New Developments Summary

August 25, 2020
NDS 2020-10

ASU 2020-06 simplifies accounting for convertible instruments and contracts in entity's own equity

Contents

The guidance in ASU 2020-06 simplifies the accounting for convertible debt and convertible preferred stock by removing the requirements to separately present certain conversion features in equity. In addition, the amendments in the ASU also simplify the guidance in ASC 815-40, *Derivatives and Hedging: Contracts in Entity's Own Equity,* by removing certain criteria that must be satisfied in order to classify a contract as equity, which is expected to decrease the number of freestanding instruments and embedded derivatives accounted for as assets or liabilities. Finally, the amendments revise the guidance on calculating earnings per share, requiring use of the if-converted method for all convertible instruments and rescinding an entity's ability to rebut the presumption of share settlement for instruments that may be settled in cash or other assets.

A. Overview

The FASB recently issued ASU 2020-06, *Debt – Debt with Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging – Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*, to reduce complexity in applying GAAP to certain financial instruments with characteristics of liabilities and equity.

The guidance in ASU 2020-06 simplifies the accounting for convertible debt instruments and convertible preferred stock by removing the existing guidance in ASC 470-20, *Debt: Debt with Conversion and Other Options*, that requires entities to account for beneficial conversion features and cash conversion features in equity, separately from the host convertible debt or preferred stock. The guidance in ASC 470-20 applies to convertible instruments for which the embedded conversion features are not required to be bifurcated from the host contract and accounted for as derivatives.

In addition, the amendments revise the scope exception from derivative accounting in ASC 815-40 for freestanding financial instruments and embedded features that are both indexed to the issuer's own stock and classified in stockholders' equity, by removing certain criteria required for equity classification. These amendments are expected to result in more freestanding financial instruments qualifying for equity classification (and, therefore, not accounted for as derivatives), as well as fewer embedded features requiring separate accounting from the host contract.

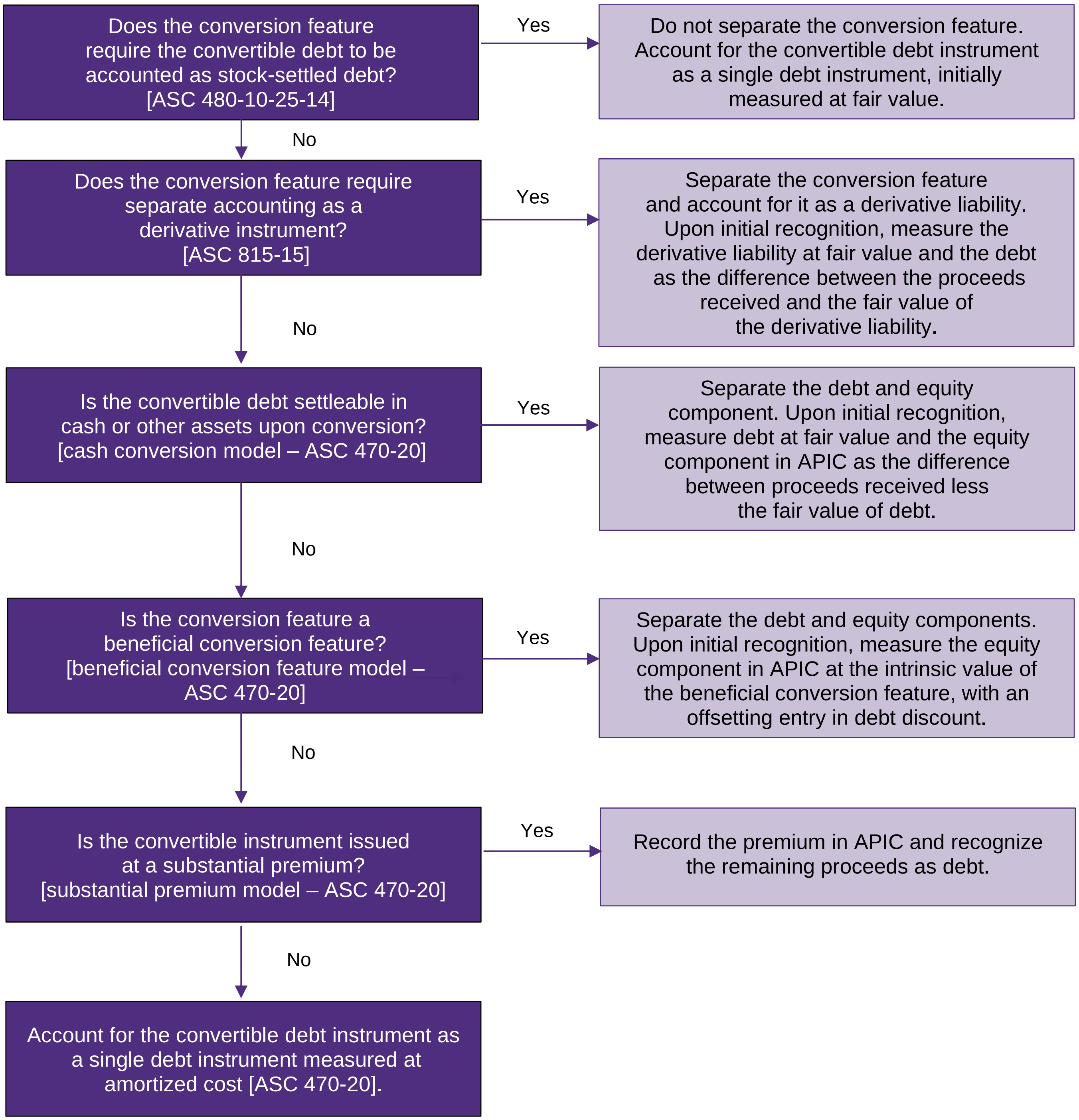
The amendments in ASU 2020-06 further revise the guidance in ASC 260, *Earnings Per Share,* to require entities to calculate diluted earnings per share (EPS) for convertible instruments by using the if-converted method. In addition, entities must presume share settlement for purposes of calculating diluted EPS when an instrument may be settled in cash or shares.

