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December 28, 2020

Ms. Hillary Salo
Technical Director
FASB
401 Merritt 7
PO Box 5116
Norwalk, CT 06856

Re: File Reference No. 2020-800

Dear Ms. Salo:

We appreciate the opportunity to comment on Proposed Accounting Standards Update, *Earnings Per Share (Topic 260)*, *Debt – Modifications and Extinguishments (Subtopic 470-50)*, *Compensation – Stock Compensation (Topic 718)*, and *Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Forwards and Options* ("the Proposal"). We appreciate the Board's efforts to clarify an issuer's accounting for modifications or exchanges of freestanding equity-classified forwards and options that remain equity-classified after modification or exchange. While we generally support the Board's proposed amendments, we encourage the Board to consider our suggestions in its continued deliberations.

Our responses to the questions in the Board's Proposal have been attached as Appendix A.

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 script.

Crowe LLP

cc: Jim Dolinar, Partner, Crowe LLP

Appendix A – Responses to Questions

Overall

Question 1: Do you agree that the amendments in this proposed Update should apply to freestanding equity-classified forwards and options that remain equity classified after modification or exchange and are not within the scope of Topic 718 or accounted for as derivatives under Topic 815? Why or why not?

The initial scope of the project and agenda request focused on an issuer's accounting for modifications of written warrants (i.e. options.) During deliberations, the project was expanded to include forwards and is not limited to options sold by the issuer. We believe the proposed scope of the amendments as written will reduce diversity in accounting for modifications of equity-classified written warrants. However, we do not believe expanding the scope was necessary to address the diversity that exists. We have not frequently observed modifications of equity-classified forwards or purchased options in practice and are concerned that potential unintended consequences might arise if the scope of the amendments includes instruments beyond equity-classified written options. For example, we do not believe the Board considered the accounting for increases in the value of forwards or purchased options that are equity classified. We believe limiting the scope to "written options and other similar contracts" is adequate to address the practice issues that exist, and scope out purchased options and other similar contracts.

Question 2: Do you agree that an issuer should recognize the effect of a modification or an exchange of a freestanding equity-classified forward or option on the basis of the substance of the transaction as described in paragraph 815-40-35-17? Why or why not?

We agree that an entity should account for the effect of a modification or exchange of a freestanding equity-classified forward or option based on the substance of the transaction (i.e. in the same manner as if cash is paid as consideration.)

Question 3: For modifications or exchanges of freestanding equity-classified forwards and options that are within the scope of the proposed amendments, an issuer would not recognize the effect of a modification or an exchange that results in a reduction in the fair value of that instrument (similar to the share-based payment model in Topic 718). Do you agree with that accounting? Why or why not?

With respect to instances where the modification of a warrant is done in conjunction with a modification or exchange of an existing debt instrument, we are concerned that recognizing only increases, but not decreases, in the fair value of a modified or exchanged freestanding equity-classified forward or option is inconsistent with existing practice in Subtopics 470-50 and 470-60. For example, the 10 percent cash flow test contained in Topic 470 requires both amounts paid by the debtor to the creditor and amounts received by the debtor from the creditor as part of the exchange or modification of the debt. In practice, we understand that a decrease in the fair value of a modified warrant does not frequently occur; nonetheless, they do occur in practice and excluding such a transfer in value would be inconsistent with the application of the 10 percent cash flow test. For this reason, we recommend the Board reconsider the recognition of decreases in fair value of the modified instrument when the modification or exchange of the warrant is done in conjunction with a modification or exchange of an existing debt instrument.

Outside of circumstances categorized in paragraph 815-40-35-17(c), we agree that the proposed approach of not recognizing the effect of a modification or exchange resulting in a reduction in the fair value of the instrument aids the operability of the amendments and is consistent with existing guidance in Topic 718, to which many entities currently analogize to.

Lastly, we observe that the guidance is not explicit if decreases result in no accounting. We note some paragraphs in the proposal are silent while others specifically mention omitting decreases in fair value. For instance, the proposed amendments to paragraph 470-50-40-17A and 470-50-40-18A states "(but not a decrease)", whereas paragraph 470-50-40-12A does not contain this language. In addition, proposed paragraph 815-40-35-16 only discusses how to treat the excess but is silent on any decrease. Paragraph

BC9 indicates that the measurement approach is “similar” to Topic 718 “which does not result in accounting by the issuer for modifications that result in a reduction in the value of an instrument.” The Board should explicitly clarify if decreases result in no accounting in the codification and ensure the language is consistent in the final standard. If there are exceptions to this approach, such as our recommendation to consider both increases and decreases for debt modifications in scope of ASC 815-40-35-17(c), we believe the Board should state that in the codification.

Question 4: Are the proposed amendments operable, including for situations in which the substance of the transaction includes multiple elements (for example, debt financing and equity financing)? If not, what changes do you recommend and why?

We believe the proposed amendments are generally operable; however, we offer the following suggestions for the Board to consider.

