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October 14, 2019

Mr. Shayne Kuhaneck
Acting Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: File Reference No. 2019-730

Dear Mr. Kuhaneck:

We appreciate the opportunity to comment on Proposed Accounting Standards Update, Debt—Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40) - *Accounting for Convertible Instruments and Contracts in an Entity's Own Equity* ("Proposed ASU"). We support the Board's efforts to simplify unnecessary complexity in the accounting for convertible instruments and contracts in an entity's own equity. It is a complex area of GAAP that presents users, preparers, and auditors with significant challenges in applying the existing number of accounting models to individual fact patterns and understanding the accounting results.

While we support the overarching goal of the Proposed ASU, we believe several of the proposed amendments introduce unneeded complexity, open the door to potential structuring opportunities, and may result in unintended consequences. The remainder of this letter highlights our concerns and outlines recommendations for the Board to consider as it continues its deliberations towards the issuance of a final ASU.

Convertible Debt

Under the Proposed ASU, fewer conversion options would be accounted for separately from their host contract. One of the primary effects of this outcome is that the effective interest rate on a convertible instrument, and the accompanying interest expense recorded by the issuing entity, would be lower than it is under existing accounting guidance.

While we support the desired simplicity of the whole-instrument ("one-unit") concept, we are concerned about the potential for structuring opportunities that may result. Many of the standards that gave rise to the complexity in the current accounting for convertible debt instruments were issued so that 1) the resulting accounting would reflect the true economic cost of the instrument and 2) entities would be deterred from embedding conversion options in instruments with significant value to lower an entity's reported cost of funds in its income statement. The removal of these safeguards could also lead to unintended consequences, including the ability to recognize negative interest expense on such instruments.

We acknowledge that the Board has performed outreach to users (paragraph BC22) and that outreach suggested users generally view and analyze instruments on a one-unit basis. As noted, these users prefer cash (coupon) interest or may calculate their own marginal borrowing rate and, therefore, prefer simple recognition, measurement, and presentation approaches with adequate disclosures as their starting point. However, we question whether all users apply such a sophisticated approach in their

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analyses – that is, would all investors adjust the coupon rate to an incremental borrowing rate or model the convertible instrument's potential dilutive effects under a one-unit approach? We recommend the Board perform further outreach with different classes of users, especially smaller investors, to understand if approaches other than the one-unit approach would be the preferred starting point for most investors.

One possible approach for the Board to consider that would simplify the current accounting model, but still provide safeguards to reflect the true economic cost of the arrangement in the income statement, would be a model like that used today for share-based awards (Topic 718). Under that approach, an entity would present the convertible debt instrument as a single unit in the balance sheet. However, an entity would also be required to determine the fair value of any non-bifurcated embedded conversion options at the inception date of the instrument and recognize this amount as interest expense over the instrument's contractual life. While potentially more complex than the Proposed ASU's model, this approach is arguably less complex than the current GAAP model (e.g., beneficial conversion features, cash settled conversion options, etc.) and would maintain safeguards to capture an entity's true cost of funds. The Board could also consider further refinements to the recognition and measurement requirements of such an approach's applicability to nonpublic business entities.

Derivative Scope Exception for Contracts in an Entity's Own Equity - Remote Threshold

The Proposed ASU adds a likelihood threshold to the indexation and equity classification guidance in Subtopic 815-40 with the objective of reducing complexity and form-over-substance driven conclusions. We are concerned that a **remote** threshold may not achieve the Board's objective of reduced complexity because 1) it adds another step to an already complex analysis and 2) given the relatively low threshold that "remote" represents in practice, an entity may need to exercise considerable judgment to support an assertion that the remote threshold for a given triggering event is met.

For example, a common trigger is the occurrence of a change in control event. While this trigger often may not be probable of occurring, we believe it will frequently have a more than remote possibility of occurring. Consider, for example, startup companies. Many start-up companies—who commonly issue instruments with change in control triggers—have a more than remote probability of sale. The models used to value these companies typically include an input assumption regarding the likelihood that a change in control (or exit) event will occur, with a probability that may be assessed as more than remote. These assumptions are inherently subjective and, as a result, the addition of the remote threshold in the guidance will further compound reliance on significant management judgment.

Other common triggers we have observed in instruments that may or may not have higher than remote likelihoods of occurring include the occurrence of a qualified financing, an IPO, or a tender offer among other examples. Frequently, an instrument will include a combination of these triggers. We recommend the Board clarify whether an entity should assess the probability of these features individually or in combination with each other.

To address these concerns, we recommend that the Board either 1) explicitly exempt certain triggers from the guidance in Subtopic 815-40 or, 2) increase the threshold to either a **reasonably possible** or **more-likely-than-not** threshold. We believe these alternative thresholds 1) are understood and applied in practice under other Topics in the Codification (e.g., Topic 470 and Topic 450) and 2) would reduce the level of management judgment required to support an entity's accounting conclusions.

Derivative Scope Exception for Contracts in an Entity's Own Equity – Reconsideration Events

The Proposed ASU removes the requirement to continually reassess whether the derivative scope exception is met. Instead, classification would be reassessed only upon the occurrence of certain reconsideration events, which explicitly exclude changes in the likelihood that a triggering event will occur. As a result, instruments classified as equity would be more likely to remain equity-classified as compared to existing GAAP, even when the likelihood of cash settlement becomes highly likely.

