FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: November 2, 2026
Comments Due: January 4, 2027

Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40)

Targeted Improvements to Indexation

The Board issued this Exposure Draft to solicit public comment on proposed changes to Subtopic 815-40 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2026-ED900, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until January 4, 2027. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2026-ED900
- Sending a letter to "Technical Director, File Reference No. 2026-ED900, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Board is issuing this proposed Update to simplify the application of the indexation guidance in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity, and to improve the decision usefulness of information provided to investors. Subtopic 815-40 provides a scope exception from derivative accounting for contracts that are issued or held by a reporting entity that are indexed to its own stock (referred to as the "indexation guidance") and classified in stockholder's equity (referred to as the "equity classification guidance").

Feedback received from stakeholders as part of the 2025 Invitation to Comment, *Agenda Consultation*, indicated that the indexation guidance in Subtopic 815-40 is complex, costly to apply, and a frequent source of financial statement restatements. Stakeholders also noted that diversity in practice exists in assessing leverage factors. As a result, some contracts that should qualify for equity classification do not under current guidance.

To address that feedback, the amendments in this proposed Update would simplify Step 2 of the indexation guidance by eliminating the requirement to evaluate whether the settlement amount of an equity-linked instrument is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or a forward contract on equity shares (referred to as the "fixed-for-fixed assessment"). Instead, an instrument (or embedded feature) would be considered indexed to an entity's own stock if the only variables (or contingent events) that could cause the settlement amount to vary are related to specified acceptable variables. The proposed amendments also would (1) eliminate the scope exception for down round features, since it would no longer be needed, and (2) require annual disclosure of variables that could, or did, affect an equity-classified contract's settlement amount to improve the decision usefulness of information provided to investors.

The amendments in this proposed Update would not change related guidance in other areas, such as Step 1 of the indexation guidance in Section 815-40-15, the equity classification guidance in Section 815-40-25, the accounting for

derivatives guidance in Topic 815 (besides Step 2 of the indexation guidance), or the liability classification requirements in Topic 480, Distinguishing Liabilities from Equity.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities that enter into contracts that are indexed to, and potentially settled in, their own stock. The proposed amendments would apply to freestanding instruments and embedded features.

What Are the Main Provisions, How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP), and Why Would They Be an Improvement?

Overall

Under the indexation guidance in Section 815-40-15, an entity determines whether a contract is indexed to its own stock by evaluating the following:

1. The contract's contingent exercise provisions, if any (Step 1)
2. The contract's settlement provisions (that is, the settlement amount) (Step 2).

Both Step 1 and Step 2 must be met for a contract to be considered indexed to the entity’s own stock and potentially classified as equity.

Under current GAAP, when applying Step 2 of the indexation guidance, an entity must evaluate the fixed-for-fixed assessment for all freestanding instruments and embedded features (collectively referred to as “instruments” or “contracts”). In doing so, an entity first analyzes whether an instrument’s settlement amount equals the difference between (1) the fair value of a fixed number of the entity’s equity shares and (2) a fixed monetary amount or a fixed amount of a debt instrument issued by the entity. An instrument’s strike price or the number of shares used to calculate the settlement amount is not fixed if

the terms provide for any potential adjustments. If the settlement amount is not fixed, the instrument is considered indexed to the entity's own stock only if the variables that could affect the settlement amount would be inputs to the fair value of a fixed-for-fixed forward or option on equity shares.

Acceptable Variables Approach

The amendments in this proposed Update would eliminate the requirement to evaluate the fixed-for-fixed assessment.

Under the proposed amendments, unless Step 1 precludes it, an equity-linked instrument would be considered indexed to an entity's own stock as long as the variables (or contingent events) that could cause the instrument's settlement amount to vary (including through an adjustment to the strike price or the number of shares used to calculate the settlement amount) are related to the following specified acceptable variables (regardless of the magnitude of the adjustment):

1. The entity's own stock price
2. Term of the instrument
3. The entity's own expected dividends or other dilutive activities
4. Stock borrow costs associated with the entity's own stock
5. Interest rates
6. The entity's own stock price volatility
7. The entity's own credit spread
8. The entity's own operations or activities.

The amendments in this proposed Update are intended to (1) simplify the application of the indexation guidance (including the assessment of leverage factors) and (2) improve the decision usefulness of information provided to investors. The proposed amendments also are expected to result in more contracts being considered indexed to the entity's own stock.

Down Round Features

Paragraph 815-40-15-5D currently provides a scope exception for down round features when determining whether an instrument is indexed to an entity's own stock. A down round feature reduces the strike price of an equity-linked financial instrument when triggered by certain financing events. The amendments in this proposed Update would eliminate that feature-specific

exception, including the related guidance in Topic 260, Earnings Per Share, and Topic 505, Equity. That guidance would no longer be necessary because down round features would be considered related to an entity's own operations or activities.

Disclosures

Subtopic 815-40 specifies how the disclosure requirements in Section 505-10-50 apply to contracts within the scope of Subtopic 815-40. To improve the decision usefulness of information provided to investors, the amendments in this proposed Update would require that an entity disclose the following information about variables (or contingent events) that could, or did, cause the settlement amount of equity-classified contracts to vary (including through an adjustment to the strike price or the number of shares used to calculate the settlement amount):

1. Variables (or contingent events) that could have a significant effect on the contract's settlement amount (for example, adjustments related to the entity's own stock price volatility that contain a leverage factor)
2. Actual changes to variables (or contingent events that occurred) that had a significant effect on the contract's settlement amount, including a description of those changes and what caused them to occur (for example, the strike price of the entity's warrants was reduced because of a financing event or because of a change in control).

What Are the Transition Requirements and When Would the Amendments Be Effective?

An entity would be required to apply the amendments in this proposed Update on a modified prospective basis. This transition approach would require that an entity apply the proposed amendments prospectively to both new contracts that are entered into on or after the date of adoption and contracts outstanding at the date of adoption. The proposed amendments would provide transition guidance for outstanding instruments that would be reclassified from an asset or a liability to equity as a result of applying the proposed amendments. Contracts that were settled (or expired) prior to the date of adoption would be unaffected.

The Board will determine the effective date and whether early adoption should be permitted after it considers stakeholder feedback on the amendments in this proposed Update.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Acceptable Variables Approach

Question 1: Would the amendments in this proposed Update (a) simplify the application of the indexation guidance in Subtopic 815-40 and (b) reduce diversity in practice? Are the proposed amendments clear and operable? Do you anticipate any auditing challenges? Please explain why or why not.

Question 2: Is the proposed description of an entity's own operations or activities clear and operable? Do you anticipate any auditing challenges? Please explain why or why not.

Question 3: Is the proposed description of an entity's own stock price volatility clear and operable? Do you anticipate any auditing challenges? Please explain why or why not.

Question 4: The proposed amendments would not specifically include *the ability to maintain a standard hedge position in the underlying shares* as an acceptable variable (see paragraphs BC34 and BC35). The Board intends that adjustments related to the ability to maintain a standard hedge position in the underlying shares would not preclude an instrument from being considered indexed to an entity's own stock under the proposed amendments, consistent with current GAAP.

a. Do you agree with the proposed amendments? Please explain why or why not.

b. Are you aware of any settlement adjustments that are currently captured by the *ability to maintain a standard hedge position in the underlying shares* variable that you believe would not be captured by the proposed *entity's own operations and activities* variable? Please explain why or why not.

Question 5: Would the proposed amendments address practice issues on assessing leverage factors (such as "greater of" inputs)? Please explain why or why not. If not, what changes would you suggest?

Question 6: Are the proposed examples in paragraphs 815-40-55-53 through 55-59 helpful in illustrating the proposed amendments? Please explain why or why not.

Question 7: The Board expects more contracts to be classified as equity under the proposed amendments. Do you agree with that expectation? Please explain why or why not.

Question 8: If you think an alternative approach would be more operable or result in more intuitive outcomes, please describe that approach, including providing examples of contracts encountered currently in practice and why the accounting under the preferred approach would be more appropriate for those arrangements.

Down Round Features

Question 9: The proposed amendments would eliminate the down round scope exception in Section 815-40-15 and the related guidance in Topics 260 and 505. Consequently, an entity would no longer recognize the value of the effect of a triggered down round feature as a deemed dividend and as a reduction of income available to common stockholders in basic earnings per share (EPS).

a. For preparers and practitioners, do you agree with the proposed amendments? Do you anticipate any unintended consequences? Please explain why or why not.
b. For investors, does recognizing the effect of a triggered down round feature as a deemed dividend in the calculation of basic EPS provide decision-useful information? Would eliminating that information affect your capital allocation decisions? Please explain why or why not.

Disclosure

Question 10: The proposed amendments would require that on an annual basis an entity disclose information about variables (or contingent events) that could, or did, significantly affect an equity-classified contract's settlement amount (including through an adjustment to the strike price or the number of shares used to calculate the settlement amount).

a. For preparers and practitioners, is the proposed disclosure requirement clear and operable? Do you anticipate any auditing challenges? Please explain why or why not.
b. For investors, would the proposed disclosure requirement provide decision-useful information? How would this information be used in your capital allocation decisions? Please explain.

Transition

Question 11: An entity would be required to apply the proposed amendments using a modified prospective approach. Are the proposed transition requirements clear and operable? Please explain why or why not. If not, what transition guidance would be more appropriate and why?

Question 12: Are there any transition expedients that the Board should consider permitting, such as a one-time election or revocation of the fair value option under Topic 825, Financial Instruments, upon adoption of the proposed amendments? Please explain why or why not.

Effective Date and Early Adoption

Question 13: How much time would be needed to implement the proposed amendments? Should the effective date for entities other than public business entities differ from the effective date for public business entities? If so, how much additional time would you recommend for entities other than public business entities? Should early adoption be permitted? Please explain.

Benefits and Costs

Question 14: Would the expected benefits of the proposed amendments justify the expected costs? If not, please describe the nature and magnitude of those costs, differentiating between one-time costs and recurring costs.

Amendments to the *FASB Accounting Standards Codification®*

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table provides a summary of the proposed amendments to the Accounting Standards Codification.

Codification Subtopic	Description of Proposed Changes
Master Glossary	• Superseded the Master Glossary term *Down Round Feature*. • Superseded the Master Glossary terms *Equity Restructuring* and *Standard Antidilution Provisions* from Subtopic 260-10.
Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity	• Amended guidance to eliminate the fixed-for-fixed assessment, to clarify how an entity would apply the acceptable variables approach, and to eliminate guidance related to the down round feature scope exception. • Amended guidance to remove examples that primarily illustrate the fixed-for-fixed assessment and to clarify current disclosure requirements. • Added certain examples to illustrate how an entity would apply the proposed amendments.
Subtopic 260-10, Earnings Per Share—Overall	• Superseded guidance related to the effects of down round features.

