

Interpretation of the Emerging Accounting Issues Working Group**INT 02-19: EITF 01-1: Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash****ISSUE NULLIFIED BY SSAP NO. 95****INT 02-19 Dates Discussed**

September 10, 2002; December 8, 2002

INT 02-19 References

SSAP No. 28—Nonmonetary Transactions (SSAP No. 28)

SSAP No. 95—Exchange of Nonmonetary Assets, A Replacement of SSAP No. 28—Nonmonetary Transactions (SSAP No. 95)

INT 02-19 Issue

1. Questions sometimes arise about the appropriate recognition and measurement by an issuer for a convertible instrument that is issued to a nonemployee in exchange for goods or services or a combination of goods or services and cash. The convertible instrument contains a nondetachable conversion option that permits the holder to convert the instrument into the issuer's stock.

2. *APB Opinion 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB No. 14), *EITF No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios* (EITF 98-5), and *EITF No. 00-27, Application of Issue No. 98-5 to Certain Convertible Instruments* (EITF 00-27) address an issuer's accounting for a conversion option for which the issuer's stock is the underlying when that conversion option is embedded in a debt or preferred stock instrument that is issued in a financing transaction. *FASB Statement No. 123, Accounting for Stock-Based Compensation* and *EITF No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18) address the issuer's accounting for equity securities (including convertible securities that are in equity form or that can be converted into equity securities) issued in exchange for goods or services.

3. The issues are:

Issue 1 – For a convertible instrument issued in exchange for goods or services (or a combination of goods or services and cash), whether the intrinsic value of the conversion option should be measured under the EITF 98-5 model, as interpreted by EITF 00-27, at (a) the commitment date for the instrument as defined in EITF 00-27, (b) the measurement date under EITF 96-18, or (c) the later of the two dates

Issue 2 – If a convertible instrument is issued in exchange for goods or services (or a combination of goods or services and cash), how to measure the fair value of that instrument

Issue 3 – Whether distributions paid or payable on a convertible instrument issued or granted in exchange for goods or services (or a combination of goods or services and

cash) should be recognized as a financing cost (that is, interest expense or dividends) or as a cost of the goods or services received or receivable from the counterparty

Issue 4 – A company issues a convertible instrument for cash proceeds that indicate that the instrument includes a beneficial conversion option. The purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract. The issue is whether any goods or services provided (received) by the purchaser should be accounted for as an adjustment to the consideration for the convertible instrument.

INT 02-19 Discussion

4. The working group reached a consensus to adopt the consensus positions of *EITF 01-1, Accounting for a Convertible Instrument Granted or Issued to a Nonemployee for Goods or Services or a Combination of Goods or Services and Cash* with certain modifications to refer to the guidance in SSAP No. 95 and to incorporate guidance in EITF 96-18 regarding the measurement date. EITF 96-18 was previously rejected by the working group in *INT 99-13: EITF 96-18: Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* in the context of SSAP No. 13—*Stock Options and Stock Purchase Plans*; however, the measurement guidance included in Issue 1 of EITF 96-18 is adopted in this INT.

a. On Issue 1, the EAIWG reached a consensus that if a convertible instrument is issued in exchange for goods or services, the measurement date under Issue 96-18 should be used both to measure the fair value of the convertible instrument and to measure the intrinsic value, if any, of the conversion option. Issue 96-18 states that the measurement date is the earlier of either of the following:

1. The date at which a commitment for performance by the counter party to earn the convertible instrument is reached (a “performance commitment”); or
2. The date at which the counter party’s performance is complete.

b. On Issue 2, the EAIWG believes it is impracticable to provide detailed guidance on determining the fair value of a convertible instrument. However, in order to promote consistent application of the accounting guidance cited in this Issue to convertible instruments, the EAIWG reached a consensus on the following guidelines for determining the fair value of convertible instruments:

- i. Consistent with SSAP No. 95, the fair value of an equity instrument shall be determined based on either the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. Accordingly, if the fair value of the goods or services received is reliably determinable, and the issuer has not recently issued similar convertible instruments, the fair value of the goods or services should be used to measure the transaction.
- ii. Recent issuances of similar convertible instruments for cash to parties that only have an investor relationship with the issuer may provide the best evidence of fair value of the convertible instrument.
- iii. If reliable information about (a) or (b), above, is not available, the fair value of the convertible instrument should be deemed to be no less than the fair value of the equity shares into which it can be converted.

- c. On Issue 3, the EAIWG reached a consensus that once the instrument is considered "issued" for accounting purposes, distributions paid or payable should be characterized as financing costs. Prior to that time, distributions paid or payable under the instrument should be characterized as a cost of the underlying goods or services. The EAIWG observed that the accretion of a discount on a convertible instrument resulting from a beneficial conversion option does not begin until the instrument is issued for accounting purposes.
- d. On Issue 4, the EAIWG reached a consensus that the terms of both the agreement for goods or services and the convertible instrument should be evaluated to determine whether their separately stated pricing is equal to the fair value of the goods or services and convertible instrument. If that is not the case, the terms of the respective transactions should be adjusted. The convertible instrument should be recognized at its fair value with a corresponding increase or decrease in the purchase or sales price of the goods or services. The EAIWG acknowledged the difficulty in evaluating whether the separately stated pricing of a convertible instrument is equal to its fair value. The EAIWG noted that if an instrument issued to a goods or services provider (or purchaser) is part of a larger issuance, a substantive investment in the issuance by unrelated investors (who are not also providers or purchasers of goods or services) may provide evidence that the price charged to the goods or services provider represents the fair value of the convertible instrument.

INT 02-19 Status

5. No further discussion is planned.