The amendments in ASU 2020-06 are effective for public entities that meet the definition of an SEC filer, excluding smaller reporting companies as defined by the SEC, for fiscal years beginning after December 15, 2021. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2023. Early adoption is permitted, but no earlier than fiscal years beginning after December 15, 2020. Entities should adopt the guidance as of the beginning of the fiscal year of adoption and cannot adopt the guidance in an interim reporting period. See Section G for more about the effective date and transition provisions in ASU 2020-06.

B. Convertible debt instruments

The guidance under current GAAP contains multiple models to account for convertible debt instruments. The flowchart below summarizes the accounting models for convertible debt instruments that exist in U.S. GAAP until the amendments in ASU 2020-06 take effect.

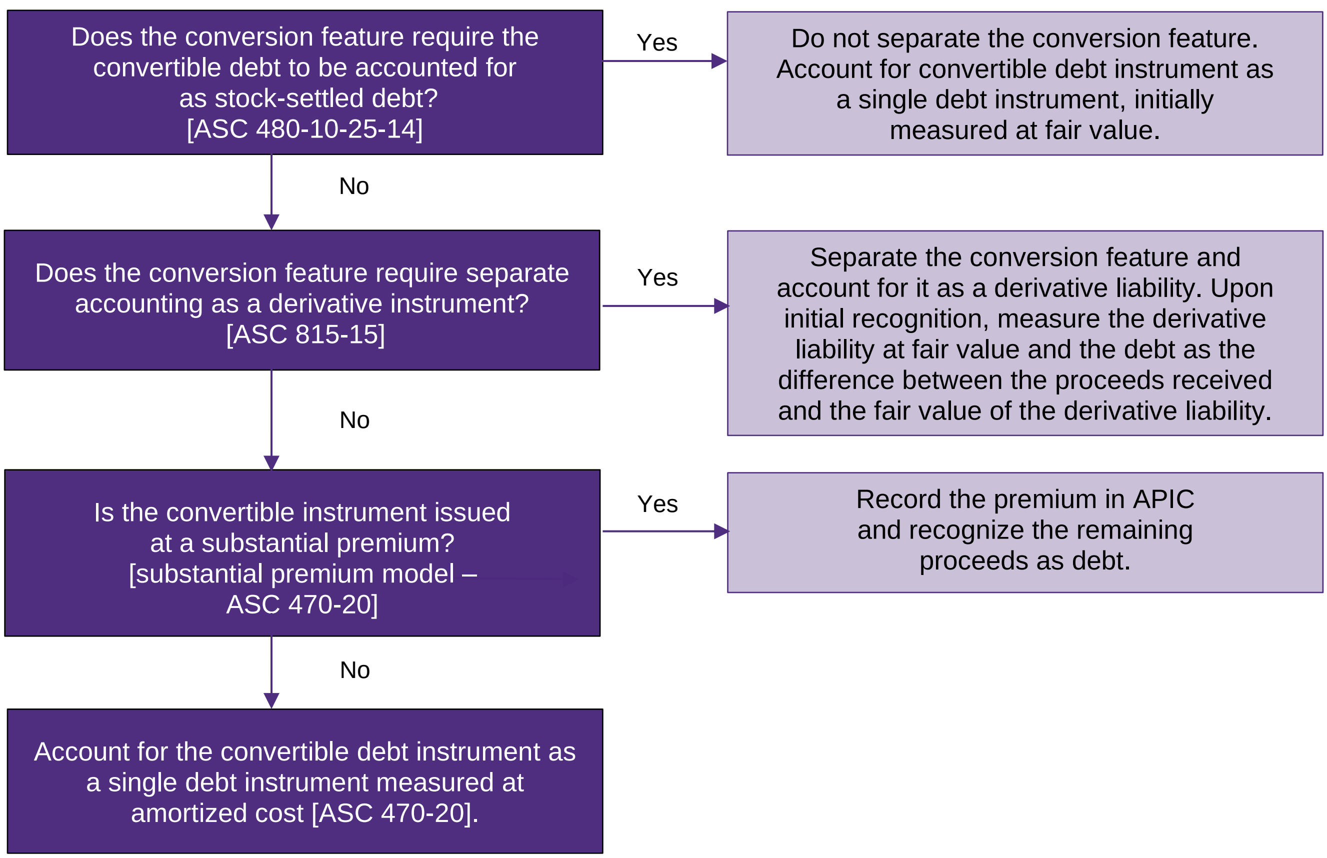
Figure 1: Convertible debt accounting summary (before ASU 2020-06)



The amendments in ASU 2020-06 eliminate the beneficial conversion feature model and the cash conversion model in order to simplify the accounting for convertible debt instruments. Therefore, convertible debt instruments with a conversion feature that does not require derivative accounting under ASC 815, *Derivatives and Hedging,* and does not result in a substantial premium that should be recorded in additional paid-in capital (APIC) must no longer be accounted for separately from the convertible debt instrument.

The following flowchart summarizes the accounting models for convertible debt instruments under the amendments in ASU 2020-06.

Figure 2: Convertible debt accounting summary (after ASU 2020-06)



