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February 3, 2017

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

File Reference No. 2016-370

Re: Proposed Accounting Standards Update, *Distinguishing Liabilities From Equity (Topic 480): I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception*

Dear Ms. Cospers:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Distinguishing Liabilities From Equity (Topic 480): I. Accounting for Certain Financial Instruments With Down Round Features and II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception*.

We support the Board's efforts under its simplification initiative to improve aspects of U.S. GAAP that are unnecessarily complex and costly. Similarly, we support the aim of the proposed ASU and certain of its key provisions because they further the Board's simplification objective. We concurrently acknowledge that some aspects of the proposed amendments would add complexity to an accounting model that is already complex and prone to misunderstanding by preparers, practitioners, and other stakeholders. We believe that to limit such complexity, the Board should modify or remove certain of the proposed ASU's provisions before it finalizes the amendments. To this end, this letter suggests our modifications to the proposed approach for the Board's consideration.

As discussed in our letter of October 17, 2016, in response to the FASB's Invitation to Comment, *Agenda Consultation* (File Reference No. 2016-290), we believe that the FASB should add to its agenda a broad project on distinguishing liabilities from equity. We believe that as part of such a project, the Board should comprehensively address the conceptual and practical issues associated with the classification of different types of instruments and features. The Board's objective should be to replace the piecemeal, fact-specific guidance in U.S. GAAP with a robust, coherent, and internally consistent set of principles. Our support for certain of the key provisions in the proposed ASU, therefore, is based on the premise that they will serve to simplify the application of existing U.S. GAAP as an interim solution pending the completion of a broad project on liabilities and equity.

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Appendix A to this letter contains our responses to the proposed ASU's questions for respondents. Appendix B includes other significant comments for the Board's consideration.

We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Magnus Orrell at (203) 761-3402.

Yours truly,

Deloitte & Touche LLP

cc: Jonathan Howard

Robert Uhl

Appendix A

Deloitte & Touche LLP

Responses to Questions for Respondents

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

Yes. We support the proposal to exclude a down-round feature from the analysis of whether an instrument is indexed to an entity's own stock under ASC 815-40-15. The proposed guidance would reduce the cost and complexity of derivative accounting under ASC 815 and eliminate counterintuitive accounting outcomes that are associated with the application of fair value accounting to a financial instrument merely because of a down-round feature.

We note, however, that the definition of a down-round feature that would be included in proposed ASC 480-20 and in the ASC master glossary does not appear to exempt features for which the amount of the reduction upon a down round is indexed to an unrelated underlying (e.g., the S&P 500 Index). We suggest that the Board amend the definition of a down-round feature so that a reduction in the strike price that is indexed to a variable that would have precluded the instrument from being considered indexed to its own stock under ASC 815-40-15 (other than variability based on the future issuance price of shares of stock or the strike price in future issuance of equity-linked financial instruments) would preclude a feature from meeting the definition.

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

We agree that the effect of the down-round feature should be recognized when it is triggered for instruments that are within the scope of proposed ASC 480-20. As outlined below, however, we believe that the Board should make certain modifications to the proposal's scope and other provisions to avoid adding unnecessary complexity to U.S. GAAP.

Convertible Instruments

The proposal to exclude down-round features from the analysis of whether an instrument is indexed to an entity's own stock under ASC 815-40-15 (which we support; see our response to Question 1) implies that convertible instruments that contain a conversion term that is bifurcated as a derivative instrument under ASC 815 solely because of a down-round feature would be subject instead to analysis under ASC 470-20 in the determination of whether they contain a cash conversion feature (CCF) or a beneficial conversion feature (BCF). This means that a down-round feature in a convertible instrument generally would be treated as a contingent BCF if it is not subject to the embedded derivative or CCF guidance (see, e.g., ASC 470-20-35-4).¹ Because instruments and features that are measured at fair value on a recurring basis and

¹ In theory, the contingent BCF guidance would not apply if the down-round feature could never become beneficial to the counterparty relative to the commitment-date stock price (i.e., if the down-round feature has a floor that equals or exceeds the commitment-date stock price). In practice, however, we do not see such terms.

convertible instruments that are subject to the CCF or BCF guidance (including contingent BCFs that have not yet been triggered; see paragraph BC31) are exempt from the scope of proposed ASC 480-20 under ASC 480-20-15-3, we expect that the proposed provisions in ASC 480-20 will be practically irrelevant for convertible instruments (both convertible debt and convertible stock). As acknowledged by the Board in paragraph BC31, “convertible instruments with down round features generally will . . . not [be subject to] the proposed model for financial instruments with down round features” (see also paragraph BC14(c)).

