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Summary of the September Meeting of the Emerging Issues Task Force

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This *EITF Snapshot* summarizes the September 3, 2020, meeting of the Emerging Issues Task Force (EITF or “Task Force”). Initial Task Force consensuses (“consensuses-for-exposure”) are exposed for public comment upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting to reach a final consensus. Those final consensuses are then provided to the FASB for final ratification and, ultimately, issuance as an Accounting Standards Update (ASU).

After each meeting, the official EITF minutes, including the results of the FASB’s ratification process, will be posted to the Deloitte Accounting Research Tool (DART) and to the FASB’s Web site (note that the official EITF minutes may contain details that differ from those in this publication). EITF Issue Summaries (released before the meeting and used to frame the discussion) are also available on those sites.

Issue 19-C, "Warrant Modifications: Issuers' Accounting for Modifications of Equity Classified Freestanding Call Options That Are Not Within the Scope of Topic 718, *Compensation — Stock Compensation*, or Topic 815, *Derivatives and Hedging*"

Status: Initial deliberations.

Affects: Entities that issue freestanding equity-classified warrants or written call options that are similar to warrants in economic substance when the warrants are modified and classified in equity after modification.[1]

Background: A warrant is a written call option under which the holder has the right, but not the obligation, to purchase a specified quantity or amount of common stock from the issuing entity at a specified price. An issuer may consider modifying outstanding warrants for various reasons, including, but not limited to, raising cash and capital, inducing additional financing, compensating for goods or services, or making a distribution of value to a warrant holder similar to a dividend.

Stakeholders have raised concerns that U.S. GAAP guidance does not address the accounting for warrant modifications from the issuer's perspective. Such stakeholders have indicated that diversity in practice exists because entities analogize to other Codification topics and SEC guidance to reflect the economics of the warrant modification and therefore achieve different accounting outcomes for economically similar transactions. Accordingly, stakeholders have asked the Board to provide guidance on whether the effect of a warrant modification should be (1) recognized through earnings immediately, (2) amortized into earnings as a debt issuance cost, or (3) recognized as a deemed dividend or other equity transaction.

At its September 18, 2019, meeting, the FASB decided to add a project on warrant modifications to the EITF's technical agenda. The scope of the project, when it was added to the technical agenda, was limited to modifications of equity-classified warrants that remain equity-classified after modification.

Summary: At its September 3, 2020, meeting, the Task Force discussed the accounting for modifications and reached a consensus-for-exposure on this Issue as follows:

- The proposed guidance will be a principles-based framework for determining the issuer's accounting for modifications on the basis of the economic substance of the transaction in the same manner as if the issuer had paid cash.
  - If the nature of the modification is a financing transaction to raise equity, an entity should account for the additional value as an equity issuance cost in accordance with ASC 340.[2]
  - If the nature of the modification is a financing transaction to raise debt, an entity should account for the additional value as a debt discount or debt issuance cost in accordance with ASC 835.
  - If the nature of the modification is a financing transaction to modify debt, an entity should account for the additional value in accordance with ASC 470-50.
  - If the nature of the modification is compensation for goods or services, an entity should account for the additional value as compensation cost in accordance with ASC 718.
- If, after an entity evaluates the substance of the transaction, the modification is not related to financing transactions or compensation for goods or services as described

[1] As mentioned in the Summary, the Task Force decided to modify the scope of the Issue to include all freestanding equity-classified derivative instruments.

[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

above, the entity should account for the effect of the modification as a deemed dividend.

- There are no new modification-related disclosure and presentation requirements apart from those currently in ASC 260, ASC 505-10, ASC 815-40, and ASC 850.

In addition, the Task Force discussed whether the scope of the proposed guidance should be limited to equity-classified warrants and tentatively decided to expand the Issue's scope to include all freestanding equity-classified derivative instruments.

Effective Date and Transition: The Task Force tentatively decided that an entity would have the option of applying either a retrospective or prospective transition method when adopting the final guidance and tentatively decided not to provide any additional transition disclosure requirements apart from the disclosure requirements in ASC 250. The Task Force will discuss the effective date at a future meeting after considering stakeholder feedback on the proposed amendments.

Next Steps: The FASB staff will draft a proposed ASU and will issue this proposal for public comment provided that it is ratified by the Board.

Administrative Matters

The next EITF decision-making meeting is tentatively scheduled for November 5, 2020.

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