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February 6, 2017

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

Via email to director@fasb.org

Re: File Reference No. 2016-370

Dear Ms. Cospers:

We are pleased to comment on the Financial Accounting Standards Board's (FASB or Board) 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*.

We are supportive of the Board's efforts to address complexity in the accounting for certain financial instruments with down round features. While we understand the Board's intention to make targeted improvements to simplify the accounting for financial instruments with characteristics of liability and equity, we have several concerns for the Board to consider as it continues to deliberate this project.

Specifically:

- There are situations where the proposed amendments increase the financial reporting burden for private companies.
- The proposed amendments perpetuate the existing path-dependent rules based nature of distinguishing liabilities from equity. Improvements could be made in the drafting of the proposed amendments to clarify the applicability of the final guidance. Furthermore, we suggest the Board consider additional illustrative examples, including flowcharts, to demonstrate the steps in the analysis for certain instruments.
- There is a potential for unintended consequences with the proposed removal of ASC 815-40-55-34.

Ms. Susan Cospers Technical Director
Financial Accounting Standards Board
February 6, 2017
Page 2

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

We understand the Board's intention to make targeted improvements to simplify the accounting for financial instruments with characteristics of liability and equity. We generally support this goal but have some concerns about potential burdens on private companies, new complexities introduced, and the potential for practice issues or unintended consequences associated with the proposed guidance.

Increased Cost Burden for Certain Private Companies

Frequently, private companies with certain down round features in a freestanding equity linked instrument, such as a warrant, are required to classify the warrant as a liability. However, they may not be required to measure the warrant on a recurring basis at fair value under the current guidance in circumstances when the warrant does not meet the definition of a derivative. The proposed amendments would require the effects of the trigger of a down round feature on such instruments to be recognized. This will likely lead to an increased financial reporting burden for some private companies. The Board acknowledges this issue in paragraph BC21, but does not identify that it is concentrated in private companies. We suggest that the Board, in its continued deliberations on this topic, consider whether the increased financial reporting burden outweighs the benefits. In our experience, we have observed that private company stakeholders in many cases are more concerned with the impact that the settlement of such instruments will have on available cash flows as opposed to the instrument's fair value.

New Complexities and Navigational Issues

Other areas of increased complexity caused by the proposed amendments include the need to navigate different models for initial recognition and subsequent amortization/accretion depending on if a feature is embedded in a host debt or equity instrument versus in a warrant. As an example, the existing measurement guidance for beneficial conversion features is at intrinsic value, but the proposed changes would require incremental fair value for a warrant with a down round feature. The subsequent accretion or amortization of discount recorded in connection with a cash conversion (debt) and beneficial conversion feature (debt or equity) is generally required; in contrast, under the proposed guidance, the subsequent accretion or amortization of an adjustment for a down round feature is not required unless the instrument is liability classified.

Generally, we find that the creation of a new model for down round features in freestanding financial instruments (such as warrants) and the retention of the current beneficial conversion and cash conversion models increases complexity and potential codification navigation issues. We have concern that the scoping and navigation of the proposed amendments will be unclear if the codification is read in isolation. We noted some discussion in the basis for conclusions (principally paragraph BC14) that would assist in providing insight into application of the amendments. We suggest such discussion be incorporated into the codified section of the

Ms. Susan Cospers Technical Director
Financial Accounting Standards Board
February 6, 2017
Page 3

final standard. Additionally, illustrative examples, including flow charts, would assist financial statement preparers with understanding the order under which the proposed guidance should be applied. For example, it would appear that the guidance in ASC 480-20 should be applied to a warrant with a down round feature after all other applicable guidance has been considered.

Potential Practice Issues and Unintended Consequences

We suggest the Board consider providing clarification in the final standard with respect to several potential practice issues and/or unintended consequences of the proposed amendments presented below.

