

# MEMO

Memo No. **Education Materials No. 1<sup>1</sup>**

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Meeting Date **EITF Meeting June 15, 2023**

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Project	<b>EITF Issue No. 23-A, “Induced Conversions of Convertible Debt Instruments”</b>		
Project Stage	<b>Initial Deliberations</b>		
Issue(s)	<b>Education and High-Level Approaches</b>		

## Memo Purpose

- At its April 26, 2023 meeting, the Board added a project to the EITF’s agenda on induced conversions of convertible debt instruments. The objective of the project is to improve the relevance of the existing induced conversion guidance in Subtopic 470-20, Debt—Debt with Conversion and Other Options. The project scope focuses on the applicability of the induced conversion guidance to the early settlement of convertible debt instruments.
- The purpose of this memo is to provide Task Force members with background on convertible debt instruments and induced conversions and to introduce high-level approaches for discussion at the June 15, 2023 EITF meeting. The purpose of the June EITF meeting is to (a) provide the Task Force with background on the EITF Issue, and (b) obtain initial feedback on the potential approaches and next steps.
- This memo includes the following sections:
  - Background on Convertible Debt Instruments
  - Agenda Request on Induced Conversions and Board Decision
  - High-Level Approaches
  - Next Steps

<sup>1</sup> The alternative views presented in the Educational Materials are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.

## Discussion Questions for the Task Force

### Background and Issues Raised in Agenda Request

1. Does the Task Force have any questions or comments on the background or agenda request sections?

### High-Level Approaches

2. For Issues 1 and 2, does the Task Force agree that the guidance in paragraph 470-20-40-13(b) should be updated to address certain scope and application issues raised related to induced conversion accounting?
3. For Issue 3, does the Task Force agree that Issue 3 is unrelated to Issues 1 and 2 and that there should be guidance to address whether contingencies affect the induced conversion assessment?
4. Does the Task Force have any feedback on the high-level approaches?

### Next Steps

5. Is there any specific research or outreach on the induced conversion guidance in Subtopic 470-20 that the Task Force would need for a future decision-making meeting?

## Background on Convertible Debt Instruments

### What is Convertible Debt and How is it Accounted for Upon Issuance?

4. The accounting for convertible debt instruments was first addressed in APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14), which was issued in 1969.<sup>2</sup> APB 14 described convertible debt instruments as debt securities that are convertible into common stock of the issuer or an affiliated company at a specified price at the option of the holder and that are sold at a price or have a value at issuance not significantly in excess of the face amount.<sup>3</sup> APB 14 stated that convertible debt instruments generally included the following features:
  - (a) An interest rate that is lower than the issuer could establish for nonconvertible debt.
  - (b) An initial conversion price that is greater than the market value of the common stock at the time of issuance.
  - (c) A conversion price that does not decrease except pursuant to antidilution provisions.
5. As discussed in paragraph 470-20-05-5 (codified from APB 14), convertible debt instruments may offer advantages to both the issuer and the holder. From the point of view of the issuer, convertible debt has a lower interest rate than nonconvertible debt due to the existence of and potential value attributable to the conversion option. Furthermore, if the fair value of the underlying common stock increases sufficiently in the future, the issuer can potentially issue common stock to settle the debt instrument

<sup>2</sup> Convertible debt instruments were also discussed in APB Opinion No. 10, *Omnibus Opinion*.

<sup>3</sup> APB 14 also established what is referred to in practice as the “substantial premium model.” The substantial premium model, which remains applicable after the effective date of the amendments in Update No. 2020-06, *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*, is described in paragraph 470-20-25-13 requiring that “if a convertible debt instrument is issued at a substantial premium, there is a presumption that such premium represents paid-in capital.”

without a cash outlay. If the fair value of the stock does not increase sufficiently to result in conversion of the debt, the issuer will have received the benefit of borrowing at a relatively low cash interest cost.

6. From the point of view of the convertible debt holder, they receive either (a) the face or redemption amount of the debt instrument or (b) the number of common shares into which the debt instrument is convertible. If the fair value of the underlying common stock increases above the conversion price, the holder benefits through appreciation. However, should the fair value of the underlying common stock decrease (or not increase) in the future, the holder has the protection of a debt instrument.
7. Under the guidance in APB 14, the issuer would account for a convertible debt instrument in its entirety as a liability, with no separate recognition of (or allocation of proceeds to) the conversion feature (even though some portion of the instrument's value was attributable to the embedded conversion option). APB 14 did not appear to contemplate convertible debt instruments that could be settled in cash and noted that a convertible debt security "will either be converted into common stock or be redeemed for cash. The holder cannot exercise the option to convert unless he forgoes the right to redemption, and vice versa."
8. In the years that followed the issuance of APB 14, there was an evolution in the types of, and features included in, convertible debt instruments being issued. In response, the Board and EITF established several models for accounting for various types of convertible debt instruments. This included guidance for how to account convertible debt instruments settleable in cash. Notably, EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion," and the SEC staff (through various speeches) summarized different types of convertible debt for which the issuer is either required to or has the option to satisfy all or part of the obligation in cash. For reference, the staff has summarized these different types of convertible debt instruments below.
  - (a) **Traditional Convertible Debt:** Upon conversion, the issuer *must* satisfy the obligation entirely in shares based on a fixed number of shares into which the debt instrument is convertible.
  - (b) **Instrument A:** Upon conversion, the issuer *must* satisfy the obligation entirely in cash based on a fixed number of shares multiplied by the stock price on the date of conversion (conversion value).<sup>4</sup>
  - (c) **Instrument B:** Upon conversion, the issuer *may* satisfy the entire obligation in either all stock or all cash (or cash equivalents) in an amount equal to the conversion value.
  - (d) **Instrument C:** Upon conversion, the issuer *must* satisfy the accreted value of the obligation in cash and *may* satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock.

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<sup>4</sup> The conversion option for Instrument A would be subject to the derivative guidance in Topic 815, Derivatives and Hedging, and evaluated for potential bifurcation.

- (e) **Instrument X:** Upon conversion, the issuer *may* settle the conversion value of the debt in shares, cash, or any combination of shares and cash.<sup>5</sup>
9. In 2008, FASB Staff Position No. APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*, established guidance for all convertible debt instruments that may be settled in cash (or other assets) upon conversion, including full and partial cash settlement (Instruments C and X).<sup>6</sup> FSP APB 14-1 established a model requiring that an entity allocate the proceeds between the liability and equity components. This model was referred to in practice as the “cash conversion model.”
10. The most recent significant change to the accounting for convertible debt was made in Update No. 2020-06, *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*. The amendments in Update 2020-06 simplified the requirements by reducing the number of accounting models potentially applicable to convertible debt instruments issued without detachable warrants. The reduction in number of accounting models was achieved, in part, by eliminating the cash conversion model established in FSP APB 14-1. Upon the effective date of the amendments in Update 2020-06,<sup>7</sup> a convertible debt instrument is accounted for as a liability in its entirety under Subtopic 470-20 when (a) it is not accounted for under the fair value option (under Topic 825, Financial Instruments), (b) the embedded conversion option does not need to be bifurcated as an embedded derivative, and (c) the instrument was not issued at a substantial premium.
11. Notably, various instruments with cash conversion features (for example, Instrument C and Instrument X) that were previously subject to bifurcation between liability and equity components under the cash conversion model would be accounted for as a liability in their entirety under Update 2020-06. The following are excerpts of guidance from Update 2020-06:

**470-20-05-7** Entities may issue convertible debt instruments that may be convertible into common stock at the lower of a conversion rate fixed at time of issuance and a fixed discount to the market price of the common stock at the date of conversion.

**470-20-05-7A** Entities also may issue convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement.

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<sup>5</sup> The SEC’s reference to Instrument X was made as part of its remarks at the [2003 Thirty-First AICPA National Conference on Current SEC Developments](#).

<sup>6</sup> Unless the embedded conversion option was required to be separately accounted for as a derivative under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

<sup>7</sup> The amendments in Update 2020-06 became effective for public business entities that meet the definition of an SEC filer, excluding smaller reporting companies, for fiscal years beginning after December 15, 2021. For all other entities, the amendments will become effective for fiscal years beginning after December 15, 2023. Early application is permitted.

**470-20-25-12** A debt with an embedded conversion feature shall be accounted for in its entirety as a liability and no portion of the proceeds from the issuance of the convertible debt instrument shall be accounted for as attributable to the conversion feature unless the conversion feature is required to be accounted for separately as an embedded derivative under Subtopic 815-15 or the conversion feature results in a premium that is subject to the guidance in paragraph 470-20-25-13.

12. The EITF Issue No. 23-A focuses on induced conversions of convertible debt instruments that, in accordance with paragraph 470-20-25-12, are accounted for in their entirety as liabilities (with no portion of the proceeds from the issuance of the convertible debt attributed to the conversion feature).
13. To illustrate the initial recognition of a cash-settleable convertible debt instrument that is accounted for in its entirety as a liability prior to conversion, the staff has excerpted an example from KPMG's *Debt and Equity Financing* handbook.

**Example 10A.7.20 Conversion of debt to common shares (cash conversion feature)**

On January 1, Year 1, ABC Corp. issues a series of 1,000 fixed-rate bonds with a 20-year maturity. The bonds were issued for their aggregate par amount of \$1,000,000. The bonds have a 4% stated coupon interest rate and cash interest payments are made annually on December 31.