Subtopic 505-10, Equity—Overall	• Superseded disclosure requirements related to down round features and the related cross-reference to Topic 260.
Subtopic 815-10, Derivatives and Hedging—Overall	• Superseded references to down round features.

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–9. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

3. Supersede the Master Glossary term *Down Round Feature*, with a link to transition paragraph 815-40-65-3, as follows:

~~**Down Round Feature**~~

~~A feature in a **financial instrument** that reduces the strike price of an issued financial instrument if the issuer sells shares of its stock for an amount less than the currently stated strike price of the issued financial instrument or issues an equity-linked financial instrument with a strike price below the currently stated strike price of the issued financial instrument.~~

~~A down round feature may reduce the strike price of a financial instrument to the current issuance price, or the reduction may be limited by a floor or on the basis of a formula that results in a price that is at a discount to the original exercise price but above the new issuance price of the shares, or may reduce the strike price to below the current issuance price. A **standard antidilution provision** is not considered a down round feature.~~

4. Supersede the following Master Glossary terms from Subtopic 260-10 as follows:

~~**Equity Restructuring**~~

~~A nonreciprocal transaction between an entity and its shareholders that causes the per-share fair value of the shares underlying an option or similar award to change, such as a stock dividend, stock split, spinoff, rights offering, or recapitalization through a large, nonrecurring cash dividend.~~

~~**Standard Antidilution Provisions**~~

~~Standard antidilution provisions are those that result in adjustments to the conversion ratio in the event of an **equity restructuring** transaction that are designed to maintain the value of the conversion option.~~

Amendments to Subtopic 815-40

5. Supersede paragraphs 815-40-15-5D, 815-40-15-7D, 815-40-15-7G, and 815-40-55-26 through 55-48 and their related headings, amend paragraphs 815-40-15-7A through 15-7C, 815-40-15-7E through 15-7F, 815-40-15-8, 815-40-50-5, and 815-40-55-25A, and add paragraphs 815-40-15-7J through 15-7K and their related headings and 815-40-55-53 through 55-59 and their related headings, with a link to transition paragraph 815-40-65-3, as follows:

Derivatives and Hedging—Contracts in Entity's Own Equity

Scope and Scope Exceptions

> Entities

815-40-15-1 The guidance in this Subtopic applies to all entities.

> Instruments

815-40-15-2 The guidance in this Subtopic applies to **freestanding contracts** that are potentially indexed to, and potentially settled in, an entity's own stock.

815-40-15-2A The scope of this Subtopic includes security price guarantees or other **financial instruments** indexed to, or otherwise based on, the price of the entity's stock that are issued in connection with a business combination and that are accounted for as contingent consideration.

815-40-15-3 The guidance in this Subtopic does not apply to any of the following:

a. Subparagraph superseded by Accounting Standards Update No. 2020-06.
b. Contracts that are issued to compensate grantees in a **share-based payment arrangement** within the scope of Topic 718
c. Subparagraph superseded by Accounting Standards Update No. 2018-07.
d. A written put option and a purchased call option embedded in the shares of a noncontrolling interest of a consolidated subsidiary if the arrangement is accounted for as a financing under the guidance beginning in paragraph 480-10-55-53
e. Financial instruments that are within the scope of Topic 480 (see paragraph 815-40-15-12).

815-40-15-4 The guidance in this Subtopic applies to derivatives embedded in contracts in analyzing the embedded feature under paragraphs 815-15-25-1(c) and 815-15-25-14 as though it were a freestanding instrument (as further discussed in paragraphs 815-40-25-39 through 25-40).

> Evaluating Whether an Instrument or Embedded Feature Is Considered Indexed to an Entity's Own Stock

815-40-15-5 The guidance in this paragraph through paragraph 815-40-15-8 applies to any **freestanding financial instrument** or embedded feature that has all the characteristics of a **derivative instrument** (see the guidance beginning in paragraph 815-10-15-83). That guidance applies for the purpose of determining whether that instrument or embedded feature qualifies for the first part of the scope exception in paragraph 815-10-15-74(a). That guidance does not address the second part of the scope exception in paragraph 815-10-15-74(a), which is addressed in Section 815-40-25. The guidance also applies to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative instrument for purposes of determining whether the instrument is within the scope of this Subtopic.

815-40-15-5A The guidance in this paragraph through paragraph 815-40-15-8 does not apply to share-based payment awards within the scope of Topic 718 for purposes of determining whether instruments are classified as liability

awards or equity awards under that Topic. Equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options are not within the scope of Topic 718 themselves. Consequently, the guidance in this paragraph through paragraph 815-40-15-8 applies to such market-based share-based payment stock option valuation instruments for purposes of making the determinations described in paragraph 815-40-15-5.

815-40-15-5B The guidance in paragraphs 815-40-15-5 through 15-8 shall be applied to the appropriate unit of accounting, as determined under other applicable U.S. generally accepted accounting principles. For example, if an entity issues two freestanding financial instruments and concludes that those two instruments are required to be accounted for separately, then the guidance in paragraphs 815-40-15-5 through 15-8 shall be applied separately to each instrument. In contrast, if an entity issues two freestanding financial instruments and concludes that those two instruments are required to be linked and accounted for on a combined basis as a single financial instrument (for example, pursuant to the guidance in paragraph 815-10-15-8), then the guidance in paragraphs 815-40-15-5 through 15-8 shall be applied to the combined financial instrument.

815-40-15-5C Freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary are not precluded from being considered indexed to the entity's own stock in the consolidated financial statements of the parent if the subsidiary is a substantive entity. If the subsidiary is not a substantive entity, the instrument or embedded feature shall not be considered indexed to the entity's own stock. If the subsidiary is considered to be a substantive entity, the guidance beginning in paragraph 815-40-15-5 shall be applied to determine whether the freestanding financial instrument (or an embedded feature) is indexed to the entity's own stock and shall be considered in conjunction with other applicable GAAP (for example, this Subtopic) in determining the classification of the freestanding financial instrument (or an embedded feature) in the financial statements of the entity. The guidance in this paragraph applies to those instruments (and embedded features) in the consolidated financial statements of the parent, whether the instrument was entered into by the parent or the subsidiary. The guidance in this paragraph does not affect the accounting for instruments (or embedded features) that would not otherwise qualify for the scope exception in paragraph 815-10-15-74(a). For example,

freestanding instruments that are classified as liabilities (or assets) under Topic 480 and put and call options embedded in a noncontrolling interest that is accounted for as a financing arrangement under Topic 480 are not affected by this guidance. For guidance on presentation of an equity-classified instrument (including an embedded feature that is separately recorded in equity under applicable GAAP) within the scope of the guidance in this paragraph, see paragraph 810-10-45-17A.

815-40-15-5D Paragraph superseded by Accounting Standards Update No. 202X-XX.~~When classifying a financial instrument with a **down round feature**, the feature is excluded from the consideration of whether the instrument is indexed to the entity's own stock for the purposes of applying paragraphs 815-40-15-7C through 15-7I (Step 2).~~

815-40-15-6 The guidance in this paragraph applies to both the issuer and the holder of the instrument. Outstanding instruments within the scope of the guidance in paragraphs 815-40-15-5 through 15-8 shall always be considered issued for accounting purposes, except as discussed in the next sentence. **Lock-up options** shall not be considered issued for accounting purposes unless and until the options become exercisable.

815-40-15-7 An entity shall evaluate whether an equity-linked financial instrument (or embedded feature), as discussed in paragraphs 815-40-15-5 through 15-8 is considered indexed to its own stock within the meaning of this Subtopic and paragraph 815-10-15-74(a) using the following two-step approach:

a. Evaluate the instrument’s contingent exercise provisions, if any.
b. Evaluate the instrument’s settlement provisions.

• > Evaluation of Contingent Exercise Provisions (Step 1)

815-40-15-7A An **exercise contingency** shall not preclude an instrument (or embedded feature) from being considered indexed to an entity's own stock provided that it is not based on either of the following:

a. An observable market, other than the market for the issuer's stock (if applicable)
b. An observable index, other than an index calculated or measured solely by reference to the issuer's own operations (for example, sales revenue

of the issuer; earnings before interest, taxes, depreciation, and amortization of the issuer; net income of the issuer; or total equity of the issuer).

If the evaluation of Step 1 (this paragraph) does not preclude an instrument from being considered indexed to the entity's own stock, the analysis shall proceed to Step 2 (see the guidance beginning in paragraph 815-40-15-7C).

815-40-15-7B If an instrument's strike price or the number of shares used to calculate the settlement amount would be adjusted upon the occurrence of an exercise contingency, the exercise contingency shall be evaluated under Step 1 (see ~~the preceding~~ paragraph 815-40-15-7A) and the potential adjustment to the instrument's settlement amount shall be evaluated under Step 2 (see the guidance beginning in ~~the following~~ paragraph 815-40-15-7C).

• > Evaluation of Settlement Provisions (Step 2)

815-40-15-7C Unless paragraph 815-40-15-7A precludes it, an instrument (or embedded feature) shall be considered indexed to an entity's own stock if ~~its~~the strike price and the number of shares used to calculate the settlement amount are fixed~~will equal the difference between the following:~~

~~a. The fair value of a fixed number of the entity's equity shares~~
~~b. A fixed monetary amount or a fixed amount of a debt instrument issued by the entity.~~

~~For~~ (for example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond issued by the entity shall be considered indexed to the entity's own ~~stock~~stock).

815-40-15-7D Paragraph superseded by Accounting Standards Update No. 202X-XX.~~An instrument's strike price or the number of shares used to calculate the settlement amount are not fixed if its terms provide for any potential adjustment, regardless of the probability of such adjustment(s) or whether such adjustments are in the entity's control. If the instrument's strike price or the number of shares used to calculate the settlement amount are not fixed, the instrument (or embedded feature) shall still be considered indexed to an entity's own stock if the only variables that could affect the settlement amount would~~

~~be inputs to the fair value of a fixed-for-fixed forward or option on equity shares (provided that paragraph 815-40-15-7A does not preclude such a conclusion).~~

815-40-15-7E If the instrument's strike price or the number of shares used to calculate the settlement amount is not fixed, the instrument (or embedded feature) shall be considered indexed to an entity's own stock if the only variables (or contingent events) that could cause the settlement amount to vary (including through an adjustment to the strike price or the number of shares used to calculate the settlement amount) are related to any ~~A fixed-for-fixed forward or option on equity shares has a settlement amount that is equal to the difference between the price of a fixed number of equity shares and a fixed strike price. The fair value inputs of a fixed-for-fixed forward or option on equity shares may include the entity's stock price and additional variables, including all~~ of the following (referred to as the acceptable variables):

a. The entity's own stock price~~Strike price of the instrument~~
b. Term of the instrument
c. The entity's own expected~~Expected~~ dividends or other dilutive activities
d. Stock borrow ~~cost~~costs associated with the entity's own stock
e. Interest rates
f. The entity's own stock~~Stock~~ price volatility (see paragraph 815-40-15-7J)
g. The entity's own credit spread
h. Subparagraph superseded by Accounting Standards Update No. 202X-XX.~~The ability to maintain a standard hedge position in the underlying shares.~~
i. The entity's own operations or activities (see paragraph 815-40-15-7K).

