EITF ABSTRACTS

Issue No. 07-2

Title: Accounting for Convertible Debt Instruments That Are Not Subject to the Guidance in Paragraph 12 of APB Opinion No. 14

Dates Discussed: March 15, 2007; June 14, 2007

References:
- FASB Statement No. 123 (revised 2004), Share-Based Payment
- FASB Statement No. 128, Earnings per Share
- FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities
- FASB Statement No. 155, Accounting for Certain Hybrid Financial Instruments
- APB Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants
- International Accounting Standard 32, Financial Instruments: Presentation
- EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion"
- EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments"
- EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios"
- EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock"
- EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"
- EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128"
- EITF Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments"
- EITF Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share"

ISSUE

1. Paragraph 12 of Opinion 14 specifies that no portion of the proceeds from the issuance of the types of convertible debt instruments described in paragraph 3 of that Opinion should be accounted for as attributable to the conversion feature. However,
paragraph 18 of that Opinion specifies that it is not practicable to discuss all possible types of debt with conversion features and that instruments not explicitly discussed therein should be accounted for in accordance with the substance of the transaction.

2. Opinion 14 does not contain any discussion of debt instruments with embedded conversion options that are indexed to the issuer's own stock but provide the issuer with the ability to settle its obligation to the holder (or some portion thereof) in cash upon conversion. However, pursuant to the Task Force's consensus on Issue 90-19, as revised, convertible debt instruments that, upon conversion, would require cash settlement of the debt's accreted value and permit the issuer to settle the conversion spread in either cash or shares (referred to as "Instrument C" in Issue 90-19) are accounted for pursuant to the guidance in paragraph 12 of Opinion 14, provided that the embedded conversion option would meet the conditions for equity classification in Issue 00-19 if it were a freestanding instrument. Additionally, the consensus on Issue 90-19, as revised, specifies that the if-converted method should not be used to determine the earnings-per-share treatment of Instrument C.

3. The revised consensus in Issue 90-19 requires that Instrument C be treated as convertible debt for accounting purposes but prescribes a diluted earnings-per-share methodology that is consistent with debt issued with detachable warrants. As a result, Instrument C generally has less of a dilutive impact in the calculation of diluted earnings per share than a convertible debt instrument that requires application of the if-converted method. Prior to the revision of Issue 90-19 at the January 23–24, 2002 meeting, convertible debt instruments that required or permitted cash settlement upon conversion
were relatively uncommon. After observing the proliferation of such instruments in the marketplace over the past several years since the consensus in Issue 90-19 was revised, questions have been raised as to whether the accounting guidance in Issue 90-19, as revised, appropriately reflects the economics of those instruments.

4. The issues are:

Issue 1—What is the scope of the guidance in paragraph 12 of Opinion 14?

Issue 2—What is the appropriate accounting model for convertible debt instruments that are not subject to the guidance in paragraph 12 of Opinion 14?

EITF DISCUSSION

5. The original issue brought to the Task Force at the March 15, 2007 meeting was as follows:

How an entity should account for a convertible debt instrument that requires or permits partial cash settlement upon conversion if, at issuance, the embedded conversion option is not required to be separately accounted for as a derivative under Statement 133.

6. At the March 15, 2007 meeting, the Task Force discussed this Issue but was not asked to reach a conclusion. The Task Force requested that the FASB staff form a working group to discuss (a) the scope of this Issue, (b) diluted earnings-per-share considerations, and (c) other potential short-term improvements to the accounting for convertible instruments. The Issues described in paragraph 4 were developed based on input from this working group.

7. At the June 14, 2007 meeting, the Task Force discussed Issue 1 but was unable to reach a conclusion. The Task Force agreed to discontinue discussion of this Issue and, accordingly, to remove it from the EITF's agenda. FASB Board members in attendance
indicated that they would consider adding a project to the Board's agenda to address the issue.

**STATUS**

8. No further EITF discussion is planned.
Suggested Index Entries for Issue No. 07-2, “Accounting for Convertible Debt Instruments That Are Not Subject to the Guidance in Paragraph 12 of APB Opinion No. 14”

CONVERTIBLE DEBT
Instruments That Are Not Subject to the Guidance in Paragraph 12 of APB Opinion No. 14 07-2

DEBT: CONVERTIBLE DEBT AND DEBT WITH STOCK PURCHASE WARRANTS
Convertible Debt Instruments That Are Not Subject to the Guidance in Paragraph 12 of APB Opinion No. 14 07-2

DERIVATIVE INSTRUMENTS
Embedded Derivatives

EARNINGS PER SHARE