The holder has the option to convert each bond at any time to 20 of ABC's \$1 par value common shares (i.e. a conversion price of \$50 per share). On conversion, ABC can elect to settle by delivering a combination of cash and/or common shares with an aggregate value equal to the current market price of 20 of ABC's common shares (i.e. the if-converted value); an instrument with this feature is commonly referred to as 'Instrument X'.<sup>8</sup>

ABC records the following journal entry [To recognize issuance of convertible bonds].

Cash (received from issuance)	1,000,000 [debit]
Bonds Payable	1,000,000 [credit]

ABC subsequently measures the bonds at their amortized cost. Because the convertible debt was issued at par, interest expense is recorded each period based on the debt's stated interest rate.

ABC records the following journal entry to recognize interest expense for each of Years 1 through 4. [Footnotes omitted]

Interest Expense	40,000 [debit]
Cash	40,000 [credit]

14. Under models of accounting for convertible debt issuances that require bifurcation of the embedded conversion option, some amount is initially assigned to the embedded conversion option, which would

<sup>8</sup> As noted in the example, the bonds do not contain embedded features other than the conversion option. The debt is not measured at fair value. The conversion feature does not require bifurcation as an embedded derivative. Because the debt was issued at its principal amount, it was not issued at a substantial premium. For simplicity, this example does not reflect debt issuance costs.

then be accounted for as a separate unit of account from the debt instrument.<sup>9</sup> Compared to accounting models that require a portion of the proceeds to be allocated to the conversion option, a convertible debt instrument that is accounted for as a liability in its entirety and subsequently measured at amortized cost (as illustrated above) will initially report a greater amount attributable to the debt instrument and lower interest expense after issuance.

### **Why Was the Cash Conversion Model Eliminated in Update 2020-06?**

15. The Board in its basis for conclusions in Update 2020-06 pointed to feedback from preparers and practitioners that the multiple models for economically similar instruments had created unnecessary complexity and significant cost to account for convertible debt instruments. The Board had also received feedback from financial statement users indicating that they generally did not find the accounting models that separated convertible debt instruments into liability and equity components (including the cash conversion model) to be useful or relevant because they generally view and analyze those instruments on a whole-instrument basis.
16. In response to the feedback received, the Board decided to simplify the accounting for convertible instruments by removing certain accounting models that separated convertible debt instruments into multiple components (including the cash conversion model).

### **What Is Conversion Accounting and When Does It Apply?**

17. Although APB 14 described convertible debt instruments and the required accounting for those instruments upon issuance, it did not describe the accounting required when the convertible debt is converted.
18. AIN-APB 26, *Early Extinguishment of Debt: Accounting Interpretations of APB Opinion No. 26* (issued in 1973), described the accounting for conversions of convertible debt instruments by noting that the carrying amount of the debt, including any unamortized premium or discount, is credited to the capital accounts upon conversion to reflect the common stock issued and no gain or loss is recognized. That guidance was codified in paragraph 470-20-40-4 and subsequently updated after the issuance of Update 2020-06 to accommodate conversion features that incorporate settlement in forms of consideration other than equity securities (for example, cash or other assets).
19. Paragraph 470-20-40-4 also notes that it applies to a convertible debt instrument that is “accounted for in its entirety as a liability” and is converted “in accordance with the conversion privileges provided in the terms of the instrument.”

**470-20-40-4** If a convertible debt instrument accounted for in its entirety as a liability under paragraph 470-20-25-12 is converted into shares, cash

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<sup>9</sup> For example, convertible debt instruments for which the conversion option is required to be bifurcated under Topic 815, Derivatives and Hedging, or convertible debt instruments issued with detachable warrants.

(or other assets), or any combination of shares and cash (or other assets), in accordance with the conversion privileges provided in the terms of the instrument, upon conversion the carrying amount of the convertible debt instrument, including any unamortized premium, discount, or issuance costs, shall be reduced by, if any, the cash (or other assets) transferred and then shall be recognized in the capital accounts to reflect the shares issued and no gain or loss is recognized.

20. Prior to the amendments in Update 2020-06, conversions of convertible debt instruments under the cash conversion model resulted in the recognition of a gain or loss.<sup>10</sup> Under the amendments in Update 2020-06, conversion accounting for a convertible debt instrument accounted for in its entirety as a liability does not result in the recognition of a gain or loss. Therefore, under the amended guidance, an instrument (for example, Instrument X) that can be settled entirely in cash would not require the recognition of a gain or loss upon conversion. The following example (a continuation of the KPMG example included in paragraph 13) is included below to illustrate the accounting for a conversion of a convertible debt instrument under Update 2020-06.<sup>11</sup>

**Example 10A.7.20 Conversion of debt to common shares (cash conversion feature) [continued]**

On January 1, Year 5, the conversion option is exercised by all holders of the convertible bonds. At the conversion date, the fair value of ABC common shares is \$75 per share. Therefore, the if-converted value of the bonds is \$1,500,000; each bond is convertible into 20 shares × 1,000 bonds × \$75 actual market value at conversion.

**Scenario 1: ABC settles the conversion entirely with shares**

ABC records the following journal entry to recognize the conversion.  
[Footnotes omitted.]

Bonds Payable	1,000,000 [debit]
Common Shares	20,000 [credit]
APIC	980,000 [credit]

ABC does not record the common shares at their \$1,500,000 fair value on conversion and does not record a gain or loss because the debt is converted based on the terms of the original debt agreement.

**Scenario 3: ABC settles the conversion entirely in cash**

ABC records the following journal entry to recognize the conversion.

Bonds Payable	1,000,000 [debit]
APIC	500,000 [debit]
Cash	1,500,000 [credit]

<sup>10</sup> Specifically, as noted in the agenda request, for instruments subject to the guidance on cash conversion features, an entity would be required to calculate an extinguishment gain or loss based on the difference between the carrying amount of the liability component and the fair value of similar debt without a conversion feature immediately before extinguishment.

<sup>11</sup> The staff excerpted examples where convertible debt is settled entirely in shares and settled entirely in cash.

## What Is Extinguishment Accounting and When Does It Apply?

21. As noted in the agenda request, when a convertible debt instrument is subject to extinguishment accounting, paragraph 470-50-40-4 requires that a gain or loss be recognized for the difference between the fair value of the consideration transferred and the net carrying amount of the debt.

**470-50-40-4** The extinguishment of convertible debt does not change the character of the security as between debt and equity at that time. Therefore, a difference between the cash acquisition price of the debt and its net carrying amount shall be recognized currently in income in the period of extinguishment as losses or gains.

22. An example of the accounting required for the extinguishment of a convertible debt from Deloitte's *Distinguishing Liabilities from Equity – Roadmap* is included below.

### Example 9-6 Redemption of Convertible Debt

Entity K has outstanding convertible debt with a net carrying amount of \$1,000. The conversion feature is deeply in-the-money because of an increase in K's stock price after the debt was issued. Entity K pays \$2,200 to repurchase the debt, which is also the current fair value of the debt. Entity K recognizes the following accounting entry:

Debt	1,000 [debit]
Debt Extinguishment Loss	1,200 [debit]
Cash	2,200 [credit]

23. The agenda request notes that extinguishment accounting applies when (a) settlement of convertible debt is not subject to conversion accounting or (b) there is a substantial modification of a convertible debt instrument.<sup>12</sup>
24. In accordance with paragraph 405-20-40-1, a liability is considered extinguished when a debtor pays the creditor and is relieved of its obligation for the liability or when the debtor is legally released from being the primary obligor under the liability, either judicially or by the creditor.
25. Absent the specialized guidance for conversions (including induced conversions) of convertible debt, the final settlement of convertible debt entirely accounted for as a liability would be accounted for as an extinguishment. Therefore, unless the guidance applicable to conversions or induced conversions applies, the settlement of convertible debt instruments would be accounted for as an extinguishment. As noted in paragraph 19, a convertible debt instrument that is accounted for in its entirety as a liability and is converted in accordance with its original conversion terms would be subject to *conversion accounting* (and, therefore, would not be subject to *extinguishment accounting*).
26. In accordance with the guidance in Subtopic 470-50, modifications and exchanges of debt instruments (including convertible debt instruments) can also trigger extinguishment accounting. Paragraphs 470-

<sup>12</sup> The guidance for extinguishments would also not apply to a troubled debt restructuring within the scope of Subtopic 470-60, Debt—Troubled Debt Restructurings by Debtors. This memo does not consider transactions within the scope of that Subtopic.

50-40-10 and 470-40-50-12 establish a quantitative cash flow test for determining whether the terms of a modified convertible debt instrument that is accounted for in its entirety as a liability are “substantially different” and would, therefore, trigger extinguishment accounting.<sup>13,14</sup> That guidance notes that a modified debt instrument that adds or eliminates a substantive conversion option would also be considered to be “substantially different” and would require extinguishment accounting.

27. Notably, the guidance in Subtopic 470-50 on modifications and extinguishments of debt does not apply if conversion accounting applies (conversion occurring pursuant to the instrument's original conversion terms) and would also not apply if *induced conversion* accounting applies (Subtopic 470-50 explicitly scopes out both *conversions* and *induced conversions* from the guidance on modifications).