- The proposed guidance does not provide a discussion of how the trigger of a down round feature that is treated like a dividend would impact earnings per share. We suggest the Board clarify and provide an illustrative example of the effect of this dividend on earnings per share.
- Application of the criteria for equity classification in ASC 815-40-25 to a warrant with a down round feature. For example, it is not clear whether an entity should consider if they have the ability to settle in registered shares or if they have sufficient authorized shares by including the potential probability of the trigger of the down round feature. Further, while the warrant holder's preferential return versus the underlying share is not isolated to bankruptcy, it is not clear if the warrant is considered to have counterparty rights that rank higher than shareholder rights of the underlying share because it has a preferential return. ASC 815-40-25-10(f) as interpreted by ASC 815-40-25-31 through 25-34 could be understood to be limited to obtaining creditor rights in bankruptcy and not impacted by the presence of a down round feature in isolation.
- Application of the proposed amendments to features other than an explicit down round feature. Paragraph BC26 indicates that the scope is broad and is not limited to down round features that are reset to being equal to the current issuance price; however, BC36 indicates that the guidance should not be analogized to features other than a down round feature. It appears that the intended use of the guidance should be limited to features that meet the definition of a down round feature or that operate "like a down round feature" providing an adjustment to something less than the current issuance price. Clarification is needed regarding whether other features that may cause a different change are subject to the scope of the proposed amendments. For example, ASC 815-40-55-34 (Example 9) is removed in its entirety. This example included a down round feature and also discussed variability caused by future equity offerings or the issuance of equity-linked financial instruments. We are concerned that the removal of that example could have unintended consequences for features that might involve changes that are similar to a down round feature but instead involve variability for future offerings or issuances.

Ms. Susan Cospers Technical Director
Financial Accounting Standards Board
February 6, 2017
Page 4

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 if the Board proceeds with this proposed amendment, the approach (dividend versus expense) for recognition and timing should follow the classification of the instrument when triggered; however, we foresee potential practice issues related to this. For instance, assume a warrant is issued with a down round feature but is otherwise equity classified at issuance. Upon triggering of the down round feature, if the warrant now fails one of the various attributes required to be equity classified, it is not clear which approach would be followed for recognition. Clarification is needed to indicate the order in which the analysis should be conducted. For example, it may be preferred to re-evaluate classification first to then determine how the effect of the down round feature should be recognized.

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 believe that the creation of a separate model for the determination of fair value, which is different from the model utilized when the feature is embedded in a debt host, adds complexity to the measurement process. While we understand that the use of fair value before and after the down round feature is triggered minimizes potential double counting, and aligns with the models discussed in paragraph BC34, we suggest the Board consider if it would be simpler to allow entities to utilize an intrinsic value approach similar to the model for conversion features embedded in debt hosts (that is the beneficial conversion feature measurement model). We are concerned that the requirement to develop two valuations partially nullifies one of the primary benefits cited by the Board in paragraph BC20, specifically the cost and complexity reduction from not having to determine the fair value at each reporting date.

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 proposed amendments as presented.

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.

We agree that a cumulative effect approach is the most appropriate. However, we believe it would be beneficial to include discussion in the final standard regarding the impact this approach might have with both unwinding any prior fair value changes as well as re-amortizing the host instrument, if applicable. Furthermore, it would be helpful to provide more explicit guidance on the effective date. For example, we believe the inclusion of a phrase such as

Ms. Susan Cospers Technical Director
Financial Accounting Standards Board
February 6, 2017
Page 5

“outstanding at the beginning of the period the standard is effective” would provide needed clarification. Finally, if early adoption is allowed in a quarter other than the first quarter, it would be helpful to clarify how the effective date would be determined and how the transition entries should be recorded.

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 don't believe significant time would be necessary to implement the proposed amendments. Given the complexities associated with accounting for the instruments subject to the proposed amendments we suggest a deferral of one year for entities other than public business entities consistent with recent Updates issued. Finally, we recommend that the Board permit early adoption.

Other Items for Consideration

We noted the following editorial comments for the staff:

- ASC 480-20-15-3(b) is repeated. The scope guidance on convertible instruments separated under ASC 470-20 should be re-numbered to ASC 480-20-15-3(e).
- ASC 480-20-40-3 discusses convertible financial instruments with a down round feature, but our understanding would be that such instruments would not be within the scope of ASC 480-20 due to ASC 480-20-15-3(e). When a down round feature is triggered in such an instrument it would likely be recognized under the contingent beneficial conversion feature guidance. If our understanding is correct, we would recommend that the guidance in this paragraph is moved to ASC 470-20.

Please contact Scott Lehman at (630) 574-1605 or scott.lehman@crowehorwath.com or Matthew Schell at (202)779-9930 or matthew.schell@crowehorwath.com should you have any questions.

Sincerely,

Crowe Horwath LLP

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