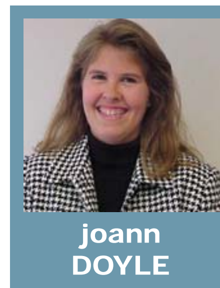
News Updates for Publicly-Traded Companies

SEC Advisor

January 2008

Proposed FASB Staff Position ('FSP') No. APB 14-a

"Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)"



joann
DOYLE

This FSP applies to convertible debt instruments that, by their stated terms, may be settled in cash (or other assets) upon conversion, including partial cash settlement, unless the embedded conversion option is required to be separately accounted for as a derivative under Statement 133. Convertible preferred shares that are accounted for in equity (or temporary equity) are not within the scope of this FSP.

The FSP clarifies that convertible debt instruments that may be settled in cash upon conversion (including partial cash settlement) are not addressed by paragraph 12 of APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*. This FSP also nullifies (Nos. 90-19 and 03-7) or amends (Nos. 98-5, 99-1, 00-27, 04-8, and 05-1) certain EITFs. The FASB Board believes that the consensus in EITF Issue No. 90-19 had inappropriately expanded the application of the guidance in paragraph 12 of Opinion 14.

Prior to the FSP, securities which give the issuer the option to settle the principal amount of the security in cash and to settle conversion value in excess of principal in cash or shares (see "Instrument C" in EITF 90-19) were afforded more favorable interest expense recognition and EPS calculation treatment than other types of debt securities.

Recognition and Initial Measurement

This FSP requires that convertible debt instruments within its scope be separated into their liability and equity components, with the liability component recorded at the fair value of a similar liability that does not have an associated equity component, and the remainder attributed to the equity component. The separation approach results in an issuer recognizing the same interest cost it would have incurred had it issued a comparable debt instrument without the embedded conversion option. The equity component is a residual amount representing the interest cost that was "paid" with the conversion option.

Subsequent Measurement

The excess of the principal amount of the liability component over its initial fair value is amortized to interest cost using the interest method. Debt discounts are to be amortized over the expected life of a similar liability that does not have an associated equity component. If the fair value was initially measured using a valuation technique consistent with an income approach, the issuer shall consider the periods of cash flows used in the fair value measurement when determining the discount amortization period. The treatment of debt discounts is consistent with the objective that an issuer's reported interest cost should reflect its nonconvertible debt borrowing rate.

The equity component is not re-measured as long as it continues to meet the conditions for equity classification in Issue 00-19. If re-measurement is necessary, the difference between the amount previously recognized in equity and the fair value of the conversion option at the date of reclassification is accounted for as an adjustment to stockholders' equity.

Modifications and Derecognition

Modification of the conversion option does not result in a change to the proposed accounting, unless extinguishment accounting is required under EITF Nos. 06-6 and 96-19.

Status

The comment period has ended and the FSP is being re-deliberated.

For more information on this FSP, please contact Joann Doyle.

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