### **What Is Induced Conversion Accounting and When Does It Apply?**

28. FASB Statement No. 84, *Induced Conversions of Convertible Debt (an amendment of APB Opinion No. 26)*, established guidance in response to concerns about extinguishment accounting being required for certain conversions of debt not made pursuant to the original conversion terms.<sup>15</sup>
29. FAS 84 established the model for “induced conversions.” Under induced conversion accounting, an entity does not recognize a gain or loss with respect to the shares issuable pursuant to the original conversion privileges of the convertible debt when additional securities or assets are transferred to a debt holder to induce prompt conversion of the instruments. Instead, an entity is required, upon conversion, to recognize an expense equal to the fair value of all securities and other consideration transferred in the transaction in excess of the fair value of securities issuable pursuant to the original conversion terms. In other words, an expense is only recognized for the sweetener provided to induce the holder to convert. Paragraph 470-20-40-16 requires that the fair value of the securities or other consideration should be measured as of the date the inducement offer is accepted by the convertible debt holders.<sup>16</sup> The transaction is recognized (including derecognition of the debt) upon conversion. An example of the accounting required for an induced conversion transaction is included below.

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<sup>13</sup> If the present value of the cash flows under the terms of the new debt instrument is at least 10 percent different from the present value of the remaining cash flows under the terms of the original instrument (excluding the change in the fair value of an embedded conversion option resulting from an exchange of debt instruments or a modification in the terms of an existing debt instrument), then the modified terms would be considered to be substantially different and would trigger extinguishment accounting.

<sup>14</sup> Paragraphs 470-50-40-14 and 40-15 note that, if a convertible debt instrument is modified or exchanged in a transaction that is not accounted for as an extinguishment, then an increase in the fair value of the embedded conversion option reduces the carrying amount of the debt instrument with a corresponding increase in additional paid-in capital. However, a decrease in the fair value of an embedded conversion option resulting from a modification or an exchange should not be recognized.

<sup>15</sup> This was also discussed in EITF Issue No. 84-3, “Convertible Debt ‘Sweeteners,’” on which the Task Force reached a consensus that accounting for the incremental value of the “sweetener” at fair value, with conversion accounting for the original conversion terms, would more appropriately reflect the economics of those transactions than extinguishment accounting. This consensus was nullified by FAS 84.

<sup>16</sup> In the basis for conclusions to FAS 84, the Board noted that the acceptance date “normally will be the date the debt holder converts the convertible debt into equity securities or enters into a binding agreement to do so.”

• • > **Case A: Reduced Conversion Price for Conversion before Determination Date—Bond Fair Value Increased**

**470-20-55-3** On January 1, 19X4, Entity A issues a \$1,000 face amount 10 percent convertible bond maturing December 31, 20X3. The carrying amount of the bond in the financial statements of Entity A is \$1,000, and it is convertible into common shares of Entity A at a conversion price of \$25 per share. On January 1, 19X6, the convertible bond has a fair value of \$1,700. To induce convertible bondholders to convert their bonds promptly, Entity A reduces the conversion price to \$20 for bondholders that convert before February 29, 19X6 (within 60 days).

**470-20-55-5** Therefore, Entity A records debt conversion expense equal to the fair value of the incremental consideration paid as follows.

	Debit	Credit
Convertible debt	\$1,000	
Debt conversion expense	400	
Common stock		\$1,400

30. FAS 84 established specific conditions for when induced conversion accounting could be applied. Specifically, it established that changes to the terms of a convertible debt instrument must (a) be made for the purpose of inducing conversion, (b) be exercisable only for a limited period of time, and (c) include the issuance of all of the equity securities issuable pursuant to the conversion privileges included in the terms of the debt at issuance.<sup>17</sup>

**470-20-40-13** The guidance in paragraph 470-20-40-16 [accounting for an induced conversion] applies to conversions of convertible debt to equity securities pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance (including changes that involve the payment of consideration) for the purpose of inducing conversion. That guidance applies only to conversions that both:

- Occur pursuant to changed conversion privileges that are exercisable only for a limited period of time (inducements offered without a restrictive time limit on their exercisability are not, by their structure, changes made to induce prompt conversion)
- Include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance for each debt instrument that is converted, regardless of the party that initiates the offer or whether the offer relates to all debt holders.<sup>18</sup>

31. Although not codified, paragraph 15 of FAS 84 also noted that “prior to an induced conversion of a convertible debt instrument, a debtor has outstanding convertible debt that is *(or will become)* convertible to equity securities of the debtor at the option of the debt holder” (emphasis added).

<sup>17</sup> The agenda request notes that this would only apply to instruments that had a substantive conversion feature.

<sup>18</sup> The guidance indicating that FAS 84 applies to all conversions of convertible debt that include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance for each debt instrument that is converted, regardless of the party that initiates the offer or whether the offer relates to all debt holders was established by EITF consensus on Issue No. 02-5, “Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are within the Scope of FASB Statement No. 84.”

32. FAS 84 did not discuss induced conversions involving convertible debt with cash conversion features (for example, Instrument X). For example, it did not discuss convertible debt instruments that would permit the issuer to settle the convertible debt instrument entirely in cash pursuant to the original conversion privileges.
33. By contrast, prior to adoption of the amendments in Update 2020-06, there was a separate induced conversion model for convertible debt subject to the cash conversion subsections of Subtopic 470-20. That induced conversion model was established in FSP APB 14-1 (concurrent with the establishment of the overall model for convertible debt with cash conversion features). As noted in paragraph 20, conversions of convertible debt instruments under the cash conversion model resulted in the recognition of an extinguishment gain or loss for the amount allocated to the settlement of the liability component. For *induced conversions* under the cash conversion model, an entity would also be required to recognize an expense equal to the fair value of all securities and other consideration transferred in the transaction in excess of the fair value of consideration issuable in accordance with the original conversion terms. This cash convertible induced conversion model provided less specific guidance for when it was required to be applied, only noting that “an entity may amend the terms of an instrument within the scope of this FSP to induce early conversion, for example, by offering a more favorable conversion ratio or paying other additional consideration in the event of conversion before a specified date.”
34. The amendments in Update 2020-06 eliminated the separate induced conversion model for convertible debt subject to the cash conversions subsections of Subtopic 470-20. The basis for conclusions in Update 2020-06 did not specifically discuss the impact of potentially requiring that entities apply the induced conversion model established in FAS 84 to convertible debt instruments with cash conversion features.
35. The elimination of the cash conversion model (and its related induced conversion model) in Update 2020-06, increases the difference in the amount of gain or loss that would be recognized under (a) extinguishment accounting and (b) induced conversion accounting.

#### **Why Are Induced Conversions Accounted for Differently Than Extinguishments?**

36. In the basis for conclusions in FAS 84, the Board provided its rationale for why it determined that a model should be created for induced conversions that was different than the existing model for extinguishments. The Board also explained why induced conversions should be subject to the criteria in FAS 84.
- (a) **Nature of Obligation Does Not Change by Incentivizing Conversion:** The Board determined that accounting for an induced conversion as an extinguishment rather than as a conversion of debt did not faithfully portray the substance of the transaction. It noted that the payment of an

incentive to a debt holder could require recognition of a loss on extinguishment that might exceed the value of the conversion incentive by a material amount.

The Board explained that the nature of the obligation recognized upon issuance does not change if an incentive is paid to a debt holder to induce the holder to exercise a right already held. Therefore, FAS 84 required no recognition of gain or loss with respect to the shares issuable pursuant to the original conversion privileges of the convertible debt when additional securities or assets were transferred to a debt holder to induce prompt conversion of the debt securities to equity securities.

- (b) **Induced Conversions Are Only Offered for a Limited Period of Time:** The Board noted that induced conversion accounting only applies to inducements that are offered for a limited period of time because inducements offered without a restrictive time limit on their exercisability are not, by their structure, changes made to induce prompt conversion.
- (c) **Transaction Is Not a Conversion If All Equity Securities Pursuant to Conversion Privileges Are Not Issued:** Some stakeholders questioned the requirement that an induced conversion “include the issuance of all of the equity securities issuable pursuant to the original conversion privileges for each debt instrument that is converted.” Those stakeholders noted that not all induced conversions would meet this requirement and that it could lead to significantly different accounting for substantially similar transactions. The Board expressed disagreement with those respondents, noting that a transaction that does not include the issuance of all of the equity securities issuable pursuant to the conversion privileges should not be characterized as a conversion transaction.

### **Summary of Differences between Extinguishment and Induced Conversion Accounting**

- 37. As noted in paragraph 21, if the settlement of convertible debt is not subject to conversion accounting or induced conversion accounting, an entity would be required to recognize an extinguishment gain or loss based on the difference between the net carrying amount of the convertible debt instrument and the fair value of the consideration issued on settlement (which includes the value of the conversion feature). This may result in the recognition of significant gains or losses on extinguishment due to the value of the conversion feature.
- 38. By contrast, under the induced conversion guidance, an entity would recognize an expense equal to the fair value of the securities and other consideration transferred in excess of the fair value of the shares issuable pursuant to the instrument's original conversion privileges. The issuer would then apply the contractual conversion accounting guidance, which results in no gain or loss recognized in accordance with paragraph 470-20-40-4.
- 39. In the simplified example below, the staff has illustrated the consequences of extinguishment versus induced conversion accounting. The example below assumes that a convertible debt instrument had a

carrying amount of \$1,000 and was settled for \$1,500 in cash. This example also assumes that the inducement premium was \$100 (that is, the fair value of the consideration transferred in excess of the fair value of the shares issuable pursuant to the instrument's original conversion privileges equaled \$100 on the date the inducement offer was accepted by the convertible debt holder).