- 1) Currently no guidance is provided on how the effect of a modification or exchange completed in conjunction with a potential troubled debt restructuring is analyzed in ASC 470-60. We recommend the board clarify if increases and potentially decreases should be considered in such an analysis.
- 2) We recommend the Board amend paragraph 815-40-35-17(b) to be more explicit on how and when amounts are recognized as a debt discount versus a debt issuance cost in order to assist entities in applying the guidance in Subtopic 470-50 as well as the four-step test for embedded call and put options in debt instruments in ASC 815-15-25-42.
- 3) The Board should consider including additional facts in Case B 815-40-55-51 to assist entities to understand why the substance of the warrant modification is not within the scope of another Topic. We recommend that Case B in paragraph 815-40-55-51 be amended to speak to the types of examples that we have seen that are likely to apply ASC 815-40-35-17d. For example, the Board could indicate the modified terms were offered as a gesture of goodwill, to avoid dilution, or to otherwise satisfy or reward the warrant holder with a benefit over other equity holders that is not in the scope of other Topics.
- 4) We recommend inserting the items in BC13 into the discussion of evaluating the substance of the transaction in paragraph 815-40-35-15.
- 5) We recommend that the Board consider aligning the wording in Case A 815-40-55-50 with ASC 718-20-35-5 to avoid potential misapplication. We believe the issuer may have offered a modification that is accepted when exercised and the intention of this example is to recognize the short-term inducement on only those warrants that are accepted (i.e. exercised.)

We also believe it would be helpful to clarify why the fact pattern in Case A is not a form of share-based payment subject to ASC 718, which would be recognized as expense rather than an equity issuance cost. Historically, the accounting for warrant modification inducements has been analogized to ASC 718 and recognized as an expense, without regard to differentiating whether the inducements are to raise capital or to affect an exchange to compensate an employee or nonemployee. Arguably, many inducements raise equity capital so a discussion of the differentiating factors would be helpful particularly if the Board believes inducements for instruments purchased by the holder can result in expense or inducements for instruments granted to the holder can result in equity issuance cost.

Regarding the application of the guidance to multiple element transactions involving a modification or exchange of a freestanding equity-classified forward or option we agree that the effects need to be allocated to multiple elements. However, because the allocation may follow different approaches, we recognize that it would be inappropriate to provide an example of one single approach as that might be misinterpreted to be the only approach. Accordingly, we recommend no further guidance is included on the approaches to allocation as those may depend on the individual facts and circumstances and underlying substance of the modification.

Compensation for Goods or Services

Question 5: For modifications or exchanges of freestanding equity-classified forwards and options that represent compensation for goods or services, are the proposed amendments in paragraph 815-40-35-18 and to Topic 718 necessary to clarify that those transactions are within the scope of Topic 718?

We do not object to these amendments; however, given that paragraph 815-40-35-14 states that the guidance does not apply to instruments in the scope of Topic 718 we believe the proposed amendments would be easier to apply by combining paragraph 815-40-35-18 into paragraph 815-40-35-14 such that it is clear that an analysis under Topic 718 is considered prior to application of ASC 815-40-35-15 through 35-19.

Other Modifications That Are Not Related to Financings, Compensation for Goods or Services, or Other Exchanges

Question 6: Do you agree that an issuer should recognize the effect of a modification or an exchange of a freestanding equity-classified forward or option as a dividend when the substance of the transaction is not related to a financing, compensation for goods or services, or exchange transactions addressed by other Topics? Why or why not?

In our experience, we observe modifications that are likely to fall into the “other” category (ASC 815-40-35-17d) more often than what was indicated in the meetings leading up to the Proposal and as summarized in BC15. Often such modifications are executed with the intent to transfer value to a warrant holder as either a gesture of goodwill, to compensate them for some form of dilution, or to provide a benefit over other equity holders. While there is not a clear good or service being exchanged, it is not uncommon for entities to present the effects of these modifications as an expense such that financial statement users can see the quantitative impact of the transaction. Whereas, a passthrough entity such as an LLC that reports a single category of members’ equity may report no or very limited information in its financial statements when it recognizes a modification as a deemed dividend. Furthermore, such entities typically do not present earnings per share so the impacts of a deemed dividend may not be readily apparent to financial statement users. We observe that the scope of application for the deemed dividend approach in this proposed guidance is different than ASU 2017-11 which only applies to entities who present earnings per share. The Board should consider if the disclosure approach applied in ASU 2017-11 for entities that do not present earnings per share is a more viable option.

Should the Board proceed with the proposed amendment to require entities to account for a modification or exchange not addressed by 815-40-35-17(a) through 35-17(c) as a dividend, we recommend the Board require entities to disclose the quantitative effect of the modification similar to the guidance in ASU 2017-11 (ASC 505-10-50-3A.) While paragraph BC17 refers to the presence of existing disclosure requirements, as currently written ASC 505-10-50-3A requires a disclosure of the value but only applies to instruments with downround features. Other disclosures do not provide a disclosure of the value and only require disclosures of changes in the exercise price (ASC 505-10-50-3) or other pertinent information regarding the terms of the instrument as described in ASC 815-40-50-5.

Transition and Effective Date

Question 7: Do you agree with the transition provisions, including early adoption in an interim period as of the beginning of the fiscal year that includes that interim period? If not, what changes do you recommend and why?

Though we understand there may be unique challenges associated with an early adoption in an interim period as of the beginning of the respective fiscal year, we believe the amendments improve the application and decision usefulness of guidance covering these transactions. Consequently, we agree with the transition provisions contained in the Proposal.

Question 8: How much time would be necessary to adopt the proposed amendments? Would the amount of time needed to apply the proposed amendments by entities other than public business entities and public business entities that do not meet the definition of a Securities and Exchange Commission (SEC) filer be different from the amount of time needed by public business entities that meet the SEC filer definition?

We believe entities other than public business entities that do not meet the definition of an SEC filer would benefit from additional time to understand and adopt the proposed amendments, if desired. We recommend the Board consider its typical implementation timeline for non-major standards updates.