Although the proposed approach for liability-classified instruments generally will not apply to convertible debt instruments, the guidance in proposed ASC 480-20-35-3, 40-2, and 40-3 (as well as in ASC 470-20-25-14) appears to be designed for such instruments since those paragraphs describe the accounting for instruments that contain a down-round feature and for which the interest method and debt extinguishment accounting apply. ASC 480-20-40-3 explicitly states that it applies to a convertible financial instrument classified as a liability. While there is no similar statement in ASC 480-20-35-3 and 40-2, ASC 480-20-35-3 states that the interest method in ASC 835 applies, and ASC 480-20-40-2 states that the debt extinguishment or modification guidance in ASC 470-50 applies. Given that both ASC 835 and ASC 470-50 apply to debt instruments, it would seem that ASC 480-20-35-3, 40-2, and 40-3 are intended for convertible debt instruments, even though such instruments generally are exempt from the guidance’s scope.

We believe that to eliminate redundant guidance and avoid the introduction of unnecessary complexity within U.S. GAAP, the Board should either modify these paragraphs to address liability-classified instruments that would be within the scope of proposed ASC 480-20 (rather than convertible debt instruments) or remove these paragraphs (see further discussion below). Further, to increase understandability and reduce the risk of potential misapplication of the guidance to convertible instruments, we encourage the Board to consider including a specific scope exception for convertible instruments in ASC 480-20-15-3.

If the Board were to extend the scope of proposed ASU 480-20 to include convertible debt, we disagree with the application of the subsequent accounting treatment outlined in proposed ASC 480-20-35-3, 40-2, and 40-3 to such instruments. We question the conceptual basis for recognizing a debt premium when a down round occurs, because the entity is receiving no new consideration and the debt obligation has not increased. The entity is transferring value associated with a conversion feature that, although not previously recognized, is treated as equity in the analysis of whether it should be bifurcated as a derivative instrument under the proposed amendment to ASC 815-15. Further, the recognition of a debt premium when a down round is triggered is inconsistent with that for down-round features that are accounted for as contingent BCFs (Dr. debt discount; Cr. additional paid-in capital (APIC)). Therefore, we believe that it would be more appropriate to recognize the effect of a down-round feature’s being triggered as either (1) an expense with an offset against equity (APIC) in a manner similar to the approach for equity-classified instruments in the proposed ASU or (2) a debt discount with an offset to equity (APIC) in a manner consistent with the approach for contingent BCFs in ASC 470-20. The use of consistent accounting for down-round features that are within the scope of either proposed ASC 480-20 or existing U.S. GAAP for contingent BCFs would reduce complexity. The use of such accounting would also avoid the anomalous outcome under which the expense recognized for the down-round adjustment is reversed as a result of the amortization of a debt premium or the adjustment to any debt extinguishment gain or loss.

Freestanding Liability-Classified Instruments

Given the proposed scope provisions in proposed ASC 480-20-15-3, we expect that the only instruments that will fall within the scope of the guidance on liability-classified instruments in proposed ASC 480-20-35-3, 40-2, and 40-3 are those contracts on the entity's own equity (such as options or warrants) that (1) the issuer determines do not meet the definition of a derivative instrument in ASC 815-10, (2) are not indexed to the entity's stock under ASC 815-40-15 (even if the down-round feature is excluded from the analysis), and (3) the issuer does not elect to measure at fair value on a recurring basis (we observe that the SEC's longstanding position is that registrants should account for written options and warrants at fair value on a recurring basis).

We question the usefulness of adding to U.S. GAAP a new, separate accounting model for this limited population of items and note that (1) the model would increase the complexity of U.S. GAAP, (2) the FASB did not design the guidance in the proposed ASU with such instruments in mind, and (3) fair value accounting may be a more appropriate accounting model for such instruments (and would be consistent with the accounting for instruments that, other than being considered indexed to the entity's own stock, are identical). Accordingly, we recommend that the Board omit proposed ASC 480-20-25-3(b), 35-3, 40-2, and 40-3 from the final guidance. If the FASB nevertheless decides to proceed with the proposed guidance on liability-classified instruments in these paragraphs, we suggest that the Board clarify that it would apply only to contracts on the entity's own equity that (1) the issuer determines do not meet the definition of a derivative instrument in ASC 815-10, (2) are not indexed to the entity's stock under ASC 815-40-15 (exclusive of the down-round feature), and (3) the issuer does not elect to measure at fair value on a recurring basis.