<b>Extinguishment</b>		
	<b>Debit</b>	<b>Credit</b>
Debt	1,000	
Debt Extinguishment Loss	500	
Cash		1,500

  

<b>Induced Conversion</b>		
	<b>Debit</b>	<b>Credit</b>
Debt	1,000	
Debt Conversion Expense	100	
APIC	400	
Cash		1,500

40. While the amendments in Update 2020-06 updated the contractual conversion guidance to address cash convertible debt instruments, no changes were made to the overall induced conversion guidance. Therefore, a number of questions have been raised about when the induced conversion guidance applies to certain settlements of convertible debt instruments that occur on terms that differ from the stated contractual conversion provisions because of (a) the change in the accounting for the contractual conversion of cash convertible debt instruments under Update 2020-06, (b) the significant gains and losses recognized when the settlement of convertible debt is accounted for as an extinguishment, and (c) the fact that the induced conversion guidance was not updated to address cash convertible features. As shown in the example above, whether the settlement of convertible debt is accounted for as an extinguishment or an induced conversion can significantly affect the accounting for the transaction.

## Agenda Request on Induced Conversions and Board Decision

### Summary of Issues in Agenda Request

41. In November 2022, an agenda request (see Appendix A) was submitted by the Big 4 accounting firms requesting that the EITF address whether certain convertible debt instruments<sup>19</sup> settled using terms that differ from the stated contractual conversion provisions should be accounted for as an induced conversion or extinguishment.
42. The agenda request addresses the following three issues and describes certain related views of how the existing guidance may be interpreted today:

<sup>19</sup> The convertible debt instruments that are the primary focus of the agenda request are the instruments that could be settled partially or wholly in cash, such as Instrument C and Instrument X.

- (a) **Issue 1 (Conversion with Amended VWAP Terms):** Can induced conversion accounting apply if the cash or shares issued on conversion is calculated in a manner that differs from the original stated conversion privileges because a volume-weighted average price (VWAP) formula<sup>20</sup> is incorporated, eliminated, or modified?
- (i) **View A:** No, there is a potential for the holders to receive less value under the amended terms than if they had converted under the original terms of the instrument.
  - (ii) **View B:** Yes, a premium is offered on the date that the offer is made for the early conversion.
  - (iii) **View C:** It depends. Yes, if a premium exists on the date that the offer is accepted for the early conversion. Otherwise, no. In addition, there is no need to consider what happens between the offer acceptance date and the settlement date.
- (b) **Issue 2 (Conversion with Amended Terms for Form of Consideration):** Can induced conversion accounting apply if the form of the consideration issued on settlement (ignoring the additional consideration or premium) differs from the contractual conversion terms?
- (i) **View A:** No, the form of the consideration specified in the original terms of the convertible debt instrument must be issued or paid in order to apply induced conversion accounting.
  - (ii) **View B:** Yes, induced conversion accounting may be applied as long as the issuer provides additional consideration beyond the contractual conversion provisions (that is, the form of consideration used to satisfy a contractual conversion is not determinative).
  - (iii) **View C:** It depends. No, if an entity satisfies a portion of the settlement amount in cash but the instrument's contractual conversion provisions required that portion to be settled in shares. Yes, if an entity satisfies a portion of the settlement amount in shares but the instrument's contractual conversion provisions required that portion to be settled in cash.
- (c) **Issue 3 (Conversions of Instruments That Are Not Currently Convertible):** Can induced conversion accounting apply to the settlement of a convertible debt instrument that is not currently convertible?

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<sup>20</sup> A VWAP formula measures the average price at which a security has traded over a specified period of time, taking into account the volume of shares traded. It is calculated by adding up the dollar value of all trades over the specified period and dividing it by the total number of shares traded. It is one of the formulas that determine the ultimate settlement amount of certain convertible debt instruments. For example, some convertible instruments with an option for cash settlement calculate settlement amounts based on the VWAP of the underlying shares for a period of time.

- (i) **View A:** No, a settlement cannot be considered a conversion if the instrument was not convertible at the settlement date.
- (ii) **View B:** Yes, the guidance on induced conversions does not refer to whether the instrument is currently convertible; therefore, induced conversion accounting can be applied if the settlement of the instrument substantively reflects a conversion (even if the instrument is not currently convertible).

### **Summary of Firm Guidance Addressing Issues in the Agenda Request**

- 43. The staff notes that some firms have published their views on Issues 1 and 2 in the agenda request. Those published views indicate that certain changes to VWAP terms or changes in the form of settlement can trigger extinguishment accounting today based on interpretations of the existing induced conversion criteria included in paragraph 470-20-40-13(b).

### **Summary of March 30, 2023 EITF Agenda Committee Meeting**

- 44. During the March 30, 2023 EITF Agenda Committee Meeting, Task Force members discussed the agenda request.
- 45. Task Force members were broadly supportive of the Board adding a project to the EITF's agenda to address the issues raised in the agenda request. Some EITF members indicated that they would support adding a project to improve the relevance of the existing induced conversion guidance by considering whether the existing recognition criteria should be changed or clarified to address cash convertible features and other common settlement features. Others indicated that they would support a narrower approach that focused on answering the specific questions in the agenda request. No EITF members indicated that they were supportive of a project to holistically reconsider the guidance for induced conversion accounting.

### **Summary of April 26, 2023 Board Meeting**

- 46. As noted above, the Board decided to add a project on induced conversions of convertible debt instruments to the EITF's agenda during the April 26, 2023 Board meeting. The Board voted unanimously to add the project. When providing feedback on the project's objective and scope, the Board members gave input on their priorities related to the project.
- 47. The Board did not provide specific direction or approaches it would like the EITF to pursue in addressing these issues; however, several Board members emphasized the importance of timely standard-setting. Most Board members noted either that they thought the project should focus on clarifying when the induced conversion model should apply (for increased relevance and consistent application) or that they would *not* be supportive of a fundamental revisit of the existing model that would eliminate the induced conversion model.

## High-Level Approaches

48. The staff noted from the agenda request that the primary tension point for Issue 1 (the value of consideration transferred and measurement date) and Issue 2 (the form of consideration transferred) is the existing criterion that requires “the issuance of all of the equity securities issuable” pursuant to the original conversion privileges in paragraph 470-20-40-13(b). Issue 3 (the current convertibility), which was raised because the existing guidance is silent on this area, is viewed by the staff as being unrelated to Issues 1 and 2. The staff notes that none of the issues raised in the agenda request relate to the criterion of “a limited period of time” in paragraph 470-20-40-13(a). Considering the nature of these three issues and the Board members’ feedback at their April 26, 2023 meeting, the staff has some preliminary thoughts on potential targeted improvements to the existing induced conversion model and is seeking the Task Force’s input and perspectives.
49. For Issues 1 and 2, the staff thinks that it would be beneficial to establish an underlying premise to guide the assessment of the existing induced conversion guidance, primarily focusing on “the issuance of all of the equity securities issuable” criterion, in order to ensure that the induced conversion guidance could be amended consistently to address both issues and to ensure the guidance can be applied more consistently. In addition, the staff thinks that establishing an underlying basis could reduce the need to provide case-by-case implementation guidance and could potentially provide clarity for similar issues not specifically raised in the agenda request. This may avoid ad-hoc standard setting if the terms of these instruments continue to evolve in current practice.
50. The following are two potential approaches related to the criterion of “the issuance of all of the equity securities issuable” in paragraph 470-20-40-13(b) for the Task Force to consider:
- (a) **Preexisting Contract Approach:** The underlying premise of this approach is based on the guidance in paragraph 25 of the basis for conclusions in FAS 84, which stated that in an induced conversion, the preexisting contract for conversion remains in effect and an inducement is paid in an attempt to cause the conversion option to be exercised. Under this approach, the induced conversion assessment would be based on whether the change made to the conversion privileges would effectively terminate the preexisting conversion privileges and establish new conversion privileges. The staff thinks that the preexisting conversion privileges could be specified as (1) the conversion price (or the number of issuable shares calculated as the face value of the convertible debt instrument divided by the conversion price) and (2) the form of settlement consideration included in the terms of the original convertible debt instrument at issuance. If the terms that are changed do not increase the original conversion price<sup>21</sup> (thereby

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<sup>21</sup> Under the preexisting contract approach, the original number of issuable shares is the minimum number of issuable shares for induced conversion. Therefore, reducing the original conversion price, which would result in an increase in the number of issuable shares, would be permitted thereby and the issuer would be allowed to apply the induced conversion accounting model. This is consistent with the guidance in paragraph 470-20-40-15.

resulting in fewer shares being issuable than the original number of issuable shares) and do not result in the settlement of the convertible debt instrument in a different form of consideration than what is included in the terms of the convertible debt instrument at issuance, induced conversion accounting would be applied. If the terms that are changed are different from those described above, then the issuer would apply extinguishment accounting.

