



February 6, 2017

RSM US LLP

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File Reference No. 2016-370

Dear Ms. Cospers:

RSM US LLP is pleased to provide feedback on the 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* (the “proposed ASU”). We appreciate the opportunity to provide comments and support the Board’s efforts to simplify the accounting for financial instruments with characteristics of liabilities and equity. While ideally the relevant guidance would be addressed in a holistic manner, we recognize how time consuming such a process would be and are generally supportive of these targeted improvements. We believe the decision to exclude down round features from the assessment of whether an instrument is indexed to the entity’s own stock will bring welcome relief to those entities that have been subject to the demands of ongoing fair value measurement and the attendant earnings volatility. We do however have concerns with the proposed approach to transition and the fact that certain convertible instruments with down round features would be scoped into the guidance. Please refer to our responses to the specific questions raised in the proposed ASU and the other remarks section that follow where we elaborate on these concerns and provide other feedback and recommendations.

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.*

We agree with the Board’s decision to exclude the down round feature from the assessment of whether an instrument is indexed to an entity’s own stock. It has been our experience that down round features are one of the most common triggers resulting in liability treatment for equity-linked instruments. The ongoing fair value measurement requirement for financial instruments with down round features can create significant income statement volatility that distorts financial results and is unnecessarily burdensome for a feature that is protective in nature and may in fact never be triggered or transfer any value.

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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 no accounting recognition should be given to the effect of the down round feature until it is triggered. We are also in agreement with the general concept that dividend recognition should be the consequence for a financial instrument classified as equity, and income statement recognition should be the consequence for a financial instrument classified as a liability.

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 are generally supportive of the proposed measurement approach but are not clear on the intent of proposed paragraph 480-20-30-1 and believe clarification would be beneficial. Specifically, in the context of a down round feature associated with an equity-linked embedded feature such as a conversion option in a debt or preferred stock instrument, is the term “financial instrument” from the excerpt below referring to the hybrid instrument in totality or just the embedded feature? While as drafted, we would interpret it to mean the hybrid instrument, we believe it would be more appropriate and less costly to comply with if *financial instrument* in this context is referring to the equity-linked embedded feature.

- a. *The fair value of the **financial instrument** (without the down round feature) with a strike price corresponding to the current strike price of the instrument issued (that is, before the strike price reduction)*
- b. *The fair value of the **financial instrument** (without the down round feature) with a strike price corresponding to the reduced strike price upon the down round feature being triggered.*

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 disclosures as they provide financial statement users with decision-useful information and should not be overly burdensome to prepare.

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 believe the Board should obtain and carefully consider feedback from a diverse group of impacted reporting entities, including smaller private and public companies, before definitively deciding on a transition approach. We believe the proposed approach could be extremely burdensome for reporting entities to apply to instruments that have been in place for a number of years and have had down round features triggered numerous times over the course of those years. Detailed records may no longer exist, and it likely would be a very time-consuming, costly and challenging process to recreate the history after the fact and obtain or estimate the fair values necessary to determine what the effect of each down round trigger was at the time it occurred for those instruments within the scope of ASC 480-20. We suspect that, in the vast majority of cases,

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these instruments will be reclassified to equity upon adoption, in which case, the cumulative effect adjustment will not impact earnings going forward.

For these reasons, we encourage the Board to develop a practical expedient that an entity could elect to quantify the portion of the cumulative-effect adjustment attributable to proposed paragraph 480-20-25-3. For example, rather than requiring the cumulative-effect adjustment to be determined as though the new guidance had been in effect at the issuance date and throughout the life of each instrument, consideration could be given to a practical expedient that would require one calculation of the cumulative effect of down round features being triggered. To illustrate, assume a warrant was issued in 2010 with an exercise price of \$10 that was adjusted down due to a down round feature several times in the period of time from 2011 through 2016 to ultimately result in an exercise price of \$2 at the beginning of the period of adoption. The practical expedient would permit the reporting entity to elect to determine the cumulative effect adjustment pertaining to the recognition of previously triggered down round features based on a comparison of the fair value of the warrant (ignoring the down round feature) as of the last date a down round feature was triggered using the \$10 exercise price, to the fair value of the warrant as of this same date using the \$2 exercise price. We believe a practical expedient such as this would be preferable to incurring the time and expense to obtain fair value estimates for each date on which a down round feature was triggered in the preceding years and performing separate computations based on those fair value estimates. In the absence of a practical implementation alternative, we believe prospective application should be permitted such that a reporting entity could elect to apply the guidance solely to instruments that are issued after the effective date.

Lastly, as it relates to transition approaches, in light of the fact that inconsistencies will continue to exist in the accounting treatment for the types of financial instruments that are within the scope of the proposed guidance regardless of whether all entities are required to follow the same transition approach, we believe retrospective application to the earliest period presented should be permitted. Retrospective application would improve the comparability of a reporting entity's period to period financial statements and may be a viable alternative for entities that are not unduly burdened by implementation.