Disclosures

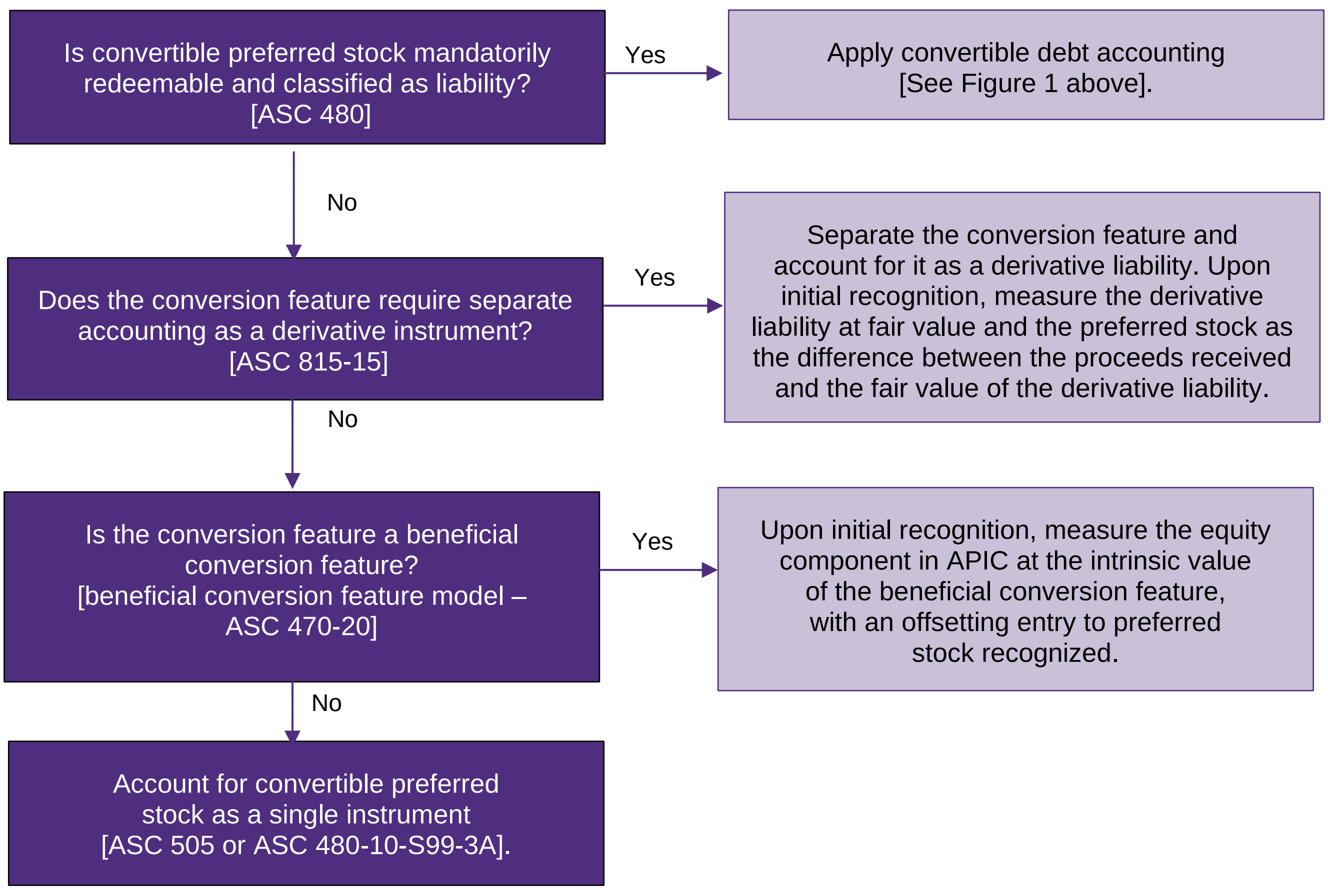
The guidance in ASU 2020-06 updates the disclosure requirements in ASC 470-20, making them easier to understand for financial statement preparers and improving the decision-usefulness and relevance of the information for financial statement users. ASU 2020-06 also introduces a disclosure objective for convertible debt instruments.

Refer to Appendix A for the revised disclosure requirements, including the disclosure objective, for convertible debt instruments.

C. Convertible preferred stock

Similar to the existing guidance for convertible debt, the existing guidance also contains multiple models to account for convertible preferred stock. The flowchart below summarizes the accounting models for convertible preferred stock that currently exist in GAAP before the amendments in ASU 2020-06 take effect. The flowchart assumes that the conversion feature does not require the convertible preferred stock to be accounted for as stock-settled debt, in accordance with ASC 480-10-25-14.

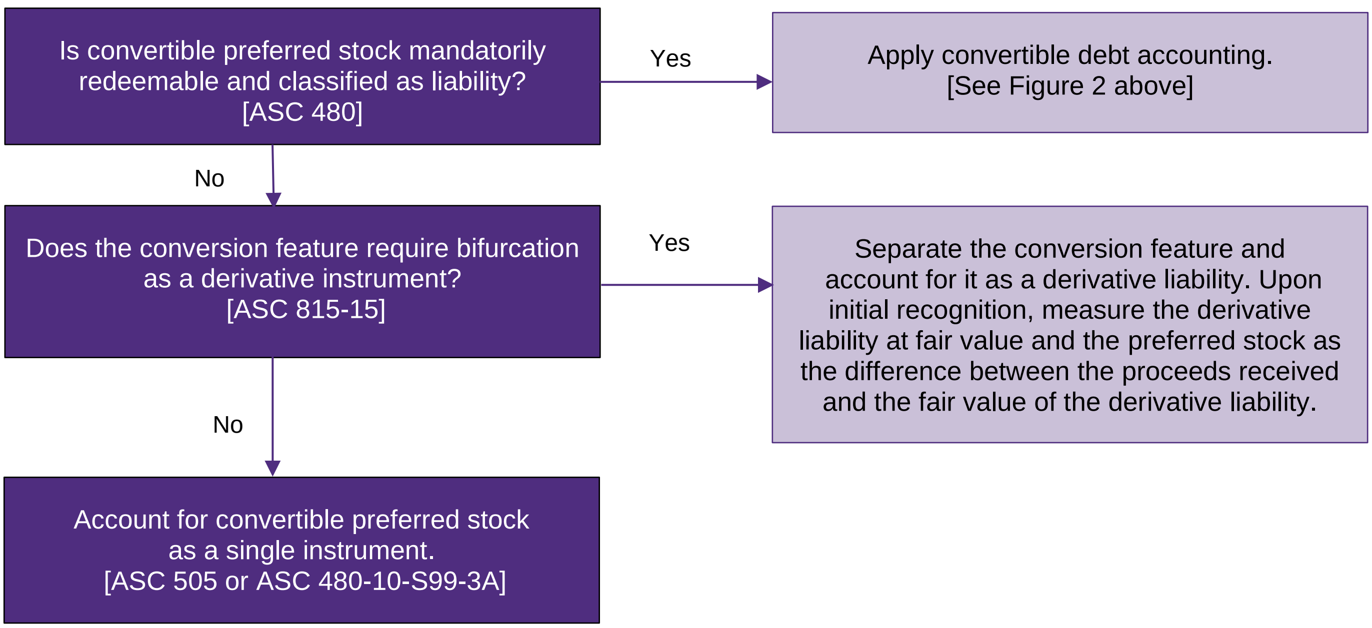
Figure 3: Convertible preferred stock accounting summary (before ASU 2020-06)