Because the underlying premise of this approach generally aligns with the existing induced conversion guidance, the improvements under this approach would be more clarifying in nature and would not be expected to significantly expand the population of early settlements of convertible debt instruments that would qualify for induced conversion accounting. The staff does not expect significant amendments to paragraph 470-20-40-13(b) in order to address Issues 1 and 2 in the agenda request. Please refer to the detailed discussion in the following section.

- (b) **Incremental Fair Value Approach:** This approach is based on the fair value of the consideration transferred, regardless of whether the form of consideration is consistent with the original terms of the convertible debt instrument. Under this approach, an issuer would assess whether the changes made to the original conversion privileges would result in a higher fair value of consideration transferred than the fair value of the consideration that would be transferred pursuant to the original conversion terms. The fair value of the consideration to be transferred under both the original and modified conversion privileges would be assessed as of the same point in time (and the EITF would determine that point in time as part of this EITF Issue). If the fair value of the consideration transferred based on the modified conversion privileges is higher than would have been provided under the original conversion privileges, then the issuer would apply induced conversion accounting.

This approach would require that the guidance in paragraph 470-20-40-13(b) be updated (with other conforming amendments made). The staff believes that this approach may more significantly expand the use of induced conversion accounting. Please refer to the detailed discussion in the following section.

- 51. For issue 3, on the basis of the nature of the not-currently-convertible debt instruments (primarily the contingently convertible debt instruments), the staff believes that guidance could be developed to clarify whether the induced conversion guidance is applicable to the settlement of a convertible debt instrument that is not currently convertible. Such clarification may be provided in the derecognition guidance in Section 470-20-40 or in the implementation guidance in Section 470-20-55.

## **Preexisting Contract Approach**

### ***Overall***

52. The existing contractual conversion guidance in paragraph 470-20-40-4 allows for conversion accounting with no gain or loss recognized only when a convertible debt instrument is settled in shares, cash (or other assets), or any combination of shares and cash (or other assets) in accordance with the conversion privileges provided in the original terms of the instrument. The staff thinks that the guidance is clear that changes to the conversion price (or number of issuable shares) or the form of consideration transferred upon conversion would result in the issuer not being able to apply the contractual conversion guidance. On the other hand, the share price and the fair value of consideration transferred do not affect the assessment of whether the contractual conversion guidance should be applied.
53. The existing induced conversion guidance comprises two parts: the guidance on induced conversion assessment in paragraphs 470-20-40-13 through 40-15 and the guidance on the measurement of the inducement expense in paragraph 470-20-40-16. The staff considered that the following guidance may support an approach that the induced conversion guidance should only be applied if the convertible debt instrument is settled using the original conversion price (or the number of issuable shares) or a lower conversion price (or a higher number of issuable shares) and in the original forms of consideration:
- (a) Paragraph 470-20-40-13(b) requires the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance. The staff thinks that “all of the equity securities issuable” refers to the number of shares issuable pursuant to the original debt terms, which is calculated as the face value of the convertible debt instrument divided by the original conversion price. Therefore, changes that increase the original conversion price would decrease the number of issuable shares and would result in the criterion of “issuance of all of the equity securities issuable” not being met. However, guidance in paragraph 470-20-40-13(b) does not explicitly address how this criterion should be specifically considered for cash convertible instruments.
  - (b) Paragraph 470-20-40-15 specifies three examples of changed terms that qualify for induced conversion accounting. The first example is the reduction of the original conversion price, which will result in an increase in the number of issuable shares. The second example is the issuance of additional warrants or other securities, and the third example is the payment of additional cash or other consideration that does not affect the original conversion price (or the original number of issuable shares) or the settlement of those issuable shares in the original forms of consideration pursuant to the debt terms at issuance.
54. As briefly discussed in paragraph 50(a), this approach would base the induced conversion assessment on the original conversion price (or the original number of issuable shares that is calculated as the face value of the convertible debt instrument divided by the original conversion price) and the original forms

of consideration to be issued at settlement provided in the debt terms at issuance. The following examples illustrate the result of applying this approach:

- (a) If a changed term resulted in the increase in the original conversion price (or the decrease in the original number of issuable shares), induced conversion accounting would not be permitted because the original number of issuable shares in the preexisting conversion privileges was not fully fulfilled.
  - (b) If a changed term resulted in different forms of consideration being issued to settle the convertible debt instrument than what was provided in the original debt terms (for example, cash is issued when the original debt was required to be settled only in shares), induced conversion accounting would not be permitted because the forms of consideration issued at settlement differed from the original terms of the debt instrument. The staff thinks that this treatment would be consistent with how the change to the forms of consideration is treated under the contractual conversion guidance in paragraph 470-20-40-4. The staff does not think that adding an inducement sweetener should change whether a settlement is a conversion or an extinguishment.
55. Under the preexisting contract view, the current share price used to calculate the value of the transferred consideration would be irrelevant for the induced conversion assessment. That is because the fluctuations in share price or changes to the debt terms affecting what share price should be used upon settlement (such as VWAP) would not affect the original conversion price (or the original number of issuable shares) or the forms of consideration under the preexisting conversion privileges. The share price only matters when determining the amount of equity (additional paid-in-capital) to be recognized as a result of the conversion of the convertible debt instruments or measuring the inducement cost. The staff notes that this is consistent with the current contractual conversion accounting discussed in paragraph 52.
56. In summary, the inducement conversion assessment under this approach would primarily be anchored to the original conversion price (or the original number of issuable shares) and the original forms of consideration to be issued at settlement provided in the debt terms at issuance. The staff thinks that this is consistent with the implied intent of the existing induced conversion guidance. Although the existing induced conversion guidance would not need to be significantly changed under this approach, the staff thinks that the guidance should be further clarified in the following areas to improve its relevance, especially considering that cash convertible debt instruments were not contemplated under FAS 84:
- (a) To state that induced conversion accounting could be applied for conversions in other forms of consideration, including cash (or other assets) or any combination of shares and cash (or other assets), if included in the preexisting conversion privileges.

- (b) To state that the conversion price (or the number of issuable shares) and the forms of consideration provided in the debt terms at issuance would be relevant for induced conversion assessment.
- (c) To clarify that the induced conversion assessment should be performed as of the date the inducement offer is accepted by the convertible debt holder. The staff notes that the existing induced conversion assessment guidance in paragraph 470-20-40-13 does not refer to offer acceptance date but implies that date when it describes what conversions of convertible debt instruments should apply the guidance in paragraph 470-20-40-16 (which requires the measurement of the inducement cost on the offer acceptance date). The staff also notes that in the basis for conclusions for FAS 84 (i) paragraph 30 states that “Until the debt holder accepts the offer, no exchange has been made between the debtor and the debt holder” and (ii) paragraph 32 states that “the transaction should not be measured until the parties agree, that is, until the inducement offer has been accepted by the debt holder” and “fair value as of acceptance date is the appropriate measure because that is the value of the inducement which presumably causes the transaction to occur.”

### ***Affected Population***

57. Currently, some early settlements of convertible debt instruments are accounted for as an extinguishment when the share price used to calculate the conversion value is changed (for example, changes to VWAP) in a way that could result in the holders receiving less consideration than if they had converted the instrument pursuant to its original conversion terms. That is based on the view that the “issuance of all of equity securities issuable” criterion in paragraph 470-20-40-13(b) is not met because the holders could receive less value and the existing guidance does not explicitly address how changes in the calculation of the consideration paid on settlement affect the induced conversion assessment. The clarification under this approach could result in those early settlements being accounted for as induced conversions by anchoring the induced conversion assessment on the conversion price (or the number of issuable shares) and the forms of consideration, rather than the share price or the value of the transferred consideration. However, because this approach generally aligns with the existing induced conversion guidance, there would not be significant changes in the population of early settlements of convertible debt instruments that qualify for induced conversion accounting.

### ***Potential Outcomes for Issues 1 and 2***

58. The staff thinks that the potential outcomes for Issues 1 and 2 would be:

- (a) Issue 1 (Conversion with Amended VWAP Terms): Although the amended VWAP terms affect the share price used to determine the value of the consideration transferred, they do not change the original conversion price (or the number of issuable shares) and the original forms of

consideration pursuant to the conversion privileges. Therefore, the amended VWAP terms would not result in the induced conversion guidance not being able to be applied.

(b) Issue 2 (Conversion with Amended Terms for Form of Consideration): Original forms of consideration allowed in the debt terms at issuance are considered one of the key preexisting conversion privileges under this approach. Therefore, if the form of consideration was changed (regardless of whether it is a shares-to-cash change in settlement or a cash-to-shares change in settlement), the settlement would not qualify for induced conversion accounting.

59. The staff thinks that these two issues could be addressed by either (a) adding implementation guidance in Section 470-20-55 to explain how the existing induced conversion guidance should be applied or (b) clarifying the existing guidance in Section 470-20-40 in the areas discussed in paragraph 56.

### **Incremental Fair Value Approach**

#### ***Overall***

60. This approach would address Issues 1 and 2 in the agenda request by amending the existing criterion in paragraph 470-20-40-13(b) to eliminate the current requirement that an induced conversion include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance. That criterion would be replaced by a new criterion requiring that the fair value of the inducement offer exceeds the fair value of what the holder would receive under the original terms of the convertible debt instrument as of a specified date (for example, offer, acceptance, or settlement date). Said differently, to apply the induced conversion accounting under this approach, the fair value of the consideration transferred by the issuer to induce conversion would have to exceed the fair value of the consideration the holder would be entitled to under the original conversion privileges as of that specified date. Both the fair value under the original conversion privileges and the fair value of the inducement offer would be measured as of the same date. The term *fair value* is meant to be consistent with how that term is defined in Topic 820, Fair Value Measurement.

