the diversity in methods that may be applied in evaluating the nature of the host contract, although the outcomes reached still may differ.

Question 5: Do you agree that the effects of the proposed amendments should be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a

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share as of the beginning of the annual reporting period in which the proposed amendments are effective? Do you further agree that retrospective application should be allowed?

We agree with providing entities a choice of applying the proposed amendments on a modified retrospective or full retrospective basis. Further, we would not object to providing entities an additional option to apply the proposed amendments prospectively. Considering the complexity inherent in these instruments, a prospective transition may be cost-beneficial, especially for the early stage and/or private companies that commonly issue redeemable convertible preferred stock.

We observe that transition paragraph 815-15-65-2 provides that if an entity is no longer required to bifurcate an embedded derivative feature as a result of applying the amendments in the ED, the carrying amount of the related hybrid financial instrument at the effective date should be the total carrying amount of the host contract and the fair value of the previously bifurcated embedded derivative feature. We agree that this would ease transition as no separate measurement would be necessary for the entire hybrid instrument, particularly for public and other issuers who may have applied the measurement provisions for mezzanine equity under ASC 480-10-S99.

Question 6: Do you agree that an entity should be permitted to early adopt the proposed amendments? If not, please explain why.

We agree.

Question 7: The proposed amendments would apply to public and nonpublic entities. Should the proposed amendments be different for nonpublic entities? If so, please describe how and why you think they should be different.

We note that a public company may be the holder of instruments issued by a private company or vice versa. As such, we do not advocate having different guidance for public and private entities.

Question 8: How much time would be needed to implement the proposed amendments and would the implementation period differ for nonpublic entities versus public entities? Please explain why.

We note that transition paragraph 815-15-65-2 provides that if an entity is required to bifurcate an embedded derivative feature as a result of applying the amendments in the ED, the carrying amount of the host contract at the effective date should be based on a pro forma bifurcation assuming the embedded derivative feature had been bifurcated as of the date the entity issued or acquired the hybrid financial instrument. As such, we believe that application of the amendments on a retrospective or modified retrospective basis may require considerable time, effort, reapplication of judgment and use of hindsight especially for very long-term instruments. The complexity would be accentuated if an entity is required to update the assessment at the end of every earlier reporting period subsequent to the issuance of the instrument.

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Considering the learning curve, we note that the Board has provided private companies a delayed effective date in some of the other standards. We believe providing a delayed effective date for this guidance for private companies would be appropriate.