Since the amendments in ASU 2020-06 remove the beneficial conversion feature and cash conversion feature models of accounting, entities are no longer required to bifurcate the conversion feature in convertible preferred stock unless the conversion feature is required to be accounted for as a derivative under ASC 815.

The flowchart below summarizes the models to account for convertible preferred stock after the adoption of ASU 2020-06. The flowchart assumes that the conversion option does not require the convertible preferred stock to be accounted for as stock-settled debt, in accordance with ASC 480-10-25-14.

Figure 4: Convertible preferred stock accounting summary (after ASU 2020-06)



Disclosures

The amendments in ASU 2020-06 update the disclosure requirements in ASC 505-10, *Equity,* so that they are easier to understand for financial statement preparers and improve the decision-usefulness and relevance of the information for users. The amendments in ASU 2020-06 also introduce a disclosure objective for convertible preferred stock.

Refer to Appendix B for revised disclosure requirements, including the disclosure objective, for convertible preferred stock.

D. Convertible instruments granted to nonemployees

Under the amendments in ASU 2020-06, a convertible instrument awarded to a nonemployee will continue to be subject to the recognition and measurement guidance in ASC 718, *Compensation: Stock Compensation,* throughout the life of the instrument, unless the instrument's terms are modified after the nonemployee vests in the award but no longer provides goods or services. This amendment makes the guidance on accounting for convertible instruments granted to nonemployees in ASC 718 consistent for both employees and nonemployees.

Under existing GAAP, a convertible instrument award granted to a nonemployee is subject to the recognition and measurement guidance in ASC 718 only until the award is fully vested; upon vesting, the convertible instrument award is accounted for in accordance with other applicable GAAP, such as the guidance in ASC 470-20.

E. Contracts in entity's own equity

The guidance in ASC 815-40 addresses both (1) the classification of a freestanding non-derivative, equity-linked instrument, and (2) whether a derivative that is either a freestanding financial instrument or an embedded feature within a hybrid financial instrument qualifies for a scope exception from the derivative accounting guidance in ASC 815. Under ASC 815-40, an entity must classify a freestanding financial instrument within equity, and is precluded from separating an embedded derivative feature within a hybrid financial instrument (that is, the entity must keep the embedded derivative feature combined with its host), if both of the following conditions exist:

- The instrument's or the embedded derivative feature's settlement amount is based on the difference between a fixed amount of consideration and the fair value of a fixed number of the entity's shares (indexation criterion).
- The instrument or the embedded feature would otherwise qualify for equity classification (the settlement criterion).

The amendments in ASU 2020-06 do not amend the guidance on the indexation criterion but revise the existing guidance on the settlement criterion.

Settlement criterion

ASC 815-40-25 provides guidance for determining whether a freestanding instrument or an embedded feature qualifies for equity classification (that is, does it meet the settlement criterion outlined above). In general, the guidance stipulates that an instrument or feature does not qualify for equity classification if the issuer could be required to settle the instrument or feature in cash, regardless of the likelihood that circumstances would arise requiring cash settlement. In particular, the guidance specifies certain conditions that must be met in order to qualify for equity classification, which are discussed in the following table.

Condition for equity classification in ASC 815-40-25	Status under ASU 2020-06
Settlement permitted in unregistered shares	Removed
No counterparty rights rank higher than shareholder rights	Removed
No collateral required	Removed
Entity has sufficient authorized and unissued shares	Retained
Contract contains an explicit share limit	Retained
No required cash payment if entity fails to timely file with the SEC	Clarified
No cash-settled top-off or make-whole provisions	Retained

Settlement permitted in unregistered shares (removed)

The amendments in ASU 2020-06 remove the requirement that the instrument or embedded feature must permit settlement in unregistered shares in order for an entity to conclude that the instrument or feature can be settled in shares, thereby meeting the settlement criterion.

However, the amendments clarify that a contract explicitly requiring an issuer to cash settle the instrument or feature if registered shares are unavailable causes the instrument or feature to fail the settlement criterion. The amendments do not require entities to look beyond the contractual terms to evaluate whether there is an *implicit* requirement to cash settle the instrument or feature that would preclude equity classification. In other words, an instrument or a feature is not precluded from meeting the settlement criterion if the contract either (1) requires settlement in registered shares but does not specify the form of settlement in the event registered shares are unavailable, or (2) is silent about whether share settlement requires registered shares. The new guidance on share settlement is summarized in the table below.

Contractual settlement share type	Contractual cash settlement required if registered shares not available	Revised guidance
Registered shares	Yes	Evaluate entity’s ability to settle in registered shares. The analysis is same as current GAAP. ASU 2020-06 does not impact such instruments or features.

Contractual settlement share type	Contractual cash settlement required if registered shares not available	Revised guidance
Registered shares	Not required/does not specify	Does not preclude equity classification
Unregistered shares	Not required/does not specify	Does not preclude equity classification
Does not specify which type of shares	Does not specify	Does not preclude equity classification

No counterparty rights rank higher than shareholder rights (removed)

The amendments in ASU 2020-06 revise the guidance in ASC 815-40-25 so that contractual provisions that indicate a counterparty's claim in a bankruptcy ranks higher than the claims of those holding the shares underlying the instrument or feature will no longer preclude the instrument or feature from meeting the settlement criterion.