61. Notably, compared to both existing guidance and the preexisting contract approach outlined in this memo, this approach would put significantly less emphasis on the form of the consideration transferred from the issuer to the holder, including whether the form of final settlement (cash, other assets, or shares) is different from the consideration the holder would be entitled to pursuant to the instrument's original terms at issuance.

62. Like the preexisting contract approach, this approach would not amend any of the other existing criteria for determining whether a transaction would be considered an induced conversion. Also like the preexisting contract approach, the objective of this approach would not be to change the existing recognition and measurement requirements for induced conversions. This approach would focus on clarifying which transactions should be accounted for as induced conversions.

63. The purpose of this change would be to replace the existing guidance (which specifies the form of consideration to be provided) with guidance that is more compatible with the types of instruments to which conversion accounting in paragraph 470-20-40-4 currently applies (which, following the amendments in Update 2020-06, includes convertible debt instruments with cash conversion features).
64. Following the amendments in Update 2020-06, the issuance of equity interests is no longer necessary for a debt instrument to be subject to the conversion guidance in paragraph 470-20-40-4. The conversion accounting described in paragraph 470-20-40-4, unlike under the cash conversion model that was eliminated by the amendments in Update 2020-06, does not result in the recognition of an extinguishment gain or loss. Instead, the conversion accounting in paragraph 470-20-40-4 can be applied to an instrument that has a substantive conversion feature, even if the entity can opt to settle the entire obligation (including the conversion spread) in any combination of cash or shares (instrument X).
65. When issuing FAS 84, the Board did not contemplate convertible debt with cash conversion features. The basis for conclusions in FAS 84 also indicated that the Board expected all induced conversions to be settled either fully in shares or in a combination of shares and other consideration.

22. APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, states that no portion of the proceeds from the issuance of convertible debt should be accounted for as attributable to the conversion feature. **The amount recognized as a liability relating to convertible debt represents an obligation either to pay a stated amount of cash or to issue a stated number of shares of equity securities.** The Board believes that the nature of that obligation does not change if an incentive is paid to a debt holder to induce the holder to exercise a right already held. [Emphasis added.]

28. The Board further noted that, **in all induced conversions of convertible debt described herein, the debtor corporation gives debt holders equity securities (or a combination of equity securities and other consideration)** whose total fair value exceeds the value of the securities it was previously obligated to give upon conversion. [Emphasis added.]

66. Therefore, the incremental fair value approach takes the view that some criteria established in FAS 84 were established assuming that conversions would be settled in a fixed number of equity securities. One perspective could be that this focus on the form of settlement is inconsistent with amendments in Update 2020-06 because the conversion model can now be applied to instruments with cash conversion features.<sup>22</sup> The staff has listed considerations below that support moving away from guidance that

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<sup>22</sup> A similar view was articulated in the agenda request. According to the agenda request, proponents of that view “believe that the underlying principle in ASC 470-20-40-13 is that the issuer must provide additional consideration beyond the contractual conversion terms to apply induced conversion accounting. That is, if the issuer pays an amount more than the stated conversion value to settle a convertible debt instrument, the transaction may represent an induced conversion. Proponents of [that view] acknowledge that the wording in ASC 470-20-40-13 that refers to ‘the issuance of all the equity securities’ has not been updated to reflect the guidance in ASU 2020-06 and the nature of convertible debt instruments that exist in today’s marketplace.”

tethers the scope of the induced conversion model to the form of consideration issuable under an instrument's original conversion terms.

- (a) **Form-over-substance outcomes:** The staff understands that, under current practice, whether induced conversion accounting is applied is affected by the form of the settlement consideration required in the original terms. For example, if Instrument X and a traditional convertible debt instrument with identical payoff profiles and fair values are settled fully in cash pursuant to a limited time offer, the criterion in paragraph 470-20-40-13(b) is sometimes interpreted in practice to provide induced conversion accounting for Instrument X and extinguishment accounting for the traditional convertible debt instrument. Notably, in both scenarios, the entity's cash flows (from borrowing and settling the debt) and the number of shares issued are identical.
- (b) **FAS 84 did not contemplate cash conversions:** The staff notes that there are no references in FAS 84 to "conversions" that are settled other than through the issuance of equity securities. This indicates that the Board did not consider application of conversion or induced conversion accounting to instruments with cash conversion features (because they did not yet exist).
- (c) **Past induced conversions guidance that was designed to apply to instruments with cash conversion features did not provide guidance based on form of settlement:** The induced conversions guidance under the cash conversions model (FSP APB 14-1) did not provide for different accounting depending on the form of settlement. The guidance on conversions in paragraph 470-20-40-4 now applies to convertible debt instruments with cash conversion features that were previously within the scope of the cash conversions model. Therefore, this approach would be supported by the idea that the scope of the current induced conversion guidance should, like the induced conversion model established in FSP APB 14-1, also not be sensitive to the form of settlement.

### ***Affected Populations***

67. Compared to the existing guidance, this approach would incorporate two changes that would increase the population of transactions that would be accounted for as induced conversions.

- (a) **The focus on fair value as of a specified point in time would increase the population of transactions accounted for as induced conversions:** By replacing the existing criterion in paragraph 470-20-40-13(b) with a criterion that would require an entity to determine whether incremental fair value is provided as of a specific point in time (for example, as the offer, acceptance, or settlement date), the staff thinks that transactions that some practitioners believe should be accounted for as extinguishments under current guidance would be accounted for as induced conversions. For example, the agenda request described an interpretation of the existing guidance that, even if a premium is offered to induce holders to convert early, certain changes to a VWAP formula would not be eligible to be accounted for as an induced conversion

if the holders could receive less consideration than if they had converted the instrument pursuant to its original conversion terms. By contrast, under the incremental fair value approach, assuming all other criteria to be considered an induced conversion are satisfied, it would not be necessary to assess whether the holder *could ultimately* receive less consideration; the only assessment would be of whether the fair value of the consideration offered under the modified terms is greater than under the original terms at a specific point in time. Therefore, transactions that some believe should be accounted for as extinguishments under current guidance (for example, due to a shortened VWAP period) could be accounted for as induced conversions under this approach. In other words, adding, modifying, or eliminating a VWAP formula would not necessarily affect whether the induced conversion model applies. Instead, an entity would need to assess changes to a VWAP formula in the context of all the changes to the conversions privileges to determine whether incremental fair value is being provided relative to the original terms as of a specific point in time.

- (b) Removing the criterion requiring that all equity securities issuable pursuant to the original conversion terms would increase the population of transactions accounted for as induced conversions:** The agenda request described two views indicating that a change in the form of consideration (including the number of issuable equity securities) would or could preclude a transaction from being accounted for as an induced conversion. Those views either interpret existing guidance to preclude the application of induced conversion accounting to (a) any change to the form of consideration or (b) any change that reduces the number of issuable equity securities. For example, under both of those views, a change that modifies a traditional convertible debt instrument (only settleable in a fixed number of equity securities) to be partially or completely settleable in cash (or other assets), would be accounted for as an extinguishment, even if all other criteria for induced conversion accounting were satisfied. By contrast, because this approach would clarify that changes to the form of settlement would not be determinative; a similar change in settlement terms could potentially be accounted for as an induced conversion. The staff expects that *some transactions* that are currently accounted for as extinguishments solely because of a change in the form of consideration would be accounted for as induced conversions. However, the staff emphasizes that because the other existing criteria for the induced conversion model would still apply, any transactions that do not satisfy those other criteria would still be accounted for as extinguishments.

#### ***Potential Outcomes for Issues 1 and 2***

68. The staff thinks this approach would address Issues 1 and 2 as follows.

- (a) Issue 1 (Conversion with Amended VWAP Terms):

- (i) **How this would affect outcomes:** Because the outcomes would be driven by whether the fair value of modified conversion privileges is greater than the original

conversion privileges as of a specified date, a change to VWAP terms that does not significantly change the fair value of the instrument would be less likely to affect whether the induced conversion model can apply. Therefore, the staff expects that more transactions would be accounted for as induced conversions and that changes to a VWAP formula would be determinative less frequently.

- (ii) **How this would be reflected in the guidance:** This issue would be addressed through updates to the criterion in paragraph 470-20-40-13(b). The Task Force would decide the appropriate date upon which the fair value of the consideration is assessed, which indirectly addresses whether changes in VWAP terms would affect the applicability of the induced conversion model.

(b) Issue 2 (Conversion with Amended Terms for Form of Consideration):

- (i) **How this would affect outcomes:** Under this approach, a change in the form of the consideration would not affect whether the induced conversion guidance applies. Therefore, some transactions that may currently be accounted for under other guidance (for example, as extinguishments) because the form of consideration was different than under the original terms would be accounted for as induced conversions.
- (ii) **How would this be reflected in the guidance:** This Issue would be addressed through updates to the criterion in paragraph 470-20-40-13(b).