An adjustment to the settlement amount that is caused by the acceptable variables shall not preclude an instrument (or embedded feature) from being considered indexed to the entity's own stock, regardless of the magnitude of the adjustment or whether the variables (or contingent events) are within the entity's control. Multiple variables may simultaneously affect the settlement amount, and each variable must be evaluated.~~ Determinations and adjustments related to the settlement amount (including the determination of the ability to maintain a standard hedge position) shall be commercially reasonable.~~

815-40-15-7F If any variable (or contingent event) that could cause the settlement amount to vary (including through an adjustment to the strike price

or the number of shares used to calculate the settlement amount) does not relate to the acceptable variables described in paragraph 815-40-15-7E, the instrument (or embedded feature) shall not be considered indexed to an entity's own stock, regardless of the probability that the adjustment will occur.~~An instrument (or embedded feature) shall not be considered indexed to the entity's own stock if its settlement amount is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares. An instrument (or embedded feature) shall not be considered indexed to the entity's own stock if either:~~

~~a. The instrument's settlement calculation incorporates variables other than those used to determine the fair value of a fixed-for-fixed forward or option on equity shares.~~
~~b. The instrument contains a feature (such as a leverage factor) that increases exposure to the additional variables listed in the preceding paragraph in a manner that is inconsistent with a fixed-for-fixed forward or option on equity shares.~~

815-40-15-7G Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Standard pricing models for equity-linked financial instruments contain certain implicit assumptions. One such assumption is that the stock price exposure inherent in those instruments can be hedged by entering into an offsetting position in the underlying equity shares. For example, the Black-Scholes-Merton option-pricing model assumes that the underlying shares can be sold short without transaction costs and that stock price changes will be continuous. Accordingly, for purposes of applying Step 2, fair value inputs include adjustments to neutralize the effects of events that can cause stock price discontinuities. For example, a merger announcement may cause an immediate jump (up or down) in the price of shares underlying an equity-linked option contract. A holder of that instrument would not be able to continuously adjust its hedge position in the underlying shares due to the discontinuous stock price change. As a result, changes in the fair value of an equity-linked instrument and changes in the fair value of an offsetting hedge position in the underlying shares will differ, creating a gain or loss for the instrument holder as a result of the merger announcement. Therefore, inclusion of provisions that adjust the terms of the instrument to offset the net gain or loss resulting from a merger announcement or similar event do not preclude an equity-linked instrument (or embedded feature) from being considered indexed to an entity's own stock.~~

815-40-15-7H Some equity-linked financial instruments contain provisions that provide an entity with the ability to unilaterally modify the terms of the instrument at any time, provided that such modification benefits the counterparty. For example, the terms of a convertible debt instrument may explicitly permit the issuer to reduce the conversion price at any time to induce conversion of the instrument. For purposes of applying Step 2, such provisions do not affect the determination of whether an instrument (or embedded feature) is considered indexed to an entity's own stock.

• • > Strike Price Denominated in a Foreign Currency

815-40-15-7I The issuer of an equity-linked financial instrument incurs an exposure to changes in currency exchange rates if the instrument's strike price is denominated in a currency other than the functional currency of the issuer. An equity-linked financial instrument (or embedded feature) shall not be considered indexed to the entity's own stock if the strike price is denominated in a currency other than the issuer's functional currency (including a conversion option embedded in a convertible debt instrument that is denominated in a currency other than the issuer's functional currency). The determination of whether an equity-linked financial instrument is indexed to an entity's own stock is not affected by the currency (or currencies) in which the underlying shares trade.

• • > The Entity’s Own Stock Price Volatility

815-40-15-7J In evaluating the guidance in paragraph 815-40-15-7E, an entity’s own stock price volatility includes the following:

a. Any fixed or prespecified volatility, including a floor or cap on an entity’s own stock price volatility
b. Any magnitude of an entity’s own stock price volatility, including a multiple of that volatility
c. When the entity does not have its own observable stock price volatility, the volatility of a reasonably appropriate peer company or peer group of companies, including any magnitude of that volatility.

For an entity that has its own observable stock price volatility, a settlement amount calculated explicitly using a stock price volatility of an unrelated entity shall preclude an equity-linked instrument from being considered indexed to an entity’s own stock.

• • > The Entity's Own Operations or Activities

815-40-15-7K In evaluating the guidance in paragraph 815-40-15-7E, an entity's own operations or activities include adjustments that are contingent on the entity's own operations (for example, sales revenue of the issuer, earnings before interest, taxes, depreciation, and amortization of the issuer, net income of the issuer, and total equity of the issuer), operational metrics (for example, number of stores opened or number of items produced), and occurrence or nonoccurrence of an event related to the entity's own operations or activities (for example, obtaining regulatory approval, selling shares in an initial public offering or other financing event, merger announcement, and a change in control). An entity's own operations or activities do not include general market prices (such as the price of a commodity), indexes (such as the Standard & Poor's S&P 500 Index), and the operations or activities of the holder of the instrument.

• > Illustrative Examples

815-40-15-8 The examples in paragraphs 815-40-55-53 through 55-59~~Examples 2-21 (see paragraphs 815-40-55-26 through 55-48)~~ illustrate the application of the guidance in paragraphs 815-40-15-5 through 15-5C, 815-40-15-6 through 15-7C, 815-40-15-7E through 15-7F, and 815-40-15-7J through 15-7K~~15-7~~. These examples do not address whether an instrument (or embedded feature) is classified in equity (or would be classified in equity if freestanding). These examples also do not address whether the instrument is within the scope of Topic 480 or whether the instrument would be subject to the two-class method under Topic 260.

Disclosure

> Interaction with Disclosures about Capital Structure

815-40-50-5 The disclosures required by Section 505-10-50 apply to all contracts within the scope of this Subtopic as follows:

a. In the case of an option or forward contract indexed to the issuer's equity, the pertinent information to be disclosed under Section 505-10-50 about the contract includes all of the following:
    1. The forward rate
    2. The option strike price

3. The number of issuer's shares to which the contract is indexed
4. The settlement date or dates of the contract
5. The issuer's accounting for the contract (that is, as an asset, liability, or equity).

b. If the terms of the contract provide settlement alternatives, those settlement alternatives shall be disclosed under Section 505-10-50, including all of the following:
   1. Who controls the settlement alternatives and a description of those alternatives
   2. The maximum number of shares that could be required to be issued to net share settle a contract, if applicable. Paragraph 505-10-50-3 requires additional disclosures for actual issuances and settlements that occurred during the accounting period.

c. If a contract does not have a fixed or determinable maximum number of shares that may be required to be issued, the fact that a potentially infinite number of shares could be required to be issued to settle the contract shall be disclosed under Section 505-10-50.

d. For each settlement alternative, the amount that would be paid, or the number of shares that would be issued and their fair value, determined under the conditions specified in the contract if the settlement were to occur at the reporting date and how changes in the fair value of the issuer's equity shares affect those settlement amounts (for example, the issuer is obligated to issue an additional X shares or pay an additional Y dollars in cash for each $1 decrease in the fair value of one share) shall be disclosed under Section 505-10-50. (For some issuers, a tabular format may provide the most concise and informative presentation of these data.)

e. The disclosures required by paragraph 505-10-50-11 shall be made for any equity instrument in the scope of this Subtopic that is (or would be if the issuer were a public entity) classified as temporary equity. (That paragraph applies to redeemable stock issued by nonpublic entities, regardless of whether the private entity chooses to classify those securities as temporary equity.)

f. The disclosures required by paragraph 505-10-50-18 also shall be made for an equity-classified contract within the scope of this Subtopic that is entered into in connection with the issuance of convertible preferred stock.

g. For equity-classified contracts, the following information shall be disclosed under Section 505-10-50 about variables (or contingent

events) that could, or did, cause the settlement amount to vary (including through an adjustment to the strike price or the number of shares used to calculate the settlement amount) as described in paragraph 815-40-15-7E:

1. Variables (or contingent events) that could have a significant effect on the contract's settlement amount (for example, adjustments related to the entity's own stock price volatility that contain a leverage factor)
2. Actual changes to variables (or contingent events that occurred) that had a significant effect on the contract's settlement amount, including a description of those changes and what caused them to occur (for example, the strike price of the entity's warrants was reduced because of a financing event or because of a change in control).

Implementation Guidance and Illustrations

> Illustrations

815-40-55-25A The Examples in paragraphs ~~815-40-55-26~~815-40-55-53 through ~~55-48~~55-59 illustrate the application of the guidance beginning in paragraph 815-40-15-5.

~~• > Example 2: Variability Involving Completion of an Initial Public Offering~~

815-40-55-26 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms; however, they only become exercisable if Entity A completes an initial public offering. The warrants are considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The **exercise contingency** (that is, the initial public offering) is not an observable market or an observable index, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.~~
b. ~~Upon exercise, the settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share).~~

~~• > Example 3: Variability Involving Sales Volume~~

815-40-55-27 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms; however, they only become exercisable after Entity A accumulates $100 million in sales to third parties. The warrants are considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The exercise contingency (that is, the accumulation of $100 million in sales to third parties) is an observable index. However, it can only be calculated or measured by reference to Entity A's sales, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.~~
b. ~~Step 2. Upon exercise, the settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share).~~

[Content amended and moved to paragraph 815-40-55-53]

~~• > Example 4: Variability Involving Stock Index~~

815-40-55-28 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms; however, they only become exercisable if the Standard & Poor's S&P 500 Index increases 500 points within any given calendar year during that 10-year period. The warrants are not considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The exercise contingency (that is, the increase of 500 points in Standard & Poor's S&P 500 Index) is based on an observable index that is not measured solely by reference to the issuer's own operations.~~
b. ~~Step 2. It is not necessary to evaluate Step 2.~~

[Content moved to paragraph 815-40-55-54]

~~• > Example 5: Variability Involving a Commodity Price~~

815-40-55-29 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues warrants that permit the holder to buy 100 shares of its common stock in exchange for one ounce of gold. The warrants have 10-year terms; however, they only become exercisable if Entity A completes an initial public offering. The warrants are not considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The exercise contingency (that is, the initial public offering) is not an observable market or an observable index, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.~~
b. ~~Step 2. The settlement amount would not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number of shares that would be issued at settlement is fixed, the strike price varies based on the price of one ounce of gold. The price of gold is not an input to the fair value of a fixed-for-fixed option on equity shares.~~

[Content amended and moved to paragraph 815-40-55-55]

~~• > Example 6: Variability Involving Merger Announcement~~

815-40-55-30 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that if there is an announcement of a merger involving Entity A, the strike price of the warrants will be adjusted to offset the effect of the merger announcement on the net change in the fair value of the warrants and of an offsetting hedge position in the underlying shares. The strike price adjustment must be determined using commercially reasonable means based on an assumption that the counterparty has entered into a hedge position in the underlying shares to offset the share price exposure from the warrants. That strike price adjustment is not affected by the counterparty's actual hedging position (for example, the strike price adjustment does not differ in circumstances when the counterparty is over-hedged or under-hedged). The warrants are considered indexed to Entity A's own stock based on the following evaluation:~~

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share), unless there is a merger announcement. If there is a merger announcement, the settlement amount would be adjusted to offset the effect of the merger announcement on the fair value of the warrants. In that circumstance, the only variables that could affect the settlement amount would be inputs to the fair value of a fixed-for-fixed option on equity shares. For further discussion, see paragraphs 815-40-15-7E and 815-40-15-7G.