No collateral required (removed)

Under existing GAAP, an instrument or a feature does not meet the settlement criterion if the entity can be required to post collateral. The amendments in ASU 2020-06 remove this criterion, so that the requirement to post collateral will no longer preclude an entity from classifying an instrument or a feature as equity.

Entity has sufficient authorized and unissued shares (retained)

Under existing GAAP, if an entity lacks sufficient authorized and unissued shares to settle an instrument or feature at the reporting date and must obtain shareholder approval to increase its authorized shares, it does not control the share settlement of an instrument or feature and would be precluded from classifying the instrument or feature in equity. To determine whether it has sufficient authorized and unissued shares, an entity would calculate the difference between the following amounts:

1. The number of currently authorized but unissued shares, less the maximum number of shares that the entity could be required to deliver while the instrument or feature is outstanding

2. The maximum number of shares that the entity could be required to deliver upon settling the instrument or feature

If the difference in shares in (1) above is less than the total shares in (2), equity classification for the instrument or feature is precluded.

Grant Thornton insights: Determining sufficient authorized and unissued shares

An entity may have multiple outstanding instruments that can be settled by issuing common stock, such as warrants, employee stock options, and convertible instruments. At each reporting date, the entity must consider whether it has sufficient authorized and unissued common shares to settle these instruments. If it lacks sufficient authorized and unissued shares, the entity must determine whether these instruments require liability classification or bifurcation of an embedded conversion feature. If all of the outstanding instruments are exercised or converted at the reporting date, the entity might have sufficient shares to settle some, but not all, of these instruments.

ASC 815-40-35-8 through 35-13 addresses the reclassification of contracts when an entity has insufficient authorized shares to settle the contract at the reporting date. ASC 815-40-35-12 describes five possible methods that an entity can use to sequence its outstanding contracts and determine which contracts, or portions of contracts, must be reclassified:

a. Earliest inception date first

b. Earliest maturity date first

c. Latest inception date first

d. Latest maturity date first

e. All contracts, partially, on a proportionate basis

An entity should establish an accounting policy whereby it employs one of these methods consistently.

Contract contains an explicit share limit (retained)

Under existing GAAP, if the number of shares to be delivered in a share settlement cannot be determined, then an instrument or feature is precluded from being classified in equity. The amendments in ASU 2020-06 retain this guidance.

No required cash payment if entity fails to timely file with the SEC (retained and clarified)

According to existing guidance, some instruments or features that permit share settlement require cash settlement if the entity fails to make timely required filings with the SEC and would therefore be precluded from equity classification. The guidance in ASU 2020-06 clarifies that penalty payments triggered if an entity fails to make timely filings with the SEC would not preclude equity classification, because these penalty payments do not result in the settlement of the instrument or feature.

No cash-settled top-off or make-whole provisions (retained)

Some instruments or features include “top-off” or “make-whole” provisions, which require an issuer to make a payment to the holder of a convertible instrument if both of the following criteria apply:

- The holder converts the instrument into shares and sells the shares for cash.
- The sales proceeds fall below a specified amount, such as the fair value of those shares at the conversion date.

Because these types of provisions might require the issuer to make a cash payment to the holder in connection with a conversion feature, they would preclude the instrument or feature from being classified in equity. The amendments in ASU 2020-06 retain this existing guidance.

Subsequent measurement

The amendments in ASU 2020-06 clarify that the subsequent measurement guidance in ASC 815-40 applies to freestanding instruments that fail either the indexation or the settlement criteria. Prior to ASU 2020-06, the scope guidance on subsequent measurement in ASC 815-40 stated that it applies to freestanding instruments that are classified as assets or liabilities because they fail to meet the settlement criterion.

The amendments in ASU 2020-06 clarify that entities should reassess both the indexation and settlement criterion at each reporting date for both freestanding instruments and embedded features.

The following table compares the subsequent measurement guidance for instruments that are assessed under ASC 815-40 with the amendments to the subsequent measurement guidance under ASU 2020-06.

Contract type	Classification under ASC 815-40	Subsequent measurement before ASU 2020-06	Subsequent measurement under ASU 2020-06
Derivative freestanding instrument and embedded feature	Equity (Meets both indexation and settlement criterion.)	No remeasurement subsequent to initial recognition	No change
Derivative freestanding instrument and embedded feature	Asset or liability Outside the scope of ASC 815-40. Apply derivative guidance in ASC 815-10 or ASC 815-15. (Does not meet either or both indexation and settlement criterion.)	Derivative guidance in ASC 815-10 or ASC 815-15 Fair value, with changes in fair value reported in earnings	No change
Non-derivative freestanding instrument	Equity (Meets both indexation and settlement criterion.)	No remeasurement subsequent to initial recognition	No change
Non-derivative freestanding instrument	Asset or liability	Fair value, with changes in fair value reported in earnings	No change

Contract type	Classification under ASC 815-40	Subsequent measurement before ASU 2020-06	Subsequent measurement under ASU 2020-06
	(Meets indexation criterion, but does not meet settlement criterion.)		
Non-derivative freestanding instrument	Asset or liability (Does not meet indexation criterion but meets settlement criterion.)	No guidance (Entities whose financial statements are filed with SEC subsequently measure written options at fair value, with changes in fair value reported in earnings.)	Fair value, with changes in fair value reported in earnings

Disclosures

The amendments in ASU 2020-06 clarify that the disclosure requirements in ASC 815-40 only apply to freestanding instruments and that the disclosures should be provided regardless of whether the freestanding instrument meets the indexation and settlement criteria. In addition, ASU 2020-06 adds a disclosure objective in ASC 815-40-50-1A to help entities understand the disclosure requirements in ASC 815-40-50.

ASC 815-40-50-1A

The disclosure guidance in this Section should help a user of financial statements understand the following:

a. Information about the terms and features of contracts in an entity’s own equity within the scope of this Subtopic

b. How those instruments have been reflected in the issuer’s statement of financial position and statement of financial performance

c. Information about events, conditions, and circumstances that can affect how to assess the amount or timing of an entity’s future cash flows but has not yet been reflected in the financial statements.