## Next Steps

69. The staff is seeking feedback from the Task Force on the following high-level approaches identified to address the three issues in the agenda request:

- (a) For Issue 1 (value of consideration transferred and measurement date) and Issue 2 (form of consideration transferred): The criterion of “the issuance of all of the equity securities issuable” in paragraph 470-20-40-13(b) could be clarified or amended, with other conforming amendments, under either the preexisting contract approach or the incremental fair value approach.
- (b) For Issue 3 (current convertibility): Guidance could be developed to clarify whether the induced conversion guidance is applicable when settling a convertible debt instrument that is not currently convertible.

70. Based on the feedback received and discussion of the potential high-level approaches during this educational session, the staff will conduct additional research and outreach, and plans to provide the Task Force with further-developed alternatives under one approach (if the Task Force has a preferred

approach) or multiple approaches (if the Task Force would like the staff to explore both approaches or other approaches) for deliberation at a future EITF meeting.

## Appendix A

### Agenda Request on Induced Conversions and Board Decision

AR-2022  
Comment Letter No. 6

Ms. Hillary Salo  
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### Agenda Request – Distinguishing Between Induced Conversions and Extinguishments of Convertible Debt Instruments

We appreciate the opportunity to submit an agenda request to the Emerging Issues Task Force (EITF). We request that the EITF address when induced conversion accounting applies to certain settlements of convertible debt instruments that occur on terms that differ from the stated contractual conversion provisions.

#### **Background**

Following the issuance of FASB ASU No. 2020-06, *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* ("ASU 2020-06"), constituents have raised questions about the accounting for certain settlements of convertible debt instruments that do not occur in accordance with the contractual conversion terms of such instruments. These questions primarily relate to convertible debt instruments whose terms permit the issuer to settle conversions partly or wholly in cash (i.e., instruments with cash conversion features, or "CCFs")), but some of the issues described below are not limited to such instruments<sup>1</sup>.

Some of the issues described below were relevant before ASU 2020-06. However, the difference between induced conversion accounting and extinguishment accounting is often more significant to an entity's financial statements after the adoption of ASU 2020-06 because of the elimination of the CCF subsections of ASC 470-20, *Debt: Debt with Conversion and Other Options*. Before ASU 2020-06, all entities that settled convertible debt with CCFs were required to both (1) calculate an extinguishment gain or loss based on the difference between the carrying amount of the liability component and the current fair value of similar debt without a conversion feature and (2) recognize the settlement of the conversion feature in equity. That is, settlements involved both extinguishment accounting and conversion accounting. Conversely, after ASU 2020-06, extinguishment accounting does not apply to settlements of convertible debt pursuant to their contractual conversion terms. However, when extinguishment accounting applies, the gain or loss on extinguishment is now calculated based on the difference between the carrying amount of the convertible debt instrument and the fair value of the consideration issued on settlement (which takes into account the value of the conversion feature). Therefore, the conversion value of the debt can result in significant gains or losses on extinguishment. Appendix A illustrates the difference between induced conversion accounting and extinguishment accounting after adoption of ASU 2020-06.

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<sup>1</sup> In practice, the most common types of convertible debt instruments with CCFs are referred to as "Instrument C" and "Instrument X." Instrument C requires the issuer to satisfy the accreted value of the obligation (i.e., the amount accrued to the benefit of the holder exclusive of any excess conversion spread) in cash and allows the issuer to satisfy the excess conversion value in either cash or shares. Instrument X permits the issuer to satisfy conversions in any combination of cash or shares.

## **Accounting Models**

Under U.S. GAAP, as amended by ASU 2020-06, the following models apply to settlements of convertible debt instruments that are not troubled debt restructurings<sup>2</sup>:

- Conversion accounting:

Conversion accounting applies when settlement occurs pursuant to the stated terms of a substantive conversion feature<sup>3</sup>. The settlement consideration may consist of cash, shares, or a combination thereof (i.e., settlement could be entirely in cash for some convertible debt instruments with CCFs). In accordance with ASC 470-20-40-4, no gain or loss is recognized on conversion of a convertible debt instrument that is presented entirely as a liability regardless of the form of settlement<sup>4</sup>.

- Extinguishment accounting:

Extinguishment accounting applies when (1) settlement of convertible debt is not subject to conversion accounting or (2) there is a substantial modification of a convertible debt instrument. The settlement consideration may consist of cash, shares, or a combination thereof. In accordance with ASC 470-50-40-3 and 40-4, an extinguishment gain or loss is recognized for the difference between the fair value of the consideration transferred and the net carrying amount of the debt.

- Induced conversion accounting:

Induced conversion accounting applies to conversions of convertible debt pursuant to terms that reflect changes made to the original conversion privileges for the purpose of inducing conversion. Induced conversion accounting may be applied only if the conditions in ASC 470-20-40-13 through 40-15 are met and the settlement would otherwise be subject to conversion accounting<sup>5</sup>. The settlement consideration may consist of cash, shares, or a combination thereof. In accordance with ASC 470-20-40-16, the issuer must recognize an expense equal to the fair value of the securities and other consideration transferred in excess of the fair value of the shares issuable pursuant to the instrument's original conversion privileges. After that expense is recognized, the issuer applies conversion accounting.

A settlement is subject to induced conversion accounting, regardless of whether (1) the settlement involves legal exercise of the contractual conversion privilege included in the terms of the debt or (2) the conversion feature is out-of-the-money<sup>6</sup>, if the following conditions in ASC 470-20-40-13 through 40-15 are met:

- The convertible debt's original terms contained a substantive conversion feature.
- Either the issuer or holder has offered revised conversion terms that include additional consideration (e.g., additional shares, cash, warrants, or other securities) to incentivize the holder to convert the debt early.
- The changed conversion terms are exercisable only for a limited period.

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<sup>2</sup> See Appendix B for excerpts from the FASB Accounting Standards Codification.

<sup>3</sup> The FASB Codification does not specifically define "conversion accounting." However, based on practice, we understand that the guidance in ASC 470-20-40-4 applies when a convertible debt instrument (whose conversion feature is not bifurcated as an embedded derivative) is settled for cash and/or shares in accordance with the stated terms of an equity conversion feature.

<sup>4</sup> A charge to earnings would occur if there was a separately recognized equity component for the instrument; however, as discussed below this paper assumes that no such equity component exists.

<sup>5</sup> Induced conversion accounting may not be applied if the settlement is required to be accounted for as an extinguishment.

<sup>6</sup> Case B in ASC 470-20-55-6 through 55-9 illustrates the application of induced conversion accounting to a convertible bond whose conversion feature is out-of-the-money.

- For each instrument converted, all equity securities that were issuable in accordance with the instrument's original conversion terms were issued (i.e., the conversion cannot result in the issuance of fewer shares than required to be issued in accordance with the original conversion terms).

## **Issues**

For purposes of the issues discussed below, it is assumed that that (1) the conversion feature is not bifurcated as an embedded derivative, (2) the convertible debt instrument is not recognized at fair value through earnings, and (3) there is no separately recognized equity component for the convertible debt instrument.

### ***Issue 1: Can induced conversion accounting apply if the cash or shares issued on conversion is calculated in a manner that differs from the original stated conversion privileges because a volume-weighted average price ("VWAP") formula is incorporated, eliminated, or modified?***

Assume an entity makes a limited time offer to holders of convertible debt to provide additional consideration (a premium) if they convert their instruments early. The consideration paid by the entity will be entirely in cash, which is a settlement alternative included in the original terms of the instrument. The offer either:

- incorporates a VWAP formula that is used to calculate the excess conversion spread when the original conversion terms did not contain such a provision,
- eliminates a VWAP formula that is included in the instrument's stated terms,
- shortens the VWAP period from the stated VWAP formula in the contractual terms of the instrument (e.g., the contractual conversion terms refer to a 30-day VWAP period to calculate the excess conversion value and the early settlement involves a 5-day VWAP period), or
- otherwise changes the VWAP formula that is included in the instrument's stated terms.<sup>7</sup>

#### **View A**

No. Proponents of View A believe that even though there is a premium offered to induce holders to convert early, the incorporation of, elimination, or change to, the VWAP formula could result in the holders receiving less consideration than if they had converted the instrument pursuant to its original conversion terms. For example, when the VWAP period is shortened and/or the percentage of shares to which it applies is reduced, if the entity's stock price increases during the original VWAP period, holders could receive less value under the amended terms than if they had converted under the original terms of the instrument. Proponents of View A do not believe that the probability of receiving less value is a relevant consideration. Furthermore, proponents of View A note that ASC 470-20-40-15 does not refer to changes in the calculation of the consideration paid on settlement. Therefore, induced conversion accounting does not apply because the condition in ASC 470-20-40-13(b) is not met.

#### **View B**

Yes. Proponents of View B believe this transaction can qualify for induced conversion accounting because (1) it involves early conversion of the instrument (and therefore is consistent with the reason for induced conversion accounting, which is to induce holders to convert the instrument early) and (2) *at the*

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<sup>7</sup> Actual situations in practice are often more complex. For example, the original conversion terms might include a VWAP formula, whereas the offered terms might include elimination of the VWAP formula. Alternatively, instead of the VWAP formula applying to the full conversion value, it might only apply to a percentage of the shares (e.g., 95%). In some cases, both the VWAP period and the percentage of shares to which it applies are changed (usually both are reduced).