• > Example 7: Variability Involving Revenue Target

815-40-55-31 Paragraph superseded by Accounting Standards Update No. 202X-XX.Entity A issues warrants that permit the holder to buy 100 shares of its common stock for an initial price of $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that the strike price is reduced by $0.50 after any year in which Entity A does not achieve revenues of at least $100 million. The warrants are not considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The settlement amount would not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number of shares that would be issued at settlement is fixed, the strike price would be adjusted after any year in which Entity A does not achieve revenues of at least $100 million. The amount of an entity's annual revenues is not an input to the fair value of a fixed-for-fixed option on equity shares.

[Content amended and moved to paragraph 815-40-55-56]

• > Example 8: Variability Involving Stock Price Cap

815-40-55-32 Paragraph superseded by Accounting Standards Update No. 202X-XX.Entity A purchases net-settled call options that permit it to buy 100 shares of its common stock for $10 per share. However, the maximum appreciation on the call options is capped when Entity A's stock price reaches

~~$15 per share (that is, the counterparty's maximum obligation is $500 [($15 − $10) x 100 shares]). The call options have 10-year terms and are exercisable at any time. The call options are considered indexed to Entity A's own stock based on the following evaluation:~~

~~a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.~~
~~b. Step 2. The settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price when Entity A's stock price is between the $10 stated exercise price and the $15 price cap. However, whenever Entity A's stock price exceeds $15, the strike price of the call options increases and decreases in amounts equal to the corresponding increases and decreases in Entity A's stock price, such that the intrinsic value of each call option always equals $5. Because the only variable that can affect the settlement amount is the entity's stock price, which is an input to the fair value of a fixed-for-fixed option contract, the call options are considered indexed to the entity's own stock.~~

~~• > Example 9: Variability Involving Future Equity Offerings and Issuance of Equity-Linked Financial Instruments~~

815-40-55-33 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~This Example illustrates the application of the guidance beginning in paragraph 815-40-15-5 for a financial instrument that includes a **down round feature**. Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify both of the following:~~

~~a. If the entity sells shares of its common stock for an amount less than $10 per share, the strike price of the warrants is reduced to equal the issuance price of those shares.~~
~~b. If the entity issues an equity-linked financial instrument with a strike price below $10 per share, the strike price of the warrants is reduced to equal the strike price of the newly issued equity-linked financial instrument.~~

[Content amended and moved to paragraph 815-40-55-57]

815-40-55-34 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~The warrants are considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.~~
b. ~~Step 2. In accordance with paragraph 815-40-15-5D, when classifying a financial instrument with a down round feature, an entity shall exclude that feature when considering whether the instrument is indexed to the entity's own stock for the purposes of applying paragraphs 815-40-15-7C through 15-7I (Step 2). The instrument does not contain any other features to be assessed under Step 2.~~

[Content amended and moved to paragraph 815-40-55-58]

815-40-55-34A Paragraph superseded by Accounting Standards Update No. 202X-XX.~~See paragraph 260-10-45-12B for earnings-per-share considerations, paragraph 260-10-25-1 for recognition considerations, and paragraphs 505-10-50-3 through 50-3A for disclosure considerations.~~

~~• > Example 10: Variability Involving Regulatory Approval~~

815-40-55-35 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that if Entity A does not obtain regulatory approval of a particular drug compound within 5 years, the holder can surrender the warrants to Entity A for $2 per warrant (settleable in shares). The contingently puttable warrants are not considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.~~
b. ~~Step 2. The settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share), unless regulatory approval of a particular drug compound is not obtained within 5 years. If that approval is not obtained within the allotted time period, the holder could elect to surrender the warrants to Entity A in exchange for $2 per warrant. The contingent obligation to settle the warrants by transferring consideration~~

with a fixed monetary value if regulatory approval of a particular drug compound is not obtained within a specified time period does not represent an input to the fair value of a fixed-for-fixed option on equity shares. A freestanding equity-linked instrument that provides for a fixed payoff upon the occurrence of a contingent event which is not based on the issuer's share price is not indexed to an entity's own stock.

• > Example 11: Variability Involving a Currency Other Than the Entity's Functional Currency

815-40-55-36 Paragraph superseded by Accounting Standards Update No. 202X-XX.Entity A, whose functional currency is U.S. dollars (USD), issues warrants with a strike price denominated in Canadian dollars (CAD). The warrants permit the holder to buy 100 shares of its common stock for CAD 10 per share. Entity A's shares trade on an exchange on which trades are denominated in CAD. The warrants have 10-year terms and are exercisable at any time. The warrants are not considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The strike price of the warrants is denominated in a currency other than the entity's functional currency, so the warrants are not considered indexed to the entity's own stock.

• > Example 12: Variability Involving Dividend Distributions

815-40-55-37 Paragraph superseded by Accounting Standards Update No. 202X-XX.Entity A enters into a forward contract to sell 100 shares of its common stock for $10 per share in 1 year. Historically, Entity A has paid a dividend of $0.10 per quarter on its common shares. Under the terms of the forward contract, if dividends per common share differ from $0.10 during any 3-month period, the strike price of the forward contract will be adjusted to offset the effect of the dividend differential (actual dividend versus $0.10) on the fair value of the instrument. Additionally, the terms of the forward contract provide for an adjustment to the strike price, using commercially reasonable means, to offset the effect of any increased cost of borrowing Entity A's shares in the stock loan market on the fair value of the instrument. The forward contract is considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The only circumstances in which the settlement amount will not equal the difference between the fair value of 100 shares and $1,000 ($10 per share) are if dividends per common share differ from $0.10 during any 3-month period or if there is an increased cost of borrowing Entity A's shares in the stock loan market. The adjustments to the strike price resulting from those events are intended to offset their effects on the instrument's fair value. In those circumstances, the only variables that could affect the settlement amount (dividends and stock borrow cost) would be inputs to the fair value of a fixed-for-fixed forward contract on equity shares.

• > Example 13: Variability Involving Average Stock Price

815-40-55-38 Paragraph superseded by Accounting Standards Update No. 202X-XX.Entity A enters into a net-settleable forward contract to sell 100 shares of its common stock in 1 year for an amount equal to $10 per share plus interest calculated at a variable interest rate (Federal Funds rate plus a fixed spread). The share price used to determine the settlement amount is based on the volume-weighted average daily market price of Entity A's common stock for the 30-day period before the settlement date. The forward contract is considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. However, the only variables that cause the settlement amount to differ from a fixed-for-fixed settlement amount are the 30-day volume-weighted average daily market price of Entity A's common stock and an interest rate index. The pricing inputs of a fixed-for-fixed forward contract include the entity's stock price and interest rates. Additionally, the floating interest rate feature does not introduce a leverage factor or otherwise increase the effects of interest rate changes on the instrument's fair value.

• > Example 14: Variability Involving Interest Rate Index

815-40-55-39 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A enters into a forward contract to sell 100 shares of its common stock in 1 year for an amount equal to $10 per share plus interest calculated at a variable interest rate that varies inversely with changes in the London Interbank Offered Rate (LIBOR) (similar to an "inverse floater," as described in paragraphs 815-15-55-170 through 55-172). The forward contract is not considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.~~
b. ~~Step 2. The settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number of shares that would be issued at settlement is fixed, the strike price varies inversely with changes in an interest rate index. The inverse floating interest rate feature increases the effects of interest rate changes on the instrument's fair value (that is, the feature increases the instrument's fair value exposure to interest rate changes) when compared to the exposure to interest rate changes of a fixed-for-fixed forward contract.~~

~~• > Example 15: Variability Involving Stock Price Cap and Floor~~

815-40-55-40 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A enters into a net-settled forward contract to sell 100 shares of its common stock in 1 year for $1,000. However, the maximum amount payable to the counterparty at maturity is capped when Entity A's stock price is greater than or equal to $15 per share (that is, Entity A's maximum obligation is $500 [($15 − $10) x 100 shares]). Additionally, the maximum amount receivable from the counterparty at maturity is capped when Entity A's stock price is less than or equal to $5 per share (that is, the counterparty's maximum obligation is $500 [($5 − $10) x 100 shares]). The forward contract is considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.~~
b. ~~Step 2. The settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($1,000) when Entity A's stock price is between $5 and $15. However, whenever Entity A's stock price is greater than or~~

~~equal to $15 at maturity, the amount payable to the counterparty always equals $500. Additionally, whenever Entity A's stock price is less than or equal to $5 at maturity, the amount receivable from the counterparty always equals $500. Because the only variable that can affect the settlement amount is the entity's stock price, which is an input to the fair value of a fixed-for-fixed forward contract, the instrument is considered indexed to the entity's own stock.~~

~~• > Example 16: Variability Involving Cap on Shares Issued~~

815-40-55-41 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A enters into a forward contract to sell a variable number of its common shares in 1 year for $1,000. If Entity A's stock price is equal to or less than $10 at maturity, Entity A will issue 100 shares of its common stock to the counterparty. If Entity A's stock price is greater than $10 but equal to or less than $12 at maturity, Entity A will issue a variable number of its common shares worth $1,000. Finally, if the share price is greater than $12 at maturity, Entity A will issue 83.33 shares of its common stock. The forward contract is considered indexed to Entity A's own stock based on the following evaluation:~~

a. ~~Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.~~
b. ~~Step 2. The settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price ($1,000). Although the strike price to be received at settlement is fixed, the number of shares to be issued to the counterparty varies based on the entity's stock price on the settlement date. Because the only variable that can affect the settlement amount is the entity's stock price, which is an input to the fair value of a fixed-for-fixed forward contract on equity shares, the instrument is considered indexed to the entity's own stock.~~