F. Earnings per share

Convertible instruments

There are two methods of calculating diluted earnings per share (EPS) under existing GAAP: the if-converted method and the treasury stock method.

The if-converted method assumes that the conversion of convertible securities occurs at the beginning of the reporting period (or at the time of issuance, if later). Under the if-converted method, the denominator in the diluted EPS calculation (that is, weighted-average shares outstanding) is adjusted to reflect the potential shares that would be outstanding upon conversion, and the numerator (that is, income available to common shareholders) is adjusted to reverse the effect of any interest and dividends associated with the convertible instrument on income available to common shareholders.

The treasury stock method considers the use of proceeds that could be obtained from exercising options and warrants in computing diluted EPS and assumes that those proceeds would be used to purchase common stock at the average market price during the reporting period.

Under existing guidance, entities generally calculate diluted EPS for many convertible instruments using the if-converted method, although the treasury stock method is used for certain convertible instruments, such as convertible securities that either permit or require the payment of cash to the security holder at conversion.

The amendments in ASU 2020-06 change the EPS guidance in ASC 260 to require the use of if-converted method for calculating diluted EPS for *all* convertible instruments.

At the crossroads: Convertible debt that requires cash settlement of principal and interest

The amendments in ASU 2020-06 change how entities apply the if-converted method to convertible instruments that require principal and interest to be cash-settled, and only the conversion premium to be share-settled, upon conversion. Under the amendments, interest charges should not be added back to the numerator for calculating diluted EPS under the if-converted method for such instruments. Therefore, the diluted EPS result under the if-converted method for such convertible instrument will be similar to the diluted EPS result from applying the treasury stock method under current GAAP.

Contracts that may be settled in stock or cash

The amendments in ASU 2020-06 require entities to presume share settlement for purposes of calculating diluted EPS when an instrument may be settled in cash or shares. The amendments revise the current guidance in ASC 260 that allows entities to rebut the share-settlement presumption if they have a history or policy that reasonably indicates the contract will be settled in cash. This amendment will affect all instruments that may be settled in cash or shares and, therefore, affects the diluted EPS calculation for both convertible instruments and contracts in an entity's own equity.

At the crossroads: Liability-classified share-based payment arrangements

Under existing guidance, the presumption of share settlement for purposes of calculating diluted EPS does not apply to liability-classified share-based payment arrangements. The amendments in ASU 2020-06 retain the guidance for such arrangements.

Existing GAAP requires an entity to examine the facts available at each reporting period to determine whether a liability-classified share-based payment arrangement that can be settled in shares or in cash at the election of either the entity or the holder should be reflected when computing diluted EPS. The guidance in ASC 260 allows entities to overcome the presumption that such arrangements will be settled in shares if their past experience or stated policy provides a reasonable basis to conclude that the arrangement will be settled partially or wholly in cash.

Use of average market prices to calculate denominator

The amendments in ASU 2020-06 require an entity to use the average market price during the reporting period to determine the denominator for diluted EPS if the exercise price of the instrument, or the number of shares that can be issued upon settlement, could change due to fluctuations in the entity's share price. Under the amendments, the average market price should be used regardless of whether the entity applies the treasury stock method or the if-converted method for calculating diluted EPS.

At the crossroads: Contingently issuable shares

The amendments in ASU 2020-06 do not change the guidance for contingently issuable shares, which requires an entity to use the period-end share price to determine the denominator for diluted EPS.

Year-to-date computations of diluted EPS

The amendments in ASU 2020-06 clarify that the incremental shares to be included in the denominator of year-to-date diluted EPS should be determined by computing a year-to-date weighted average of the number of incremental shares included in each quarterly diluted EPS computation, instead of by calculating the number of shares that would be required to settle the contract using the average price during the year-to-date period.

Financial instruments that include down-round feature

The amendments in ASU 2020-06 clarify that the recognition and measurement guidance for financial instruments that include a down-round feature applies to both an equity-classified freestanding financial instrument and a convertible preferred stock whose conversion feature has not been bifurcated. A down-round feature is a feature in a financial instrument that reduces the strike price of the outstanding financial instrument upon the occurrence of an event or a transaction.

The guidance in ASC 260 requires that when the down-round feature of such instruments is triggered (for example, the exercise price of an equity-classified warrant is adjusted downward), an entity should recognize the value of the effect of the feature as a dividend in equity and as a reduction of income available to common stockholders in basic EPS. The effect of the down-round feature is calculated as the difference between the following amounts determined immediately after the down-round feature is triggered:

- The fair value of the financial instrument (without the down-round feature) based on the strike price before the strike-price reduction

- The fair value of the financial instrument (without the down-round feature) based on the strike price after the strike-price reduction

G. Effective date and transition

Effective date

The amendments in ASU 2020-06 are effective as follows:

- *Public business entities that meet the definition of an SEC filer, except for "smaller reporting companies," as defined by the SEC:* Fiscal years, and interim periods within those fiscal years, beginning after December 15, 2021
- *All other entities (including smaller reporting companies):* Fiscal years, and interim periods within those fiscal years, beginning after December 15, 2023

Entities can early adopt the amendments in ASU 2020-06 in fiscal years, and in interim periods within those fiscal years, beginning after December 15, 2020. The guidance in ASU 2020-06 cannot be adopted in an interim reporting period and should be adopted as of the beginning of the fiscal year of adoption.

The amendments state that an entity's status as a "smaller reporting company," based on the most recent determination as of August 5, 2020, must be used to determine the effective date of the amendments in ASU 2020-06. Any change in status at a later date will not impact the adoption date determined as of August 5, 2020.

Securities and Exchange Commission (SEC) Filer

An entity that is required to file or furnish its financial statements with either of the following:

a. The Securities and Exchange Commission (SEC)

b. With respect to an entity subject to Section 12(i) of the Securities Exchange Act of 1934, as amended, the appropriate agency under that Section.

Financial statements for other entities that are not otherwise SEC filers whose financial statements are included in a submission by another SEC filer are not included within this definition.