*date the offer is made*, the consideration transferred includes a premium to the stated conversion terms. Proponents of View B note that the changes to the stated settlement terms occur solely to accelerate conversion. Furthermore, proponents of View B do not believe an entity needs to consider what could happen between the offer date and the settlement date pursuant to either the amended or original conversion terms of the instrument.

#### View C

It depends. Proponents of View C believe that induced conversion accounting is appropriate if the fair value of the consideration *at the date the offer is accepted* exceeds the consideration pursuant to the original conversion privileges. Otherwise, extinguishment accounting applies. Proponents of View C do not believe an entity needs to consider what could happen between the offer acceptance date and the settlement date pursuant to either the amended or original conversion terms of the instrument.

#### ***Issue 2: Can induced conversion accounting apply if the form of the consideration issued on settlement (ignoring the additional consideration or premium) differs from the contractual conversion terms?***

Assume an entity settles a convertible debt instrument entirely in shares and the contractual conversion terms require settlement of the accreted value in cash (i.e., Instrument C). Alternatively, assume a convertible debt instrument requires a contractual conversion to be settled entirely in shares and the issuer satisfies a portion of the contractual conversion in cash.

#### View A

No. ASC 470-20-40-13 requires the settlement include “the issuance of all of the equity securities issuable pursuant to [original] conversion privileges” even if the total consideration exceeds the fair value of the consideration issuable pursuant to the original conversion privileges. Proponents of View A believe that after the adoption of ASU 2020-06 when the settlement of a conversion option may be in shares or cash, the form of the consideration specified in the original terms of the convertible debt instrument must be issued or paid in order to apply induced conversion accounting. Therefore, induced conversion accounting cannot be applied if an entity either:

- satisfies a portion of a conversion in cash and the instrument required such portion to be settled in shares, or
- satisfies a portion of a conversion in shares and the instrument required such portion to be settled in cash (e.g., share settlement of the principal amount of an Instrument C convertible debt instrument).

Proponents of View A believe that ASC 470-20-40-13 indicates that the form of consideration issued on settlement is important to the analysis. Therefore, although not explicitly addressed in U.S. GAAP, induced conversion accounting cannot be applied if an entity settles the principal amount of a convertible debt instrument in shares and the contractual conversion terms required such amount to be settled in cash.

#### View B

Yes. Proponents of View B believe that after the amendments made by ASU 2020-06, the form of consideration used to satisfy a contractual conversion feature is not determinative of whether an induced conversion has occurred. This is supported by ASC 470-20-40-4, which allows conversion accounting in certain circumstances for which the settlement is entirely in cash. This view is also supported by ASC 470-20-40-15, which disregards whether the contractual conversion feature was legally exercised. Proponents of View B believe that the underlying principle in ASC 470-20-40-13 is that the issuer must provide additional consideration beyond the contractual conversion terms to apply induced conversion accounting. That is, if the issuer pays an amount more than the stated conversion value to settle a

convertible debt instrument, the transaction may represent an induced conversion. Proponents of View B acknowledge that the wording in ASC 470-20-40-13 that refers to “the issuance of all the equity securities” has not been updated to reflect the guidance in ASU 2020-06 and the nature of convertible debt instruments that exist in today’s marketplace.

#### View C

It depends. Proponents of View C agree with View A that the language “issuance of all the equity securities” in ASC 470-20-40-13 precludes induced conversion accounting if an entity satisfies a portion of a conversion in cash and the instrument required such portion to be settled in shares. However, proponents of View C note that there is no prohibition on applying induced conversion accounting if an entity satisfies a portion of a conversion in shares and the instrument required such portion to be settled in cash. Therefore, induced conversion accounting is not precluded just because the principal or accreted value of an Instrument C convertible debt instrument is settled in shares.

#### ***Issue 3: Can induced conversion accounting apply to the settlement of a convertible debt instrument that is not currently convertible?***

#### View A

No. Proponents of View A believe that a settlement cannot be considered a conversion if the instrument was not convertible at the settlement date. Since the transaction is not a conversion for accounting purposes, extinguishment accounting must be applied.

#### View B

Yes. Proponent of View B note that the guidance on induced conversions does not refer to whether the instrument is currently convertible; therefore, such characteristic is not relevant. Rather, the early settlement of a convertible debt instrument is consistent with the concepts of induced conversion accounting. Proponents of View B note that View A would have the effect of requiring extinguishment accounting to transactions that substantively reflect conversions, which is inappropriate.

Yours truly,

Deloitte & Touche LLP

Ernst & Young LLP

KPMG LLP

PricewaterhouseCoopers LLP

## **Appendix A – Illustration of Differences Between Induced Conversion and Extinguishment Accounting**

### **Example 1: Conversion Feature is “In-the-Money”**

ABC Corp. has convertible debt outstanding with a \$1,000 net carrying amount. The ifconverted value of the debt is \$1,500. ABC Corp. settles the instrument in a transaction in which \$100 of additional consideration is provided to the holder.

If extinguishment accounting is applied, ABC Corp. recognizes a *loss of \$600* (i.e., \$1,600 - \$1,000). If induced conversion accounting is applied, ABC Corp. recognizes a *loss of \$100* equal to the additional consideration provided.

### **Example 2: Conversion Feature is “Out-of-the-Money”**

XYZ Corp. has convertible debt outstanding with a \$1,000 net carrying amount. The ifconverted value of the debt is \$500. XYZ Corp. settles the instrument in a transaction in which \$100 of additional consideration is provided to the holder.

If extinguishment accounting is applied, XYZ Corp. recognizes a *gain of \$400* (i.e., \$1,000 - \$600). If induced conversion accounting is applied, ABC Corp. recognizes a *loss of \$100* equal to the additional consideration provided.

## **Appendix B – Relevant FASB Accounting Standards Codification Guidance**

### **Conversion Accounting**

**470-20-40-4** If a convertible debt instrument accounted for in its entirety as a liability under paragraph 470-20-25-12 is converted into shares, cash (or other assets), or any combination of shares and cash (or other assets), in accordance with the conversion privileges provided in the terms of the instrument, upon conversion the carrying amount of the convertible debt instrument, including any unamortized premium, discount, or issuance costs, shall be reduced by, if any, the cash (or other assets) transferred and then shall be recognized in the capital accounts to reflect the shares issued and no gain or loss is recognized.

### **Extinguishment Accounting**

**470-50-40-3** In an early extinguishment of debt through exchange for common or preferred stock, the reacquisition price of the extinguished debt shall be determined by the value of the common or preferred stock issued or the value of the debt — whichever is more clearly evident.

**470-50-40-4** The extinguishment of convertible debt does not change the character of the security as between debt and equity at that time. Therefore, a difference between the cash acquisition price of the debt and its net carrying amount shall be recognized currently in income in the period of extinguishment as losses or gains.

### **Induced Conversion Accounting**

**470-20-40-13** The guidance in paragraph 470-20-40-16 applies to conversions of convertible debt to equity securities pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance (including changes that involve the payment of consideration) for the purpose of inducing conversion. That guidance applies only to conversions that both:

- a. Occur pursuant to changed conversion privileges that are exercisable only for a limited period of time (inducements offered without a restrictive time limit on their exercisability are not, by their structure, changes made to induce prompt conversion)
- b. Include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance for each debt instrument that is converted, regardless of the party that initiates the offer or whether the offer relates to all debt holders.

**470-20-40-14** A conversion includes an exchange of a convertible debt instrument for equity securities or a combination of equity securities and other consideration, whether or not the exchange involves legal exercise of the contractual conversion privileges included in terms of the debt. The preceding paragraph also includes conversions pursuant to amended or altered conversion privileges on such instruments, even though they are literally provided in the terms of the debt at issuance.

**470-20-40-15** The changed terms may involve any of the following:

- a. A reduction of the original conversion price thereby resulting in the issuance of additional shares of stock

- b. An issuance of warrants or other securities not provided for in the original conversion terms
- c. A payment of cash or other consideration to those debt holders that convert during the specified time period.

The guidance in the following paragraph does not apply to conversions pursuant to other changes in conversion privileges or to changes in terms of convertible debt instruments that are different from those described in this paragraph.

**470-20-40-16** If a convertible debt instrument is converted to equity securities of the debtor pursuant to an inducement offer (see paragraph 470-20-40-13), the debtor shall recognize an expense equal to the fair value of all securities and other consideration transferred in the transaction in excess of the fair value of securities issuable pursuant to the original conversion terms. The fair value of the securities or other consideration shall be measured as of the date the inducement offer is accepted by the convertible debt holder. That date normally will be the date the debt holder converts the convertible debt into equity securities or enters into a binding agreement to do so. Until the debt holder accepts the offer, no exchange has been made between the debtor and the debt holder. Example 1 (see paragraph 470-20-55-1B) illustrates the application of this guidance.

**470-20-40-17** The guidance in the preceding paragraph does not require recognition of gain or loss with respect to the shares issuable pursuant to the original conversion privileges of the convertible debt when additional securities or assets are transferred to a debt holder to induce prompt conversion of the debt to equity securities. In a conversion pursuant to original conversion terms, debt is extinguished in exchange for equity pursuant to a preexisting contract that is already recognized in the financial statements, and no gain or loss is recognized upon conversion.