CFGI

February 6, 2017

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

Re: Proposed Accounting Standards Updates—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 (File Reference No. 2016-370)

Dear Ms. Cosper,

CFGI, LLC is a unique and highly specialized financial consulting firm that supports companies through a range of complex business scenarios. CFGI works alongside a client's internal staff to serve a variety of roles – from technical accounting advisor and M&A support to interim Controller and CFO – and delivering valuation and other support services. CFGI provides these services to a wide array of companies from minimally staffed early-stage entities to Fortune 500 companies. Our responses within this comment letter reflect our experience and observations that comes from working with 100's of companies, both private and public, for more than fifteen years.

We appreciate the opportunity to comment on the FASB's Exposure Draft of Proposed Accounting Standards Updates—*Distinguishing Liabilities from Equity* (the "Update"). We agree with the Board's decision to address the complexity in applying generally accepted accounting principals to financial instruments with characteristics of liabilities and equity. We believe that the proposal would result in more instruments with down round being classified as equity and fewer embedded features would require bifurcation from their host instruments and accounting for the bifurcated features as derivatives. Issuers would not need to remeasure the fair value of these equity-classified instruments at each reporting date, thereby reducing the cost and complexity in this accounting area and achieving the Board's stated goals. However, we note that other criteria for equity classification in ASC 815-40, such as requirements that the contract contains an explicit limit on the number of shares to be delivered in a share settlement, may still prohibit equity treatment for some of these instruments. Additionally, we have noted that this proposal will create a difference in accounting treatment with international standards unless the International Accounting Standards Board adopts a similar simplification for classifying certain financial instruments with down round features.

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.

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We agree that the down round feature should be excluded from the assessment of whether an instrument is indexed to an entity's own stock for the following reasons:

- Recognizing a liability (and resulting changes in fair value through income) for a feature which will be settled in a company's equity and the value of which fluctuates based on a company's equity value, leads to fluctuations in income that do not significantly improve information provided to users of the financial statements.
- Accounting for the instruments at fair value does not reflect the economics of the down round feature. When applying fair value accounting, the issuer recognizes gains and losses in its earnings upon changes in the issuers' share price despite that these changes in share price do not impact the probability that a down round will be triggered.
- Measuring the fair value of these instruments is costly and complex.
- Accounting for the down round upon the occurrence of the specific event reflects the purpose and the economics of the down round feature as it is triggered only upon the occurrence of a specific event.

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.

When the instrument is classified as equity, we agree that the effect of the down round feature should be recognized when it is triggered and the impact of the triggering event should be directly recorded to equity. This approach is consistent with the accounting treatment for modifications of equity classified instruments. We recommend the Board clarify the treatment of such an event on the calculation of earnings-per-share to reduce diversity in practice.

When the instrument is classified as a liability, we do not believe that provision to amortize adjustments in the carrying value recognized upon a triggering event should be introduced. The liability would be measured at fair value initially and at each subsequent reporting date. Any changes in the probability of a triggering event for the down round would be reflected by a change in the fair value of the instrument with a corresponding gain or loss being reflecting in the issuers' statement of earnings. Therefore, we believe guidance, as proposed in paragraph 480-20-25-3(b) of the Update, should be removed as it could create confusion and diversity in practice by introducing a provision to amortize adjustments in the carrying value upon a triggering event.

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.

We agree with the approach suggested in paragraphs 480-20-30-1 through 30-2. Measuring the instruments immediately before and immediately after the strike price adjustment "without the down round" as proposed would provide a practical way for issuers to measure the effect of the down round trigger and provide a consistent

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approach for all issuers. We recommend the Board include implementation guidance that would indicate a closed-form model, such as the Black-Scholes model, would be a permissible valuation approach.

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 disclosure requirements proposed in the Update.

Question 5: Do you agree that 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.

While the proposed transition approach would simplify adoption as compared to requiring retrospective application, we believe it will impact comparability with prior period earnings. As such, we propose that the Board should allow companies to use a retrospective transition method if they elect to do so. This would allow companies that have significant variability in earnings as a result of features classified as liabilities, solely due to the down round provision, that will be reclassified to equity upon adoption of the Update to improve comparability of earnings between periods.

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?

We believe companies will need approximately one year from the date a final standard is issue until adoption to ensure the down round features, as well as all other characteristics of such financial instruments, are properly assessed. We support allowing entities other than public businesses additional time for adoption.

Sincerely,

CFGI, LLC

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