

# Snapshot

SEPTEMBER 16, 2020  
SNAPSHOT 2020-22

## Modification of equity-classified derivatives: EITF consensus-for-exposure

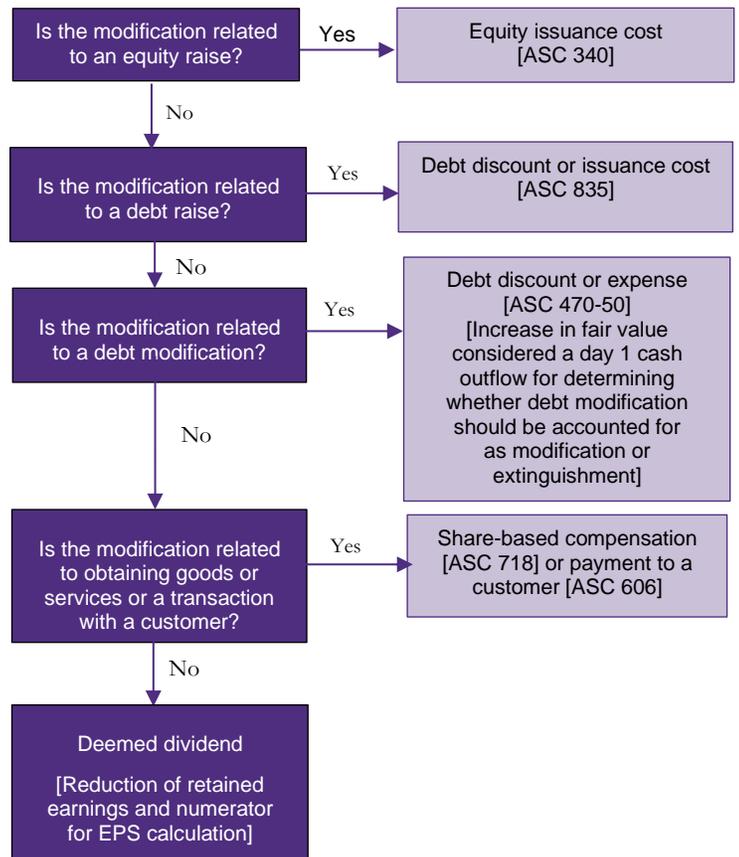
The FASB's Emerging Issues Task Force (EITF) reached a consensus-for-exposure at the September 3, 2020 meeting that would provide guidance on the modification of *all* freestanding equity-classified derivative instruments that remain equity-classified after being modified, for example, freestanding equity-classified warrants. The FASB at its September 16, 2020 meeting ratified the consensus-for-exposure, which will be exposed for public comments as a proposed Accounting Standards Update, with a comment period of 60 days.

Current U.S. GAAP does not provide guidance on the modification of freestanding equity-classified derivative instruments, which has resulted in diversity in practice. The consensus-for-exposure reached by the EITF would provide guidance on how to account for a modification based on the nature and economic substance of the modification and the principle that the accounting outcome of a transaction should be same, regardless of whether the entity pays cash or modifies an equity-classified derivative instrument to provide the holder of the instrument with the same economic benefit as a cash payment. The EITF tentatively concluded that the modification would fall into one of four categories, as summarized in the flowchart at right, and that the accounting for the modification would be based on the nature of the transaction.

The consensus-for-exposure aligns the guidance on measuring the effect of a modification of equity-classified derivative instruments with the guidance in ASC 718, *Compensation – Stock Compensation*, which requires entities to measure the value of such a modification as the difference between the fair value of

the instrument immediately before and immediately after the modification.

If there is no difference between the fair values, or if the fair value of the instrument immediately after the modification is less than the fair value of the instrument immediately before the modification, then no accounting for the modification is required.



If there is more than one element in a transaction (for example, if the modification involves both debt modification and equity issuance), then the guidance requires the change in fair value to be allocated to each element.

## **Transition and transition disclosures**

The EITF decided that the proposed guidance could be applied either prospectively to modifications that occur after the adoption of the final guidance or retrospectively to all periods presented in the financial statements.

The EITF also decided that the entities applying the guidance on a retrospective basis should provide the transition disclosures in accordance with ASC 250, *Accounting Changes and Error Corrections*, except for the effect of adoption on the financial statement line items, including earnings per share for the current period and for any prior periods retrospectively adjusted.

Early adoption of the final guidance, including in an interim reporting period, would be permitted. Early adoption in an interim period should be reflected from the beginning of the fiscal year that includes the interim period of adoption.

## Contacts



**Rahul Gupta**  
Partner  
Accounting Principles Group  
T +1 312 602 8084  
E [rahul.gupta@us.gt.com](mailto:rahul.gupta@us.gt.com)



**Ryan Brady**  
Partner  
Accounting Principles Group  
T +1 312 602 8741  
E [ryan.brady@us.gt.com](mailto:ryan.brady@us.gt.com)

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