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December 22, 2020

Via email to [director@fasb.org](mailto:director@fasb.org)

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

**Re: Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Forwards and Options (File Reference No. 2020-800)**

Dear Ms. Salo:

We are pleased to provide comments on the Board's proposal to clarify an issuer's accounting for certain modifications or exchanges of freestanding equity-classified forwards and options.

The current lack of explicit guidance in this area results in incremental time and effort to determine a reasonable treatment. Further, because issuers do not have a consistent framework to apply, the accounting for similar transactions with similar economic consequences may differ between companies. Providing explicit guidance would allow companies to perform a structured analysis and reduce diversity in practice. For these reasons, we support the Board's proposal.

The rest of our detailed responses and suggestions to the Questions for Respondents are contained in the attached Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Angela Newell at (214) 689-5669 or Adam Brown at (214) 665-0673.

Very truly yours,

A handwritten signature in black ink that reads "BDO USA, LLP". The letters are written in a cursive, slightly slanted style.

BDO USA, LLP

## Appendix

***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?***

We agree that the amendments in the proposed Update should apply to freestanding equity-classified forwards and options that remain equity classified after a modification or exchange and are not within the scope of Topic 718 or accounted for as derivatives under Topic 815, regardless of whether the instrument has all the characteristics of a derivative instrument.

We note that it would be consistent with the scope of paragraphs 815-40-15-2 and 15-5, which include any freestanding financial instrument that is potentially settled in an entity's stock, regardless of whether the instrument has all the characteristics of a derivative. We suggest adding the following language at the end of paragraph BC4 to further confirm the scope: "...freestanding instruments that remain equity classified after the modification or exchange, consistent with the scope of instruments in ASC 815-40-15-2 and 15-5."

Additionally, we observe that the proposal does not discuss or contemplate the accounting consequence of applying the amendments to purchased options (e.g., an issuer's call option on its own shares). Therefore, we recommend clarifying that the amendments only apply to written options to avoid any unintended consequences. We also note that the agenda request was for written options, considering that modifications to purchased options may not be prevalent.

***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 the accounting for the modification or an exchange of a freestanding equity-classified forward or option based on its substance is appropriate.

However, as noted in the example in proposed paragraph 815-40-55-50, some modifications or exchanges could be made to induce the holder to exercise an existing instrument. While this type of transaction may result in the issuance of shares, and thus be considered a financing transaction, we note that accounting for the effect of an induced exercise as an equity issuance cost is inconsistent with the principles applied in other guidance, for example as dividends in an induced conversion of preferred stock under ASC 260-10-599-2. Although we acknowledge the Board's stated intent to treat the cost of a financing transaction consistently whether paid in cash or via modification of an existing instrument, we believe it is more appropriate to align the accounting for the effect of an induced exercise resulting from modification of the freestanding equity-classified instrument with the accounting for inducements of other similar instruments, which would result in recognition of dividends rather than a financing cost.

***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?***

In general, we agree that a reduction in the fair value of a modified or exchanged instrument should not be given accounting recognition, similar to the share-based payment model in Topic 718.<sup>1</sup>

However, in a multiple-element transaction, an investor might agree to modify or exchange an existing instrument to facilitate the issuance of another instrument being offered in the transaction. For instance, an investor may waive a restriction in a security that otherwise prohibits the dilutive issuance of a new security, making the first instrument less valuable. The investor may decide it is appropriate to do so because a cash infusion is necessary to support the issuer's operations. We believe that it would be inappropriate to separate those two transactions and not account for the reduction in value of the exchanged instrument when they are part of the same economic event. Also, see our response to Question 4 below.

***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?***

Generally, we believe that the guidance is operable. However, we note two instances in which we believe additional guidance would be helpful. First, as noted in our response to Question 3, we believe that there may be situations in a multiple-element transaction where giving accounting recognition for a reduction in fair value would be appropriate. In this regard, we believe it would be helpful to clarify whether the “total effect of the modification or exchange” in a multiple-element transaction in paragraph 815-40-35-16 includes reductions in value. Otherwise, the last two sentences in paragraph 35-16 may conflict with one another since one is concerned only with increases in fair value, while the other contemplates the total change in fair value, as follows (**emphasis added**):

- The effect of a modification or an exchange shall be measured as **the excess, if any**, of the fair value of the modified or exchanged instrument over the fair value of the original instrument immediately before it is modified or exchanged.
- In a multiple-element transaction, **the total effect** of the modification or exchange shall be allocated to the respective elements in the transaction.

Second, we observe that while paragraph 815-40-35-17(c) refers to Subtopic 470-60, the proposed Update does not include amendments to that Subtopic. We suggest that the Board either add an amendment to clarify whether “future cash payments” in paragraph 470-60-35-5 or the computation in paragraph 470-60-55-10 includes the incremental value of the modified or exchanged instrument or discuss such in the Basis for Conclusions. Similarly, we suggest clarifying how the effect of the modification or exchange should be considered for line of credit amendments, either by including an amendment in the proposed Update or adding a discussion in the Basis for Conclusions.

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<sup>1</sup> We also note that for the evaluation of modification versus extinguishment treatment of debt instruments, and for the accounting for fees paid or received by the debtor in such transactions, both cash inflows and outflows are considered. The proposed amendments requiring the inclusion of only increases in fair value may therefore be inconsistent with those requirements and with the principle that whether cash or other consideration is paid should not affect the accounting outcome for those transactions. However, that inconsistency is an existing difference between ASC 718 and ASC 470, and we agree that leveraging the model in ASC 718 is reasonable for equity-classified instruments.

***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 believe the scope of Topic 718 is clear and adding the proposed language may result in confusion.

Further, in our experience, entities rarely if ever i) issue warrants or forward contracts as consideration for goods and services on Day 1, and ii) modify those instruments in Day 2 for purposes unrelated to the original goods or services, such that they might potentially come within the scope of this proposal. Therefore, we do not agree that adding paragraphs 815-40-35-18 and 718-10-15-5 is necessary. Rather, we believe that including a similar language or discussion in the Basis for Conclusions would be sufficient.

***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?***

Yes. While there may be a number of scenarios that involve a modification or an exchange of a freestanding equity-classified forward or option other than those identified in the proposed Update, we believe it would not be cost beneficial to identify all those arrangements or provide guidance on all possible permutations. Given that the subject of the proposal relates to equity-classified instruments, we believe that recognizing the effect of a modification or exchange as a dividend would be consistent with the equity nature of those instruments.

In addition, as noted above in our response to Question 2, we believe that modifications that are intended to induce exercise of an existing instrument are more appropriately treated as a dividend rather than as a financing transaction.

***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?***

With one exception, we agree with the transition provisions.

Since the proposal establishes a framework for considering other aspects of existing US GAAP, we do not see a benefit to prohibiting early adoption in the second, third or fourth quarter of an annual period. Whether an entity technically early adopts or not, given the lack of existing guidance, it may reach a conclusion for a warrant modification that is consistent with the final amendments anyway.

***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?***

Given that companies have the option to apply the guidance prospectively, we believe an issuer would be able to adopt the guidance immediately, as applicable transactions occur. We also believe that additional time for adoption would not be necessary for private entities.