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We are concerned with several aspects of the proposed reconsideration guidance. First, we question whether it is appropriate for an instrument to remain equity classified even if it becomes virtually certain that it will settle in cash. Further, based on paragraph 815-40-35-8A, it appears there is no reassessment requirement or accounting impact when the instrument settles in cash. We recommend the Board clearly state whether this is the intended interpretation in the Codification when issuing the final ASU.

Second, the Proposed ASU does not clearly explain how to account for changes in the terms of an instrument upon the occurrence of a reconsideration event. For example, consider an equity-classified instrument whose exercise price is adjusted downward by a pre-defined amount when an event that was originally considered remote occurs. When the triggering event occurs, the entity is required to reassess the classification of the instrument. However, if the instrument remains equity-classified (e.g., any future adjustments are not deemed more than remote), there appears to be no resultant accounting impact. This appears to conflict conceptually with the required recognition of a triggered down round feature for entities that present earnings per share.

Third, we believe modifications should be added to the list of relevant reconsideration events. The Proposed ASU is not clear whether an entity that modifies an instrument would be required to reassess the instrument under the proposed reconsideration events.

Finally, we are concerned that other unintended consequences may result from the proposed reconsideration guidance. For example, we believe the Proposed amendments do not explain how a cash-settled top-off or make-whole provision in an equity-classified instrument should be accounted for when exercised. Today, instruments with such features are classified as a liability and accounted for at fair value, with the fair value measure including both the value of the call option and the value of the make-whole or top-off provision (put option). However, under the Proposed ASU, a cash-settled top-off or make-whole provision in a warrant would not preclude equity classification if the likelihood of occurrence is remote and would not require a change in classification even if the probability of occurrence becomes more than remote. As a result, it is unclear how these provisions would be recognized or subsequently measured upon exercise of an equity-classified warrant. For example, it is unclear whether 1) a portion of the initial measurement of the warrant should be allocated to the provision or be separately recognized at its then-current fair value, and 2) any cash payment under the provision should be treated as either an expense or a dividend.

Disclosures

We support the Board's efforts to prioritize disclosures by including a disclosure objective and enhancing disclosures around the rights and privileges of convertible debt instruments. However, it is unclear how the proposed amendment in paragraph 470-20-50-1D(c) for public business entities to disclose, for each convertible debt instrument, the fair value and related fair value hierarchy level provides meaningful information to the users of the financial statements. This requirement does not result in simplification because it simply replaces a fair value recognition and measurement requirement with a fair value disclosure requirement at a more disaggregated level than currently required.

The Proposed ASU also does not clearly articulate why the disclosure is needed. As stated in paragraph BC27, there were no significant gaps identified between the needs of users of financial statements and the existing disclosure guidance. The basis for conclusions suggests that the new disclosure requirement, in part, provides greater transparency to an entity's cash flows (paragraph BC30) and changes in the down round feature (paragraph BC45). However, it may be difficult for a user to isolate the changes in fair value associated with changes in cash flows or changes to the down round feature. In addition, disaggregated disclosures are inherently costlier (e.g., cost to prepare, audit, etc.). For these reasons, it is not clear to us whether the potential benefits of the proposed disclosure outweigh the costs.

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We recommend the Board perform further outreach to users to determine if the proposed disclosure is needed. If so, the final ASU should clearly explain how the disaggregated fair value information passes the cost-benefit analysis.

Transition Provisions

We are concerned that the proposed transition provisions could, in some circumstances, be overly complex and result in significant costs to preparers. This may be especially true in situations where an entity must engage a third-party specialist to assist with the reallocation of initial transaction proceeds across multiple instruments that were issued contemporaneously.

For example, consider an entity that, upon adoption of the new guidance, determines (1) the conversion feature in its convertible debt instrument should be recombined with the host instrument and (2) warrants issued contemporaneously with the convertible debt instrument should be reclassified from liability to equity. In that scenario, the entity would be required to, among other things, determine the fair value of the convertible debt instrument at the date of original issuance in order to reallocate the initial transaction proceeds between the warrants and the convertible debt on a relative fair value basis. Such an analysis may not have previously been completed because the initial transaction proceeds were allocated under the residual approach. Further complicating the issue, an entity may need to reconsider certain accounting conclusions based on the reallocation, such as whether embedded features that were bifurcated due to the presence of a significant premium or discount still require bifurcation.

To resolve this concern, we recommend the Board include a prospective transition method alternative or, at a minimum, provide additional optional transition expedients that an entity could elect to simplify retrospective transition. For example, the Board could consider allowing entities to elect not to reallocate initial transaction proceeds among instruments issued contemporaneously with each other.

Closing Remarks

Although we appreciate the Board's efforts to simplify the accounting for complex financial instruments, we encourage the Board to continue such efforts including incorporating consistency between this project and the accounting model in Topic 480. If the Board proceeds with the issuance of a final ASU for convertible instruments and contracts in an entity's own equity, we think it is very important that the accounting model in Topic 480 be revisited to align the models as much as possible.

Please contact Scott Lehman at (630) 574-1605 (scott.lehman@crowe.com) or Matthew Schell at (202) 779-9930 (matthew.schell@crowe.com) should you have any questions or would otherwise like to discuss our response.

Sincerely,

A handwritten signature in black ink that reads "Crowe LLP". The "C" is large and stylized, and the rest of the text is in a cursive-like font.

Crowe LLP

cc: James A. Dolinar, Partner, Crowe LLP