# Interpretation of the Emerging Accounting Issues Working Group

# INT 04-07: EITF 02-15: Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are Within the Scope of FASB Statement No. 84

## ISSUE NULLIFIED BY SSAP NO. 15

**INT 04-07 Dates Discussed**

June 13, 2004; September 12, 2004; March 3, 2012; August 31, 2012

**INT 04-07 References**

*SSAP No. 15—Debt and Holding Company Obligations* (SSAP No. 15)
*SSAP No. 103—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (SSAP No. 103)

**INT 04-07 Issue**

1. *EITF 02-15, Determining Whether Certain Conversions of Convertible Debt to Equity Securities Are Within the Scope of FASB Statement No. 84* (EITF 02-15) provides guidance on the application of *FASB Statement 84*, *Induced Conversions of Convertible Debt* (FAS 84) when an offer for consideration in excess of original conversion terms is made by the debt holder rather than the debtor.

2. EITF 02-15 utilizes guidance from several sources in the GAAP hierarchy. The statutory accounting status of these statements is listed below:

   a. *FASB Statement No. 15*, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, which was adopted by *SSAP No. 36—Troubled Debt Restructuring.*

   b. FAS 84, which was adopted by SSAP No. 15.

   c. *FASB Statement No. 140*, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, which was adopted with modification in *SSAP No. 91R—Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* and refers back to SSAP No. 15 for guidance regarding any troubled debt restructuring. (FAS 166 amended FAS 140 and was adopted with modification in SSAP No. 103. SSAP No. 103 superseded SSAP No. 91R but continues to reference SSAP No. 15 for guidance regarding trouble debt restructuring.)

3. The following is excerpted from EITF 02-15:

   1. Opinion 26 provides guidance on the accounting for extinguishments of debt prior to the scheduled maturity date. In paragraph 19 of Opinion 26, the Accounting Principles Board concluded that "all extinguishments of debt are fundamentally alike. The accounting for such transactions should be the same regardless of the means used to achieve the extinguishment." Paragraph 20 of Opinion 26 specifies the accounting for early extinguishments, and states, "A difference between the reacquisition price and the net carrying amount of the extinguished debt should be recognized currently in income of the period of extinguishment as losses or gains and identified as a separate item….

Gains and losses should not be amortized to future periods" (footnote reference omitted).

2. With respect to convertible debt, paragraph 21 of Opinion 26 states, "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 should be recognized currently in income in the period of extinguishment as losses or gains."

3. Statement 84 was issued to amend Opinion 26, to exclude from its scope convertible debt that is converted to equity securities of the debtor pursuant to conversion privileges different from those included in the terms of the debt at issuance, and the change in conversion privileges is effective for a limited period of time, involves additional consideration, and is made to induce conversion. That Statement applies only to conversions that both (a) occur pursuant to changed conversion privileges that are exercisable only for a limited period of time and (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. When convertible debt is converted to equity securities of the debtor pursuant to an inducement offer (described above), the debtor shall recognize an expense equal to the excess of the fair value of all securities and other consideration transferred in the transaction over the fair value of securities issuable pursuant to the original conversion terms.

4. A question has arisen as to whether Statement 84 applies to conversions of convertible debt when the "offer" for consideration in excess of the original conversion terms was made by the debt holder rather than the debtor. In certain circumstances, for example, a bondholder may be a third party that purchased the bonds in the open market (often at a significant discount from face value) and approached the debtor to increase the conversion terms of the notes. In many of those circumstances, the offer to induce conversion is not extended to all debt holders; rather, the conversion involves only the specific debt holder that approached the debtor. The following example is provided:

Company A issued publicly traded convertible bonds (the Bonds) during a prior period. Currently, the Bonds are trading at a price that is significantly less than the carrying value (possibly due to a decline in Company A's stock price or credit rating or both). The original conversion price of the Bonds is $50 (20 shares of common stock per bond), and Company A's common stock is currently trading at $25 per share. On an individual basis, bondholders approach Company A with an offer for Company A to purchase the Bonds by providing consideration in excess of the conversion terms. Assume that on the date of the exchange, each Bond has the following values:

| | |
|---|---|
| Company A's carrying value of the Bonds | $1,000 |
| Current fair value of the Bonds | $750 |

A bondholder approaches Company A with the following two independent offers that are exercisable by Company A for a limited period of time:

1. Company A may purchase the Bonds in exchange for the Bonds' original conversion of 20 shares of Company A common stock ($500 fair value) and $300 cash.

2. Company A may purchase the Bonds in exchange for 32 shares of Company A common stock ($800 fair value).

5. The issue is whether Statement 84 applies when the "offer" for consideration in excess of the original conversion terms is made by the debt holder rather than the debtor, including (a) circumstances in which a third party purchases the debt securities in the open market (at a significant discount from face value) and approaches the debtor to

 

increase the conversion terms of the debt and (b) circumstances in which the offer to induce conversion is not extended to all debt holders.

EITF 02-15 Discussion

6. The Task Force reached a consensus that Statement 84 applies to all conversions of convertible debt that (a) occur pursuant to changed conversion privileges that are exercisable only for a limited period of time and (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.

**INT 04-07 Discussion**

4. The working group reached a consensus to adopt EITF 02-15 as an interpretation of SSAP No. 15. Thus, when an offer for consideration in excess of original conversion terms is made by the debt holder rather than the debtor, the accounting guidance is contained in SSAP No. 15.

**INT 04-07 Status**

5. No further discussion is planned.