

Convertible Debt Accounting Update

Accounting Standards Update (ASU) 2020-06

Key Changes regarding Convertible EPS Accounting	<p>After a year of deliberations, the FASB has finally issued Accounting Standards Update (ASU) 2020-06 which:</p> <ul style="list-style-type: none"> (1) improves the GAAP interest expense treatment of convertibles that include potential cash settlement but (2) precludes the use of Treasury Stock Method in convertibles with Flexible Settlement w/ Net Share Settlement Intent
Effectiveness Date	<ul style="list-style-type: none"> • The FASB has specified that an entity should adopt the guidance as of the beginning of its annual fiscal year, and for public companies, these changes will be effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years <ul style="list-style-type: none"> • Early adoption is permitted for fiscal years beginning after December 15, 2020, including interim periods • A “smaller reporting company” (SRC) will have 2 additional years to adopt these changes, and the eligibility will be based on SRC determination as of August 5, 2020
Transition Method	<ul style="list-style-type: none"> • The ASU allows entities to adopt the guidance through one of the two following methods: <ul style="list-style-type: none"> • Modified Retrospective Method: Apply the changes from the time of adoption; Recognize the cumulative effect of the change as an adjustment to equity at the date of adoption; No need to restate financial statements or EPS for prior periods • Fully Retrospective Method: Apply the changes and disclose the effect on net income, any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted; Recognize the cumulative effect of the change as an adjustment to equity in the first comparative period presented
Other Relevant Changes	<ul style="list-style-type: none"> • In addition to the aforementioned changes, the ASU removes several of the features needed for equity contracts to be exempt from derivative accounting; The new rules remove the requirements (1) to consider whether a contract would be settled in registered shares, (2) to consider whether collateral is required to be posted, and (3) to assess shareholder rights <ul style="list-style-type: none"> • These will make convertible and call spread accounting slightly simpler but should not change the accounting treatment as those instruments generally qualified for equity treatment under the old accounting rules • Also, going forward, an issuer should use the average share price for a given reporting period (and not the quarter-end stock price) to calculate any in-the-money share dilution



Convertible Debt Accounting Update (Cont'd)

	Physical Settlement	Net Share Settlement (Instrument C)	Flexible Settlement (Instrument X)	Flexible Settlement w/ Net Settlement Intent
Description	<ul style="list-style-type: none"> Always settle conversions in stock 	<ul style="list-style-type: none"> Settle conversions with (1) cash for par plus (2) shares / cash for the value in excess of par at issuer's option 	<ul style="list-style-type: none"> Settle conversions with any combination of cash and stock, at issuer's option 	<ul style="list-style-type: none"> Flexible settlement per indenture "Intent" and "ability" rep that issuer would net share settle
Old Accounting	<ul style="list-style-type: none"> Single convertible debt liability on balance sheet Interest expense reflects cash coupon If-Converted Method (worse of "coupon" and "all underlying shares") for diluted EPS 	<ul style="list-style-type: none"> Bifurcate into OID debt and equity Interest expense reflects cash coupon + OID accretion (i.e. approximates straight debt rate) In-the-money shares only for dilution 	<ul style="list-style-type: none"> Bifurcate into OID debt and equity Interest expense reflects cash coupon + OID accretion (i.e. approximates straight debt rate) Bifurcated If-Converted Method (worse of "coupon + OID accretion" and "all underlying shares") 	<ul style="list-style-type: none"> Bifurcate into OID debt and equity Interest expense reflects cash coupon + OID accretion (i.e. approximates straight debt rate) In-the-money shares only for dilution
New Accounting	<ul style="list-style-type: none"> No change 	<ul style="list-style-type: none"> Single convertible debt liability on balance sheet Interest expense reflects cash coupon In-the-money shares only for dilution 	<ul style="list-style-type: none"> Single convertible debt liability on balance sheet Interest expense reflects cash coupon If-Converted Method (worse of "coupon" and "all underlying shares") for diluted EPS 	<ul style="list-style-type: none"> Single convertible debt liability on balance sheet Interest expense reflects cash coupon If-Converted Method (worse of "coupon" and "all underlying shares") for diluted EPS (no Treasury stock treatment)