~~• > Example 17: Variability Involving Various Underlyings~~

815-40-55-42 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A enters into a forward contract to sell 100 shares of its common stock for $10 per share in 1 year. Under the terms of the forward contract, the strike price of the forward contract would be adjusted to offset the resulting dilution (except for issuances and repurchases that occur upon~~

~~settlement of outstanding option or forward contracts on equity shares) if Entity A does any of the following:~~

- ~~a. Distributes a stock dividend or ordinary cash dividend~~
- ~~b. Executes a stock split, spinoff, rights offering, or recapitalization through a large, nonrecurring cash dividend~~
- ~~c. Issues shares for an amount below the then-current market price~~
- ~~d. Repurchases shares for an amount above the then-current market price.~~

~~The contractual terms that adjust the forward contract's strike price are eliminating the dilution to the forward contract counterparty that would otherwise result from the occurrence of those specified dilutive events. The adjustment to the strike price of the forward contract is based on a mathematical calculation that determines the direct effect that the occurrence of such dilutive events should have on the price of the underlying shares; it does not adjust for the actual change in the market price of the underlying shares upon the occurrence of those events, which may increase or decrease for other reasons.~~

815-40-55-43 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~The forward contract is considered indexed to Entity A's own stock based on the following evaluation:~~

- ~~a. Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.~~
- ~~b. Step 2. The only circumstances in which the settlement amount will not equal the difference between the fair value of 100 shares and $1,000 ($10 per share) are upon the occurrence of any of the following:~~
  - ~~1. The distribution of a stock dividend or ordinary cash dividend~~
  - ~~2. The execution of a stock split, spinoff, rights offering, or recapitalization through a large, nonrecurring cash dividend~~
  - ~~3. The issuance of shares for an amount below the then-current market price~~
  - ~~4. The repurchase of shares for an amount above the then-current market price.~~

~~An implicit assumption in standard pricing models for equity-linked financial instruments is that such events will not occur (or that the strike price of the instrument will be adjusted to offset the dilution caused by such events). Therefore, the only variables that could affect the settlement amount in this~~

~~example would be inputs to the fair value of a fixed-for-fixed option on equity shares.~~

~~**• > Example 18: Variability Involving Forward Contract Settled in a Currency Other Than the Entity's Functional Currency**~~

815-40-55-44 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A, whose functional currency is US$, enters into a forward contract that requires Entity A to sell 100 shares of its common stock for 120 euros per share in 1 year. The forward contract is not considered indexed to Entity A's own stock based on the following evaluation:~~

- ~~a. Step 1. The instrument does not contain an exercise contingency. Proceed to Step 2.~~
- ~~b. Step 2. The strike price of the forward contract is denominated in a currency other than the entity's functional currency, so the forward contract is not considered indexed to the entity's own stock.~~

~~**• > Example 19: Variability Involving Contingently Convertible Debt with a Market Price Trigger, Parity Provision, and Merger Provision**~~

815-40-55-45 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A issues a contingently convertible debt instrument with a par value of $1,000 that is convertible into 100 shares of its common stock. The convertible debt instrument has a 10-year term and is convertible at any time after any of the following events occurs:~~

- ~~a. Entity A's stock price exceeds $13 per share (market price trigger).~~
- ~~b. The convertible debt instrument trades for an amount that is less than 98 percent of its if-converted value (parity provision).~~
- ~~c. There is an announcement of a merger involving Entity A.~~

815-40-55-46 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~The terms of the convertible debt instrument also include a make-whole provision. Under that provision, if Entity A is acquired for cash before a specified date, the holder of the convertible debt instrument can convert into a number of shares equal to the sum of the fixed conversion ratio (100 shares per bond) and the make-whole shares. The number of make-whole shares is determined by reference to a table with axes of stock price and time. That table was designed such that the aggregate fair value of the shares deliverable (that~~

~~is, the fair value of 100 shares per bond plus the make-whole shares) would be expected to approximate the fair value of the convertible debt instrument at the settlement date, assuming no change in relevant pricing inputs (other than stock price and time) since the instrument's inception. The embedded conversion option is considered indexed to Entity A's own stock based on the following evaluation:~~

~~a. Step 1. The market price trigger and parity provision exercise contingencies are based on observable markets; however, those contingencies relate solely to the market prices of the entity's own stock and its own convertible debt. Also, the merger announcement exercise contingency is not an observable market or an index. Therefore, Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.~~

~~b. Step 2. An acquisition for cash before the specified date is the only circumstance in which the settlement amount will not equal the difference between the fair value of 100 shares and a fixed strike price ($1,000 fixed par value of the debt). The settlement amount if Entity A is acquired for cash before the specified date is equal to the sum of the fixed conversion ratio (100 shares per bond) and the make-whole shares. The number of make-whole shares is determined based on a table with axes of stock price and time, which would both be inputs in a fair value measurement of a fixed-for-fixed option on equity shares.~~

~~• > Example 20: Variability Involving Functional Currency Debt Convertible to a Stock That Trades in a Currency Other Than the Entity's Functional Currency~~

815-40-55-47 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Entity A, whose functional currency is the Chinese yuan (CNY), issues a debt instrument denominated in CNY with a par value of CNY 1,000 that is convertible into 100 shares of its common stock. Entity A's shares only trade on an exchange in which trades are denominated in US$. Those shares do not trade on an exchange (or other established marketplace) in which trades are denominated in CNY. The convertible debt instrument has a 10-year term and is convertible at any time. The embedded conversion option is considered indexed to Entity A's own stock based on the following evaluation:~~

~~a. Step 1. The embedded conversion option does not contain an exercise contingency. Proceed to Step 2.~~

b. Step 2. Upon exercise of the embedded conversion option, the settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price denominated in its functional currency (CNY 1,000 fixed par value of the debt). The determination of whether the embedded conversion option is indexed to the entity's own stock is not affected by the currency (or currencies) in which the underlying shares trade.

• > Example 21: Variability Involving Securities Issued to Establish a Market-Based Measure of Grantee Stock Option Value

815-40-55-48 Paragraph superseded by Accounting Standards Update No. 202X-XX.Entity A issues a security to investors for purposes of establishing a market-based measure of the grant-date fair value of a grant of stock options issued in a share-based payment transaction. Under the terms of that market-based stock option valuation instrument, Entity A is obligated to make variable quarterly payments to the investors that are a function of the net intrinsic value received by a pool of Entity A's grantees, based on actual stock option exercises by those grantees each period. The market-based stock option valuation instrument has a 10-year term, consistent with the contractual term of the underlying stock options. The market-based stock option valuation instrument is not considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The analysis of the exercise contingency (or contingencies) depends on the particular terms and features of the instrument. However, as indicated in Step 2 below, a market-based stock option valuation instrument would not be considered indexed to the entity's own stock.
b. Step 2. The settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price. The instrument provides for variable quarterly payments to investors that are based on actual stock option exercises for the period. Because a variable that affects the instrument's settlement amount is stock option exercise behavior, which is not an input to the fair value of a fixed-for-fixed option or forward contract on equity shares, the instrument is not considered indexed to the entity's own stock.

• > Example 233: Variability Involving Sales Volume

815-40-55-53 Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms; however, they only become exercisable after Entity A accumulates $100 million in sales to third parties. The warrants are considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The **{add glossary link}**exercise contingency**{add glossary link}** (that is, the accumulation of $100 million in sales to third parties) is an observable index. However, it can only be calculated or measured by reference to Entity A's sales, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.
b. Step 2. Upon exercise, the instrument's strike price ($10 per share) and the number of shares (100 shares) used to calculate the settlement amount are fixed~~would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share)~~.

[Content amended as shown and moved from paragraph 815-40-55-27]

• > Example 244: Variability Involving Stock Index

815-40-55-54 Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms; however, they only become exercisable if the Standard & Poor's S&P 500 Index increases 500 points within any given calendar year during that 10-year period. The warrants are not considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The exercise contingency (that is, the increase of 500 points in Standard & Poor's S&P 500 Index) is based on an observable index that is not measured solely by reference to the issuer's own operations.
b. Step 2. It is not necessary to evaluate Step 2.

[Content moved from paragraph 815-40-55-28]

• > Example 255: Variability Involving a General Market~~Commodity~~ Price

815-40-55-55 Entity A, which is in the business of mining and selling gold, issues warrants that permit the holder to buy 100 shares of its common stock

in exchange for one ounce of gold. The warrants have 10-year terms; however, they only become exercisable if Entity A completes an initial public offering. The warrants are not considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The exercise contingency (that is, the initial public offering) is not an observable market or an observable index, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.
b. Step 2. The strike price that is used to calculate the settlement amount would vary on the basis of the market price of gold. Therefore, not all of the variables that would affect the settlement amount are related to the acceptable variables in paragraph 815-40-15-7E~~would not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price~~. Although Entity A is in the business of mining and selling gold, ~~the number of shares that would be issued at settlement is fixed, the strike price varies based on the price of one ounce of gold. The~~the price of gold is a general market price (the price of a commodity) as described in paragraph 815-40-15-7K~~not an input to the fair value of a fixed-for-fixed option on equity shares~~.

[Content amended as shown and moved from paragraph 815-40-55-29]

• > Example 26~~7~~: Variability Involving Revenue Target

815-40-55-56 Entity A issues warrants that permit the holder to buy 100 shares of its common stock for an initial price of $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that the strike price is reduced by $0.50 after any year in which Entity A does not achieve revenues of at least $100 million. The warrants are ~~not~~ considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The strike price that is used to calculate the settlement amount could vary on the basis of the entity's own operations or activities. Therefore, all of the variables that would affect the settlement amount are related to the variables in paragraph 815-40-15-7E. ~~would not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number~~

~~of shares that would be issued at settlement is fixed, the~~The strike price of the warrants would be adjusted after any year in which Entity A does not achieve revenues of at least $100 million. The amount of an entity's annual revenues is related to the entity's own operations or activities as described in paragraph 815-40-15-7K~~not an input to the fair value of a fixed-for-fixed option on equity shares~~.

[Content amended as shown and moved from paragraph 815-40-55-31]

• > Example 27~~9~~: Variability Involving Financing Events~~Future Equity Offerings and Issuance of Equity-Linked Financial Instruments~~

815-40-55-57 ~~This Example illustrates the application of the guidance beginning in paragraph 815-40-15-5 for a financial instrument that includes a **down round feature**.~~ Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify ~~both of~~ the following:

a. If the entity sells shares of its common stock for an amount less than $10 per share, the strike price of the warrants is reduced to equal the issuance price of those shares.
b. If the entity issues an equity-linked financial instrument with a strike price less than~~below~~ $10 per share, the strike price of the warrants is reduced to equal the strike price of the newly issued equity-linked financial instrument.
c. If the entity modifies an existing equity-linked financial instrument (or embedded feature) so that it now has a strike price less than $10 per share, the strike price of the warrants is reduced to equal the strike price of the modified equity-linked financial instrument.