Effective date for convertible securities with down-round features

An entity that has not adopted the amendments in ASU 2017-11, *Accounting for Certain Financial Instruments with Down Round Features,* can early adopt the amendments to the recognition and measurement of convertible securities guidance in ASU 2020-06 for fiscal years, or interim periods with those fiscal years, beginning after December 15, 2019 if the entity has not yet issued the financial statements or made them available for issuance. However, early adoption can only be applied to a convertible security that includes a down-round feature.

Transition methods

The amendments in ASU 2020-06 should be adopted as of the beginning of the fiscal year using either a modified retrospective method or a full retrospective method.

Modified retrospective method

Entities using a modified retrospective method should apply the amendments in ASU 2020-06 to outstanding financial instruments as of the beginning of the fiscal year of adoption, with the cumulative effect of the change recognized as an adjustment to the opening balance of retained earnings as of the date of adoption.

Under the modified retrospective method, no adjustment should be made to the comparative-period information including EPS.

Full retrospective method

Entities using a full retrospective method should apply the amendments in ASU 2020-06 to outstanding financial instruments as of the beginning of the first comparative reporting period presented in the fiscal year of adoption, with the cumulative effect of the change recognized as an adjustment to the opening balance of retained earnings as of the beginning of the first comparative reporting period.

Fair value election upon adoption

The transition guidance in ASU 2020-06 allows entities to irrevocably elect the fair value option in ASC 825, *Financial Instruments,* as of the adoption date for any liability-classified financial instrument that is a convertible security within the scope of ASC 825. An entity that elects the fair value option must record the difference between the instrument's carrying amount and fair value as a cumulative-effect adjustment to the opening retained earnings in accordance with the transition method elected.

Paragraph BC129 in the Basis for Conclusions of ASU 2020-06 provides the following examples on how the transition guidance should be applied if an instrument or embedded feature previously failed to meet the settlement criterion, but meets the settlement criterion after the adoption of the amendments in ASU 2020-06.

Instrument type and current U.S. GAAP classification	Effect of guidance (If scope exception currently failed, but passed under the amendments)
Freestanding instrument is classified as a liability.	Reclassify to equity and adjust basis of instrument to what would have been the value at initial measurement.
Embedded feature is classified as a liability, and the host is classified as a liability.	Recombine instruments into a single liability instrument. Determine what the basis of that instrument would have been originally if the embedded feature had not been bifurcated. This would include a recalculation of the effective interest rate and any amortization of a discount (or premium).
Embedded feature is classified as a liability, and the host is classified as equity.	Recombine instruments into a single equity instrument and recalculate basis. Determine what the basis of that instrument would have been originally if the embedded feature had not been bifurcated.

Instrument type and current U.S. GAAP classification	Effect of guidance (If scope exception currently failed, but passed under the amendments)
Multiple embedded features are bifurcated from the host and classified as liabilities (host is classified as equity).	Recombine instruments into a single equity instrument (except for features not affected by this guidance) and recalculate basis. Determine what the basis of that instrument would have been originally if the embedded feature(s) had not been bifurcated.
Multiple embedded features are bifurcated from the host and classified as liabilities (host is classified as a liability).	Recombine instruments into a single liability instrument (except for features not affected by this guidance) and recalculate basis. Determine what the basis of that instrument would have been originally if those embedded features had not been bifurcated. This would include a recalculation of the effective interest rate and any amortization of a discount (or premium).
Debt is issued with detachable warrants.	Recalculate Day 1 allocation between the debt and warrants. Reclassify the warrants to equity on the basis of original relative fair value. Recalculate the basis of the debt. This would include a recalculation of the effective interest rate and any amortization of a discount (or premium).

Transition disclosures

In the fiscal year of adoption (including each interim period within that fiscal year), the amendments require entities to make the following disclosures:

- The nature of the change in accounting principle, including an explanation of the newly adopted accounting principle
- The method of applying the change
- The cumulative effect of the change on retained earnings or other components of equity in the statement of financial position
- For entities that present EPS information, the effect of the change on affected per-share amounts for the period of adoption

An entity that elects the full retrospective method of adoption should also disclose the effect of applying the amendments in ASU 2020-06 on income from continuing operations, net income, any affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted.

Appendix A: Convertible debt instruments: disclosures

This appendix features the revised disclosure requirements for convertible debt instruments under ASU 2020-06, as codified in ASC 470-20-50.

Convertible Debt Instruments

ASC 470-20-50-1A

The objective of the disclosure about convertible debt instruments is to provide users of financial statements with:

a. Information about the terms and features of convertible debt instruments

b. An understanding of how those instruments have been reported in an entity’s statement of financial position and statement of financial performance

c. Information about events, conditions, and circumstances that can affect how to assess the amount or timing of an entity’s future cash flows related to those instruments.

ASC 470-20-50-1B

An entity shall explain the pertinent rights and privileges of each convertible debt instrument outstanding, including, but not limited to, the following information:

a. Principal amount

b. Coupon rate

c. Conversion or exercise prices or rates and number of shares into which the instrument is potentially convertible

d. Pertinent dates, such as conversion date(s) and maturity date

e. Parties that control the conversion rights

f. Manner of settlement upon conversion and any alternative settlement methods, such as cash, shares, or a combination of cash and shares

g. Terms that may change conversion or exercise prices, number of shares to be issued, or other conversion rights and the timing of those rights (excluding standard antidilution provisions)

h. Liquidation preference and unusual voting rights, if applicable

i. Other material terms and features of the instrument that are not listed above.

ASC 470-20-50-1C

An entity shall provide the following incremental information for contingently convertible instruments or the instruments that are described in paragraphs 470-20-05-8 through 05-8A:

a. Events or changes in circumstances that would adjust or change the contingency or would cause the contingency to be met

b. Information on whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share (EPS) and the reasons why or why not

c. Other information that is helpful in understanding both the nature of the contingencies and the potential impact of conversion.