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 are supportive of permitting early adoption and believe careful consideration should be given to feedback from reporting entities of various sizes and sophistication in determining the necessary time for implementation. As elaborated on in our response to Question 5, if the Board moves forward with the proposed transition, we believe adoption could be a very time-consuming process for certain entities due to the potential need to recreate historical data and obtain fair values for multiple instruments with multiple down round triggers occurring at various points in time. In addition, it could take reporting entities a significant amount of time to understand the final standard and to re-analyze the accounting treatment for their various outstanding instruments with down round features to determine if, in light of the final standard, the instruments meet all other requirements for equity treatment, and to evaluate the applicability and interplay with ASC 470-20. We believe it would be appropriate to allow entities other than public business entities at least an additional year to prepare for adoption. Such entities tend to have fewer resources and will likely be more heavily burdened with fair value determinations to compute the effect of triggered down round features given that their stock is not actively traded.

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Other remarks

Feedback related to the scope of ASC 480-20

We are uncertain if and under what circumstances convertible instruments with down round features would be within the scope of ASC 480-20. We encourage the Board to clearly scope out all convertible instruments with down round features as we believe the accounting for such instruments is adequately addressed in ASC 470-20. As indicated at 470-20-15-2, all debt and convertible preferred stock instruments are included in the scope of the guidance for beneficial conversion features and the guidance for conversion features that reset. Additionally, a convertible instrument with a down round feature would not be considered to have a conversion feature that is not beneficial as described in ASC 470-20-25-10 through 12, given conversion price decreases for the instruments described in that section are limited to antidilution provisions. In the event the Board does not heed our suggestion to exclude all convertible instruments with down round features from the scope of ASC 480-20, we strongly encourage the Board to clearly articulate the circumstances under which a convertible instrument with a down round feature would be within the scope of ASC 480-20.

As proposed, we believe the scope exception outlined for convertible instruments at 480-20-15-3 will cause confusion and diversity in practice. To illustrate, we are uncertain whether a convertible instrument that is issued with an active conversion feature that is not beneficial at the issuance date but has a down round feature that may result in the subsequent recognition of a contingent beneficial conversion feature is in the scope, given that as drafted, the scope exception applies to "*Convertible instruments that **are required to be separated** under the following guidance... Convertible instruments with a beneficial conversion feature or a contingent beneficial conversion feature within the scope of Subtopic 470-20*". We believe the scope exception should apply to convertible instruments that **may** be required to be separated rather than to convertible instruments that **are** required to be separated, given that at the time an instrument such as the one we described is issued, no separation is required and it is unknown whether separation will be required given the possibility that a down round will either not be triggered or will be triggered but not create intrinsic value. (There are differing viewpoints applied in practice related to how contingent beneficial conversion features are computed, and under one viewpoint, the triggering of a down round feature may not always lead to the recognition of a contingent beneficial conversion feature. Some entities apply paragraph ASC 470-20-35-1 literally, and we believe under this approach would recognize a beneficial conversion feature any time a down round is triggered, even if the adjusted conversion price is higher than the commitment date fair value of the underlying shares. Other entities do not apply this guidance literally but rather compute the actual intrinsic value associated with the conversion price adjustment, in which case, as long as both the initial and any down round adjusted conversion prices are greater than the commitment date stock price, no beneficial conversion feature would be recognized under ASC 470-20). We believe the instrument described and all convertible instruments with downround features should be excluded from the scope of ASC 480-20 given the complexities that would otherwise ensue as touched on in paragraph BC 31 of the proposed ASU.

Lastly as it relates to scope, we noticed a minor error related to the lettering of the list of exceptions in proposed paragraph 480-20-15-3 in that the last exception should be subparagraph "e" rather than "b".

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Suggested additions to ASC 480-20

While initial and subsequent measurement of the down round feature is addressed in proposed sections 480-20-30 and 30-35, we believe it would be beneficial to also comment on the initial and subsequent measurement for the instrument that contains the down round feature. For example, it would be beneficial to specifically state in ASC 480-20-30 whether the fair value used in establishing the issuance date carrying value of the related financial instrument should consider the down round feature.

Suggested modification to paragraph 815-40- 15-7D

We believe it would be beneficial to add the bold wording below to paragraph 815-40- 15-7D. While as proposed, it is noted at 815-40-15-3A that a down round feature should be excluded from the consideration of whether the instrument is indexed to the entity's own stock, by adding this proposed wording to paragraph 815-40- 15-7D, it is less likely that reporting entities will overlook this.

*An instrument's strike price or the number of shares used to calculate the settlement amount are not fixed if its terms provide for any potential adjustment, regardless of the probability of such adjustment(s) or whether such adjustments are in the entity's control. If the instrument's strike price or the number of shares used to calculate the settlement amount are not fixed, the instrument (or embedded feature) shall still be considered indexed to an entity's own stock if the only variables that could affect the settlement amount would be inputs to the fair value of a fixed-for-fixed forward or option on equity shares **or are attributable to a down round feature.***

Transition requirements

We noticed transition requirements such as those outlined in proposed paragraphs BC47 and BC48 were not incorporated in the proposed changes to ASC 815. We are not sure if this was an oversight or intentional but recommend that they be incorporated.

We appreciate this opportunity to provide feedback on the proposed ASU and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Rick Day at 563.888.4017 or Faye Miller at 410.246.9194.

Sincerely,

RSM US LLP

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