[Content amended as shown and moved from paragraph 815-40-55-33]

815-40-55-58 The warrants are considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. ~~In accordance with paragraph 815-40-15-5D, when classifying a financial instrument with a down round feature, an entity shall exclude~~

~~that feature when considering whether the instrument is indexed to the entity's own stock for the purposes of applying paragraphs 815-40-15-7C through 15-7I (Step 2). The instrument does not contain any other features to be assessed under Step 2.~~The strike price that is used to calculate the settlement amount could vary on the basis of the entity's own operations or activities. Therefore, all of the variables that could affect the settlement amount are related to the variables in paragraph 815-40-15-7E. The strike price of the warrants would be adjusted if Entity A sells shares of its stock for an amount less than $10 per share, issues an equity-linked financial instrument with a strike price less than $10 per share, or modifies an existing equity-linked financial instrument so that it has a strike price less than $10 per share. These financing transactions are related to an entity's own operations or activities as described in paragraph 815-40-15-7K.

[Content amended as shown and moved from paragraph 815-40-55-34]

• > Example 28: Variability Involving Change in Control and Volatility

815-40-55-59 Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have five-year terms and are exercisable at any time. However, the terms of the warrants specify that if Entity A has a change in control, the holder has the right to require Entity A to settle the warrants for an amount determined using the Black-Scholes-Merton option-pricing model as of the date of consummation of the change in control. Upon such an event, the volatility used in the option-pricing model would be equal to the greater of a fixed volatility and Entity A's historical volatility as of the trading day immediately following the consummation of the change in control. The warrants are considered indexed to Entity A's own stock based on the following evaluation:

a. Step 1. The instruments do not contain an exercise contingency. Proceed to Step 2.
b. Step 2. The settlement amount could vary on the basis of the entity's own stock price volatility and the entity's own operations or activities. Therefore, all of the variables that could affect the settlement amount are related to the variables in paragraph 815-40-15-7E. The warrants contain a volatility floor equal to a fixed volatility percentage. Both the entity's own stock price volatility (as described in paragraph 815-40-15-7J) and a change in control (which relates to an entity's own operations

or activities as described in paragraph 815-40-15-7K) are related to acceptable variables under paragraph 815-40-15-7E.

6. Add paragraph 815-40-65-3 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 202X-XX, *Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Targeted Improvements to Indexation*

815-40-65-3 The following represents the transition and effective date information related to Accounting Standards Update No. 202X-XX, *Derivatives and Hedging—Contracts in Entity's Own Equity (Subtopic 815-40): Targeted Improvements to Indexation*:

Effective date and early adoption

a. All entities shall apply the pending content that links to this paragraph for annual reporting periods beginning after [date to be inserted after exposure] and interim reporting periods [within or beginning after] those annual reporting periods.
b. Early adoption of the pending content that links to this paragraph [is or is not] permitted.

Transition methods

c. An entity shall apply the pending content that links to this paragraph on a modified prospective basis, as follows:
    1. Prospectively to new contracts that are entered into on or after the date of adoption of the pending content that links to this paragraph.
    2. Prospectively to contracts outstanding as of the date of adoption of the pending content that links to this paragraph as follows:
        i. For an outstanding freestanding instrument that, prior to the date that the pending content that links to this paragraph is adopted, had been classified as an asset or a liability because the indexation requirements had not been met, but for which the entity determines shall be reclassified to equity because as of the date that the pending content is adopted, the indexation requirements are met (and all other criteria to be equity classified in this Subtopic are met), the entity shall mark the instrument to

fair value immediately prior to reclassifying the instrument to equity. Gains and losses recorded to account for the instrument at fair value during the period that the contract was classified as an asset or a liability shall not be reversed.

ii. For an outstanding embedded feature that was previously bifurcated from its host contract and accounted for as a derivative because it did not meet the derivatives scope exception in paragraph 815-10-15-74(a) because the indexation requirements were not met, but for which the entity determines shall be reclassified to equity because as of the date that the pending content that links to this paragraph is adopted the indexation requirements are met (and all other criteria of the derivatives scope exception in paragraph 815-10-15-74(a) are met), the entity shall mark the embedded feature to fair value immediately prior to reclassifying the embedded feature to equity. Gains and losses recorded to account for the embedded feature at fair value during the period that the embedded feature was accounted for as a derivative shall not be reversed. The previously bifurcated embedded feature shall not be recombined with its host contract.

Transition disclosures

d. An entity that applies the pending content that links to this paragraph shall disclose:
    1. The nature of and reason for the change in accounting principle
    2. Any amount(s) reclassified from assets or liabilities to equity upon adoption of the pending content that links to this paragraph.

Amendments to Subtopic 260-10

7. Supersede paragraphs 260-10-05-1A, 260-10-25-1 and its related heading, 260-10-30-1 through 30-2 and their related heading, 260-10-35-1 and its related heading, 260-10-45-12B and its related heading, and 260-10-55-95 through 55-97 and their related heading and amend paragraph 260-10-45-21A, with a link to transition paragraph 815-40-65-3, as follows:

Earnings Per Share—Overall

Overview and Background

260-10-05-1A Paragraph superseded by Accounting Standards Update No. 202X-XX.An entity may issue a freestanding **financial instrument** (for example, a warrant) with a **down round feature** that is classified in equity. This Subtopic provides guidance on earnings per share and recognition and measurement of the effect of a down round feature when it is triggered.

Recognition

> Financial Instruments That Include a Down Round Feature

260-10-25-1 Paragraph superseded by Accounting Standards Update No. 202X-XX.An entity that presents **earnings per share** (EPS) in accordance with this Topic shall recognize the value of the effect of a **down round feature** in an equity-classified freestanding **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) when the down round feature is triggered. That effect shall be treated as a dividend and as a reduction of income available to common stockholders in **basic earnings per share**, in accordance with the guidance in paragraph 260-10-45-12B. See paragraphs 260-10-55-95 through 55-97 for an illustration of this guidance.

Initial Measurement

> Financial Instruments That Include a Down Round Feature

260-10-30-1 Paragraph superseded by Accounting Standards Update No. 202X-XX.As of the date that a **down round feature** is triggered (that is, upon the occurrence of the triggering event that results in a reduction of the strike price) in an equity-classified freestanding **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance), an entity shall measure the value of the effect of the feature as the difference between the following amounts determined immediately after the down round feature is triggered:

a. The fair value of the financial instrument (without the down round feature) with a strike price corresponding to the currently stated strike price of the issued instrument (that is, before the strike price reduction)
b. The fair value of the financial instrument (without the down round feature) with a strike price corresponding to the reduced strike price upon the down round feature being triggered.

260-10-30-2 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~The fair values of the financial instruments in paragraph 260-10-30-1 shall be measured in accordance with the guidance in Topic 820 on fair value measurement. See paragraph 260-10-45-12B for related **earnings per share** guidance and paragraphs 505-10-50-3 through 50-3A for related disclosure guidance.~~

Subsequent Measurement

~~> Financial Instruments That Include a Down Round Feature~~

260-10-35-1 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~An entity shall recognize the value of the effect of a **down round feature** in an equity-classified freestanding **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) each time it is triggered but shall not otherwise subsequently remeasure the value of a down round feature that it has recognized and measured in accordance with paragraphs 260-10-25-1 and 260-10-30-1 through 30-2. An entity shall not subsequently amortize the amount in additional paid-in capital arising from recognizing the value of the effect of the down round feature.~~

Other Presentation Matters

> Basic EPS

~~• > Freestanding Equity-Classified Financial Instrument with a Down Round Feature~~

260-10-45-12B Paragraph superseded by Accounting Standards Update No. 202X-XX.~~For a freestanding equity-classified **financial instrument** and an equity-classified convertible preferred stock (if the conversion feature has not been bifurcated in accordance with other guidance) with a **down round feature**, an entity shall deduct the value of the effect of a down round feature (as recognized in accordance with paragraph 260-10-25-1 and measured in accordance with paragraphs 260-10-30-1 through 30-2) in computing income available to common stockholders when that feature has been triggered (that is, upon the occurrence of the triggering event that results in a reduction of the strike price).~~

> Diluted EPS and Related Topics

• > Variable Denominator

260-10-45-21A Changes in an entity's share price may affect the exercise price of a **{add glossary link}**financial instrument**{add glossary link}** or the number of shares that would be used to settle the financial instrument. For example, when the principal of a convertible debt instrument is required to be settled in cash but the conversion premium is required to (or may) be settled in shares, the number of shares to be included in the diluted EPS denominator is affected by the entity's share price. In applying both the treasury stock method and the if-converted method of calculating diluted EPS, the average market price shall be used for purposes of calculating the denominator for diluted EPS when the number of shares that may be issued is variable, except for contingently issuable shares within the scope of the guidance in paragraphs 260-10-45-48 through 45-57. See paragraphs 260-10-55-4 through 55-5 for implementation guidance on determining an average market price.

Implementation Guidance and Illustrations

> Illustrations

~~**• > Example 16: Equity-Classified Freestanding Financial Instruments That Include a Down Round Feature**~~

260-10-55-95 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~Assume Entity A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share and that Entity A presents EPS in accordance with the guidance in this Topic. The warrants have a 10-year term, are exercisable at any time, and contain a **down round feature**. The warrants are classified as equity by Entity A because they are indexed to the entity's own stock and meet the additional conditions necessary for equity classification in accordance with the guidance in Subtopic 815-40 on derivatives and hedging—contracts in entity's own equity (see paragraphs 815-40-55-33 through 55-34A for an illustration of the guidance in Subtopic 815-40 applied to a warrant with a down round feature). Because the warrants are an equity-classified freestanding **financial instrument**, they are within the scope of the recognition and measurement guidance in this Topic. The terms of the down round feature specify that if Entity A issues additional shares of its common stock for an amount less than $10 per share or issues an equity-~~

~~classified financial instrument with a strike price below $10 per share, the strike price of the warrants would be reduced to the most recent issuance price or strike price, but the terms of the down round feature are such that the strike price cannot be reduced below $8 per share. After issuing the warrants, Entity A issues shares of its common stock at $7 per share. Because of the subsequent round of financing occurring at a share price below the strike price of the warrants, the down round feature in the warrants is triggered and the strike price of the warrants is reduced to $8 per share.~~

260-10-55-96 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~In accordance with the measurement guidance in paragraphs 260-10-30-1 through 30-2, Entity A determines that the fair value of the warrants (without the down round feature) with a strike price of $10 per share immediately after the down round feature is triggered is $600 and that the fair value of the warrants (without the down round feature) with a strike price of $8 per share immediately after the down round feature is triggered is $750. The increase in the value of $150 is the value of the effect of the triggering of the down round feature.~~

260-10-55-97 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~The $150 increase is the value of the effect of the down round feature to be recognized in equity in accordance with paragraph 260-10-25-1, as follows:~~