ASC 470-20-50-1D

An entity shall disclose the following information for each convertible debt instrument as of each date for which a statement of financial position is presented:

a. The unamortized premium, discount, or issuance costs and, if applicable, the premium amount recorded as paid-in capital in accordance with paragraph 470-20-25-13

b. The net carrying amount

c. For public business entities, the fair value of the entire instrument and the level of the fair value hierarchy in accordance with paragraphs 825-10-50-10 through 50-15.

See Example 11 (paragraph 470-20-55-69A) for an illustration of this disclosure requirement.

ASC 470-20-50-1E

An entity shall disclose the following information as of the date of the latest statement of financial position presented:

a. Changes to conversion or exercise prices that occur during the reporting period other than changes due to standard antidilution provisions

b. Events or changes in circumstances that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed

c. Number of shares issued upon conversion, exercise, or satisfaction of required conditions during the reporting period

d. Maturities and sinking fund requirements for convertible debt instruments for each of the five years following the date of most recent statement of financial position presented in accordance with paragraph 470-10-50-1.

ASC 470-20-50-1F

An entity shall disclose the following information about interest recognized for each period for which a statement of financial performance is presented:

a. The effective interest rate for the period

b. The amount of interest recognized for the period disaggregated by both of the following (see Example 12 [paragraph 470-20-55-69D] for an illustration of this disclosure requirement):

   1. The contractual interest expense

2. The amortization of the premium, discount, or issuance costs.

ASC 470-20-50-1G

If the conversion option of a convertible debt instrument is accounted for as a derivative in accordance with Subtopic 815-15, an entity shall provide disclosures in accordance with Topic 815 for the conversion option in addition to the disclosures required by this Section, if applicable.

ASC 470-20-50-1H

If a convertible debt instrument is measured at fair value in accordance with the Fair Value Option Subsections of Subtopic 825-10, an entity shall provide disclosures in accordance with Subtopic 820-10 and Subtopic 825-10 in addition to the disclosures required by this Section, if applicable.

ASC 470-20-50-1I

An entity shall disclose the following information about derivative transactions entered into in connection with the issuance of convertible debt instruments within the scope of this Subtopic regardless of whether such derivative transactions are accounted for as assets, liabilities, or equity instruments:

a. The terms of those derivative transactions (including the terms of settlement)

b. How those derivative transactions relate to the instruments within the scope of this Subtopic

c. The number of shares underlying the derivative transactions

d. The reasons for entering into those derivative transactions.

An example of a derivative transaction entered into in connection with the issuance of a convertible debt instrument within the scope of this Subtopic is the purchase of call options that are expected to substantially offset changes in the fair value or the potential dilutive effect of the conversion option. Derivative instruments also are subject to the disclosure guidance in Topic 815.

Appendix B: Convertible preferred stock: disclosures

This appendix features the revised disclosure requirements for convertible preferred stock under the amendments in ASU 2020-06, as codified in ASC 505-10-50.

Convertible Preferred Stock

ASC 505-10-50-12

The objective of the disclosure about convertible preferred stock is to provide users of financial statements with:

a. Information about the terms and features of convertible preferred stock

b. An understanding of how those instruments have been reported in an entity's statement of financial position and statement of financial performance

c. Information about events, conditions, and circumstances that can affect how to assess the amount or timing of an entity's future cash flows related to those instruments.

ASC 505-10-50-13

To comply with the general disclosure requirements of paragraph 505-10-50-3, an entity shall explain the pertinent rights and privileges of each outstanding instrument, including, but not limited to, the following information:

a. Number of shares issued and par value

b. Dividends

c. Conversion or exercise prices or rates and number of shares into which the instrument is potentially convertible

d. Pertinent dates, such as conversion date(s)

e. Parties that control the conversion rights

f. Manner of settlement upon conversion and any alternative settlement methods, such as cash, shares, or a combination of cash and shares

g. Terms that may change conversion or exercise prices, number of shares to be issued, or other conversion rights and the timing of those rights (excluding standard antidilution provisions)

h. Liquidation preference required by paragraph 505-10-50-4 and unusual voting rights

i. Other material terms and features of the instrument that are not listed above.

ASC 505-10-50-14

An entity shall provide the following incremental information for contingently convertible instruments or the instruments that are described in paragraphs 505-10-05-6 through 05-7:

a. Events or changes in circumstances that would adjust or change the contingency or would cause the contingency to be met

b. Information on whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share (EPS) and the reasons why or why not

c. Other information that is helpful in understanding both the nature of the contingencies and the potential impact of conversion.

ASC 505-10-50-15

An entity shall disclose the amount of dividends declared for each period for which a statement of financial performance is presented, in addition to the disclosures required by paragraph 505-10-50-5.

ASC 505-10-50-16

An entity shall disclose the following as of the date of the latest statement of financial position presented:

a. Changes to conversion or exercise prices that occur during the reporting period other than changes due to standard antidilution provisions

b. Events or changes in circumstances that occur during the reporting period that cause conversion contingencies to be met or conversion terms to be significantly changed

c. The number of shares issued upon conversion, exercise, or satisfaction of required conditions during the reporting period.

ASC 505-10-50-17

If a conversion option is accounted for as a derivative in accordance with Subtopic 815-15, an entity shall provide disclosures in accordance with Topic 815 for the conversion option in addition to the disclosures required by the guidance in this Section, if applicable.

ASC 505-10-50-18

An entity shall disclose the following information about derivative transactions entered into in connection with the issuance of convertible preferred stock within the scope of this Subtopic regardless of whether such derivative transactions are accounted for as assets, liabilities, or equity instruments:

a. The terms of those derivative transactions (including the terms of settlement)

b. How those derivative transactions relate to the instruments within the scope of this Subtopic

c. The number of shares underlying the derivative transactions

d. The reasons for entering into those derivative transactions.

Contacts

Rahul Gupta
Partner
Accounting Principles Group
T +1 312 602 8084
E rahul.gupta@us.gt.com

Ryan Brady
Partner
Accounting Principles Group
T +1 312 602 8741
E ryan.brady@us.gt.com