Cash Convertibles

Regarding the scope exception for instruments with CCFs in proposed ASC 480-20-15-3(e), we note that there is no required adjustment under ASC 470-20 for such instruments when a down-round feature is triggered. This is different from the accounting for other instruments that are exempt from the scope of the approach in proposed ASC 480-20. Under existing U.S. GAAP, instruments that are subject to fair value accounting are inherently adjusted for the value of the effect of the down-round feature. Further, down-round features that are treated as contingent BCFs are recognized when the conversion price is adjusted. However, there is no requirement in existing U.S. GAAP to record the effect of a down-round feature's being triggered for cash convertibles that contain a down-round feature. Therefore, we encourage the Board to consider whether the contingent BCF model in ASC 470-20 should apply to cash convertible instruments with a down-round feature.

Equity-Classified Instruments

With one exception, we agree with the proposed approach for equity-classified instruments that are within the scope of the proposed ASU (observing that equity-classified convertible stock instruments generally would be outside the proposal's scope, as discussed above). We believe that proposed ASC 480-20-25-3(a) should not categorically require entities to recognize the charge (debit) for an equity-classified instrument in retained earnings because this debit will not always be appropriate (e.g., for entities that do not have retained earnings). We recommend that the Board instead state in the proposed ASU that entities should recognize the effect as a deemed dividend (i.e., in retained earnings, paid-in capital, or accumulated deficit, as appropriate).

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

Yes. We have not identified any concerns with the amendments in proposed ASC 480-20-30-1 and 30-2.

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

We agree with the content of the disclosure requirements in proposed ASC 480-20-50-1. However, we note that these disclosures would be required for only a subset of instruments with down-round features since proposed ASC 480-20 would not apply to all such instruments (e.g., convertible instruments would generally be exempt from its scope; see our response to Question 2). Accordingly, we recommend that the scope of the disclosure requirements be extended to other instruments for which a down-round feature has been triggered even if the instrument is not within the scope of proposed ASC 480-20, in particular for convertible instruments with a CCF or a BCF within the scope of ASC 470-20. For the Board to accomplish this, we encourage it to consider locating these disclosure requirements in ASC 505-10.

Further, we encourage the Board to consider whether to require entities to disclose the existence of down-round features that have not been triggered. Such information may be helpful to financial statement users.

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

We agree that the default transition method should be to record the cumulative effect of the change as an adjustment of the opening balance of retained earnings in the period of adoption; however, we suggest that the Board permit retrospective transition as well.

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

Given the limited nature of the proposed amendments, we expect that most entities will not need a significant amount of time to implement them. We believe that the Board should permit early adoption since the intent of this guidance is to reduce cost and complexity.

Appendix B Deloitte & Touche LLP Other Significant Comments

Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests With a Scope Exception

We support, for practical purposes, replacing the indefinite deferral of certain guidance in ASC 480-10 with a scope exception to facilitate the readability of the Codification. The complex interaction between the transition provisions and the guidance subject to deferral in ASC 480-10 increases the risk of misapplication of the guidance (in particular, a practitioner might overlook that ASC 480-10-65-1(b)(1)(i) effectively overrides the second sentence of ASC 480-10-55-9). However, we believe that the scope exception should be viewed as a temporary solution until the Board comprehensively addresses issues regarding distinguishing liabilities from equity. We acknowledge that a scope exception is significantly different from a deferral and that the Board has not yet resolved the related conceptual issues. Therefore, we believe that the Board should clearly state in the Basis for Conclusions of the final ASU (by using wording similar to that in paragraph BC51 of the proposed ASU) that the decision to replace the indefinite deferral with a scope exception does not preclude the possibility of a different decision in any long-term project the Board may undertake on liabilities and equity.

Trust-Preferred Securities

Regarding the example of trust-preferred securities in ASC 480-10-55-6 through 55-9, we believe that the Board should delete ASC 480-10-55-6 and 55-7 (in addition to ASC 480-10-55-8 and 55-9) because they provide background information to the guidance in ASC 480-10-55-8 and 55-9 that the Board is proposing to delete (i.e., these paragraphs are no longer relevant).