~~Retained earnings~~	~~$150~~	
~~Additional paid-in capital~~		~~$150~~

~~Additionally, Entity A reduces income available to common stockholders in its basic EPS calculation by $150 in accordance with the guidance in paragraph 260-10-45-12B. Entity A applies the treasury stock method in accordance with paragraphs 260-10-45-23 through 45-27 to calculate diluted EPS. Accordingly, the $150 is added back to income available to common stockholders when calculating diluted EPS. However, the treasury stock method would not be applied if the effect were to be antidilutive.~~

Amendments to Subtopic 505-10

8. Supersede paragraphs 505-10-50-3A and 505-10-60-7, with a link to transition paragraph 815-40-65-3, as follows:

Equity—Overall

Disclosure

505-10-50-3A Paragraph superseded by Accounting Standards Update No. 202X-XX.~~For a **financial instrument** with a **down round feature** that has been triggered during the reporting period and for which an entity has recognized the effect in accordance with paragraph 260-10-25-1, an entity shall disclose the following:~~

~~a. The fact that the feature has been triggered~~
~~b. The value of the effect of the down round feature that has been triggered.~~

Relationships

> Financial Instruments

505-10-60-7 Paragraph superseded by Accounting Standards Update No. 202X-XX.~~For guidance on the accounting for an equity-classified freestanding **financial instrument** with a **down round feature**, see Topic 260 on earnings per share.~~

Amendments to Subtopic 815-10

9. Supersede paragraph 815-10-15-75A, with a link to transition paragraph 815-40-65-3, as follows:

Derivatives and Hedging—Overall

Scope and Scope Exceptions

> Instruments

• > Instruments Not within Scope

• • > Certain Contracts Involving an Entity's Own Equity

815-10-15-75A Paragraph superseded by Accounting Standards Update No. 202X-XX.~~For purposes of evaluating whether a financial instrument meets the scope exception in paragraph 815-10-15-74(a)(1), a **down round feature** shall be excluded from the consideration of whether the instrument is indexed to the entity's own stock.~~

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board.

Richard R. Jones, *Chair*
Hillary H. Salo, *Vice Chair*
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt
Dr. Joyce T. Joseph
Catherine M. Shakespeare

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. The objectives of the amendments in this proposed Update are to simplify the application of the indexation guidance in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity, and to improve the decision usefulness of information provided to investors. Subtopic 815-40 provides a scope exception from derivative accounting for contracts that are issued or held by the reporting entity that are indexed to an entity's own stock (referred to as the "indexation guidance") and classified in stockholder's equity (referred to as the "equity classification guidance").

BC3. The amendments in this proposed Update would make improvements to Step 2 of the indexation guidance in Section 815-40-15 by:

a. Eliminating the requirement to evaluate whether the settlement amount of an equity-linked instrument is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares (referred to as the "fixed-for-fixed assessment")
b. Addressing issues related to diversity in practice of how leverage factors are evaluated by specifying that any magnitude of changes to the settlement amount (including adjustments to the strike price or the number of shares used to calculate the settlement amount) that relates to the acceptable variables would not, in and of itself, preclude an instrument from being considered indexed to an entity's own stock.
c. Eliminating the down round feature scope exception in Subtopic 815-40 and related earnings per share (EPS) guidance
d. Improving decision usefulness of information provided to investors by requiring that an entity disclose additional information about terms and features of its equity-classified contracts.

BC4. The amendments in this proposed Update would not change related guidance in other areas, such as Step 1 of the indexation guidance in Section 815-40-15, the equity classification guidance in Section 815-40-25, the accounting for derivatives guidance in Topic 815 (besides Step 2 of the indexation guidance), or any other aspects of the liability classification requirements in Topic 480, Distinguishing Liabilities from Equity.

Background Information

BC5. The current liabilities and equity guidance was developed through the issuance of several FASB and Emerging Issues Task Force (EITF) standards in the 2000s, including FASB Statement No. 133*, Accounting for Derivative Instruments and Hedging Activities*, EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, A Company's Own Stock," and EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock." Section 815-40-15 provides guidance for determining whether an equity-linked freestanding instrument or embedded feature is indexed to an entity's own stock. The guidance applies to freestanding instruments within the scope of Subtopic 815-40 and to embedded features when assessing eligibility for the derivatives scope exception in Subtopic 815-10, Derivatives and Hedging—Overall. The analysis to determine whether a contract is indexed to an entity's own stock is a two-step process that requires that the contract is both:

a. Indexed to the entity's own stock (Section 815-40-15)
b. Equity classified (Section 815-40-25).

BC6. If these criteria are met, a freestanding instrument would be equity classified, and an embedded feature would not be separated from its host contract. If these criteria are not met, the freestanding instrument must be accounted for as an asset or a liability (subsequently measured at fair value with changes reported in earnings) or as a derivative (if it meets the definition of a derivative in Subtopic 815-10). If an embedded feature does not meet the derivatives scope exception in Subtopic 815-10 and meets the bifurcation criteria in Subtopic 815-15, Derivatives and Hedging—Embedded Derivatives, it must be bifurcated and accounted for separately.

BC7. The Board has undertaken several projects to improve the guidance for distinguishing liabilities from equity. There have been challenges in making broader changes to the guidance because of differing views among

stakeholders about financial reporting outcomes (for example, concerns that certain instruments that are currently liability classified would become equity classified). In recent years, the Board has been successful in reducing the cost and complexity of applying the liabilities and equity guidance through narrow improvements, such as the amendments in Accounting Standards Update No. 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*, which reduced the number of accounting models for convertible debt instruments and convertible preferred stock and eliminated several additional conditions required for equity classification.

BC8. In response to the 2025 Invitation to Comment, *Agenda Consultation* (2025 ITC), stakeholders, primarily practitioners, noted that distinguishing liabilities from equity should be a top priority for the Board and that the guidance in Subtopic 815-40 (a) is complex and costly to apply and is a frequent area of financial statement restatements and (b) can result in diversity in practice and outcomes that are inconsistent, counterintuitive, and difficult for users to understand. Additionally, stakeholders indicated that entities evaluate leverage factors differently, leading to diversity in practice. Furthermore, many stakeholders supported amending the liabilities and equity guidance in Subtopic 815-40, even if those amendments would significantly change financial reporting outcomes and result in more contracts being equity classified.

Benefits and Costs

BC9. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board’s assessment of the benefits and costs of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC10. Over the course of this project, the Board and the FASB staff conducted outreach with stakeholders to obtain information about potential improvements to the indexation guidance in Section 815-40-15 and the expected benefits and costs of those improvements.

BC11. The Board expects that the key benefits of the amendments in this proposed Update would be as follows:

a. Replacing the fixed-for-fixed assessment with the acceptable variables approach would make the indexation guidance less complex to apply and understand. The Board noted that the proposed amendments would maximize the use of the operable aspects of the current indexation guidance while making targeted improvements to the areas of the guidance that are most challenging to apply in practice. Stakeholders are already familiar with the acceptable variables because those variables are largely drawn from the current indexation guidance in Section 815-40-15 and the only new acceptable variable, the entity's own operations or activities, is a concept that already exists elsewhere in GAAP, as discussed in paragraph BC30.
b. Eliminating the down round scope exception in connection with the acceptable variables approach would reduce cost and complexity for stakeholders. Under the proposed amendments, a settlement adjustment resulting from a down round feature would be considered to be related to the entity's own operations or activities and thus would not preclude a contract from being considered indexed to the entity's own stock. As a result, entities would not need to apply a separate, feature-specific indexation scope exception and the associated recognition, measurement, earnings per share, and disclosure guidance. Eliminating that separate guidance would reduce cost and complexity for stakeholders while achieving the same classification outcome.
c. The proposed amendments would improve the decision usefulness of information provided to investors. Under the proposed amendments, the Board expects that more contracts would be classified as equity and there would be enhanced disclosure of variables that drive the settlement amount of equity-classified instruments. In outreach, investors generally indicated that the changes in fair value that result from liability classification are not decision useful and that understanding the terms and features of equity-linked instruments would be more useful to their analyses. Some investors noted that they remove the fair value measurement for liability-classified instruments from their

analyses because the resulting income statement volatility is not decision useful. In addition, many investors stated that equity classification better aligns with how they analyze these instruments. To enhance transparency for investors about the contracts that would be classified as equity under the proposed amendments, the Board decided to require that an entity disclose variables (or contingent events) that could, or did, cause the settlement amount to vary significantly.

d. Equity classification would eliminate the need for subsequent remeasurement of those instruments, except for a final mark-to-market adjustment immediately before reclassification. Accordingly, the Board expects that the ongoing costs of applying the proposed amendments would not be higher (and may be lower) than those under current guidance.

BC12. As a result, the Board expects that the amendments in this proposed Update would benefit all stakeholders. The proposed amendments would be easier to apply and understand than current GAAP, reducing complexity and costs in applying the guidance. Additionally, the Board expects that investors would benefit from the increased consistency of interpretation and application as well as the enhanced transparency from the proposed disclosure.

BC13. The Board also acknowledged that the amendments in this proposed Update could introduce additional costs for preparers, including the following:

a. Entities would incur initial costs to update their accounting policies for the proposed amendments, primarily related to the evaluation of Step 2 of the indexation guidance.
b. Upon transition, entities would incur costs to reevaluate their outstanding instruments as of the adoption date and to reclassify certain instruments from asset or liability classification to equity classification. However, the Board expects that these would be one-time costs and may not be significant.

BC14. Therefore, the Board decided that the expected benefits of the amendments in this proposed Update would justify the expected costs.

Basis for Conclusions

Current Guidance and Recent Stakeholder Feedback

BC15. Section 815-40-15 provides guidance to evaluate whether contracts issued or held by an entity are indexed to the entity's own stock. Whether a contract is considered indexed to an entity's own stock is determined under a two-step process: under Step 1, an entity evaluates the contract's contingent exercise provisions, if any, and under Step 2, an entity evaluates the contract's settlement provisions (the fixed-for-fixed assessment). On the basis of that assessment, an instrument is considered indexed to the entity's own stock if its settlement amount equals the difference between the fair value of a fixed number of the entity's equity shares and a fixed monetary amount (or a fixed amount of a debt instrument issued by the entity). If the settlement amount of the contract is not fixed, the contract is considered indexed to the entity's own stock only if the variables that could affect the settlement amount would be inputs to the fair value of a fixed-for-fixed forward or option on equity shares. Paragraph 815-40-15-7E lists nine such inputs as examples, and paragraph 815-40-15-7F states that an instrument is not considered indexed to the entity's own stock if its settlement amount is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or a forward contract on equity shares (such as a leverage factor). Furthermore, there are 20 examples in paragraphs 815-40-55-26 through 55-48 that illustrate the application of the indexation guidance, which have been heavily utilized by stakeholders.

BC16. Recent stakeholder feedback, including feedback received as part of the 2025 ITC, identified the fixed-for-fixed assessment in Step 2 as the principal source of complexity, cost, and inconsistent application in the current indexation guidance. Stakeholders observed that, in practice, instruments that are evaluated under the indexation guidance rarely settle in a fixed number of shares for a fixed price. Therefore, an entity is generally required to evaluate whether the variables that could affect the settlement amount are inputs to the fair value of a fixed-for-fixed forward or option on equity shares. Stakeholders observed that applying that assessment has become more challenging because of evolving terms and features in equity-linked instruments (such as “greater of” inputs and counterparty-related adjustments) and has resulted in inconsistent interpretations in practice. Practitioners noted that although the list of acceptable inputs in paragraph 815-40-15-7E is not all-inclusive, in practice,

the indexation guidance is often applied by determining whether the contract's fact pattern is identical to or can be analogized to the illustrative examples.

BC17. Also, some stakeholders recommended that the Board consider improvements to other areas of the liabilities and equity guidance, including (a) the equity classification guidance in Section 815-40-25 and (b) the guidance in Topic 480. The Board acknowledged that improvements to those areas may be warranted. However, the Board decided to focus this project on the indexation guidance because most stakeholders have indicated that there is a sufficiently pervasive and pressing need to address Step 2 of the indexation guidance.

The Acceptable Variables Approach

BC18. Under the amendments in this proposed Update, an instrument would be considered indexed to an entity's own stock as long as the variables (or contingent events) that could cause the instrument's settlement amount to vary (including through an adjustment to the strike price or the number of shares used to calculate the settlement amount) are related to specified acceptable variables, regardless of the potential magnitude of an adjustment to the settlement amount. The specified acceptable variables would be:

a. The entity's own stock price
b. Term of the instrument
c. The entity's own expected dividends or other dilutive activities
d. Stock borrow costs associated with the entity's own stock
e. Interest rates
f. The entity's own stock price volatility
g. The entity's own credit spread
h. The entity's own operations or activities.

Most of these variables are included in current paragraph 815-40-15-7E. The proposed amendments would retain many of those variables because stakeholders generally noted that the variables relate to the entity, the entity's own stock price, or the pricing of an equity-linked instrument. Furthermore, the proposed amendments would add the entity's own operations or activities to the list of acceptable variables in response to stakeholder feedback that settlement adjustments based on an entity's own operations or activities should not preclude indexation. The Board decided to pursue the acceptable variables approach because it represents a targeted improvement to Step 2 that retains

the structure of the current guidance, while addressing the principal source of complexity—the fixed-for-fixed assessment.

BC19. Under the amendments in this proposed Update, an adjustment (including leverage factors) to the settlement amount that relates to the acceptable variables would not preclude an instrument from being considered indexed to an entity's own stock, regardless of the magnitude of the adjustment. Conversely, any variables that could affect the settlement amount that do not relate to the listed acceptable variables would preclude an instrument from being considered indexed to the entity's own stock. The Board's use of the term *related to* in the context of assessing the acceptable variables is intended to acknowledge that an adjustment may be of any magnitude, provided that it is triggered by an acceptable variable. For example, in the illustration in paragraph 815-40-55-56, the potential adjustment to the strike price would be considered related to an acceptable variable because (a) an entity's revenue is an acceptable variable (the entity's own operations or activities) and (b) the magnitude of the resulting adjustment to the strike price does not affect that conclusion.

BC20. The Board decided that the amendments in this proposed Update would:

a. Eliminate the requirement to evaluate the pricing of a fixed-for-fixed option or forward contract on equity shares, which stakeholders identified as difficult to apply and a source of inconsistent interpretation
b. Avoid the use of terms that require subjective assessments such as *extraneous* or *probable* that, based on stakeholder feedback, may introduce or perpetuate inconsistency in application (see the discussion of other approaches considered by the Board as described in paragraph BC39)
c. Result in more contracts being considered indexed to the entity's own stock, particularly contracts with settlement adjustments that relate to the entity's own operations or activities
d. Provide a clear, defined list of acceptable variables that minimizes the need to interpret the indexation principle through a comparison with illustrative examples
e. Clarify that any magnitude of an adjustment caused by the acceptable variables would not preclude indexation.

BC21. Under current GAAP, an instrument is not considered indexed to an entity's own stock if the instrument contains a feature (such as a leverage factor) that increases exposure in a manner that is inconsistent with a fixed-for-fixed forward or option on equity shares. Stakeholders indicated that there is diversity in practice in determining when leverage factors should result in an instrument not being considered indexed to the entity's own stock. For example, under current GAAP, Example 15 in paragraph 815-40-55-40 indicates that a stock price cap and floor do not preclude indexation. However, some stakeholders indicated that a cap or a floor inherently introduces leverage because it affects a holder's exposure to a given variable (in this case, stock price). Furthermore, certain provisions in a contract may require that the settlement amount be calculated using a variable specified at inception of the instrument, or the greater of a market variable at the time of settlement and a variable specified at inception of the instrument. Stakeholders indicated that there is diversity in practice on whether these provisions introduce leverage and therefore preclude an instrument from being considered indexed to the entity's own stock.

BC22. The Board considered two alternative approaches to address the practice issues relating to leverage factors: a fixed-for-fixed forward or option-pricing model approach and a commercially reasonable approach.

a. Fixed-for-fixed forward or option-pricing model approach. This approach would have required that if an instrument contains a feature that increases exposure to the stock price or the variables included in paragraph 815-40-15-7E in a manner that is inconsistent with a fixed-for-fixed forward or option on equity shares, the instrument would be precluded from being considered indexed to the entity's own stock. However, under this approach, an instrument would not be precluded from being indexed to the entity's own stock if the settlement amount varies on the basis of the entity's own operations or activities, regardless of the extent of leverage because an entity's own operations or activities are not inputs to the fair value of a fixed-for-fixed forward or option on equity shares. Therefore, adjustments to the contract's settlement amount that are intended to offset the effects of the occurrence of a contingent event, such as a change in control, would not preclude an instrument from being indexed to the entity's own stock.
b. Commercially reasonable approach. Under this approach, adjustments to the settlement amount would need to be commercially reasonable for

an instrument to be considered indexed to the entity's own stock. Additionally, similar to the fixed-for-fixed forward or option-pricing model approach, this approach would not preclude instruments with settlement adjustments intended to offset the effects of the occurrence of a contingent event, such as a change in control, on the contract's fair value from being indexed to the entity's own stock.

BC23. The Board considered these alternative approaches but ultimately decided that they would be costly and complex to apply and could have inconsistent interpretations because they (a) directly or indirectly reference the fixed-for-fixed assessment that the amendments in this proposed Update would eliminate or (b) incorporate a subjective threshold, such as commercially reasonable. Furthermore, in determining that adjustments to the settlement amount that relate to the listed acceptable variables would not preclude an instrument from being considered indexed to the entity's own stock, the Board considered that other elements of the guidance may require that contracts with a significant amount of leverage be liability classified. For example, instruments would still need to be evaluated for liability classification under Topic 480 and the equity classification guidance in Section 815-40-25. If certain freestanding instruments that represent obligations of the entity that could require settlement in a variable number of shares are predominantly based on something other than the fair value of the entity's shares, those instruments may be required to be classified as liabilities in accordance with paragraph 480-10-25-14(b). Additionally, if the instrument is so leveraged that an entity would be required to issue a significantly large amount of shares, it may not have sufficient authorized and unissued shares to meet the additional conditions for equity classification in accordance with paragraph 815-40-25-10(b). Therefore, the Board acknowledged that if the instrument contains significant leverage and meets the proposed revised indexation guidance, other GAAP guardrails may prevent the instrument from being equity classified.

BC24. In an effort to further reduce cost and complexity, the Board also considered whether the amendments in this proposed Update should include a qualitative screen to prevent variables that only affect settlement amounts upon the occurrence of contingent events (contingent events screen) from causing the instrument to not be indexed to equity. However, the Board decided not to pursue the contingent events screen because the proposed amendments should sufficiently improve the indexation guidance. In addition, although a contingent events screen may further simplify the guidance, the accounting for

the instrument upon the trigger of an event may be more complex, which would reduce the benefits of a screen. For example, additional guidance would be necessary to address the subsequent accounting for a contract that is initially classified in equity but is reclassified as a liability upon the occurrence of a contingent event.

The Acceptable Variables

BC25. The list of acceptable variables in proposed paragraph 815-40-15-7E includes the entity's own stock price and most of the variables included in current paragraph 815-40-15-7E, which, under current GAAP, are identified as examples of fair value inputs to a fixed-for-fixed forward or option on equity shares.

BC26. The Board considered whether the amendments in this proposed Update should further describe each of the acceptable variables. On the basis of stakeholder outreach, the Board decided that the entity's own stock price volatility (see paragraphs BC28 and BC29) and the entity's own operations or activities (see paragraphs BC30–BC33) require additional description to ensure consistent interpretation but that the remaining variables are widely understood in practice and do not require additional description. The Board observed that providing additional descriptions of the remaining variables could introduce complexity by suggesting that the application of these variables differs from how they are currently used in practice.

BC27. Additionally, the Board decided that the ability to maintain a standard hedge position in the underlying shares would no longer need to be included as a separate acceptable variable (see paragraphs BC34 and BC35).

The Entity's Own Stock Price Volatility

BC28. The amendments in this proposed Update would clarify that any fixed or prespecified volatility (including a floor or cap on an entity's own stock price volatility) as well as any magnitude of an entity's own stock price volatility (including a multiple) would not preclude an instrument from being considered indexed to the entity's own stock. Additionally, the proposed amendments would clarify that volatility of a reasonably appropriate peer company or group of companies is permitted when the entity does not have its own observable stock price volatility (for example, a private company that estimates its own stock price volatility on the basis of a peer group with observable stock price

volatilities). The Board observed that it would be acceptable to consider a fixed, prespecified, capped, or floored volatility input as related to an entity's own stock price volatility. In contrast, the Board noted that a settlement amount calculated explicitly in reference to the stock price volatility of an unrelated entity when an entity has its own observable stock price volatility would preclude an equity-linked instrument from being considered indexed to an entity's own stock. Furthermore, the proposed amendments would include a new illustrative example to clarify that a contract with a "greater of" stock price volatility input affecting the settlement amount would not preclude an instrument from being considered indexed to the entity's own stock (see paragraph BC38).

BC29. On the basis of feedback from stakeholders, the Board considered whether to limit the entity's own stock price volatility variable. During outreach, some stakeholders suggested that settlement adjustments based on a prespecified volatility input or on the volatility of a peer company may not relate to the entity's own stock price volatility and that allowing such a volatility could permit contracts to be considered indexed to the entity's own stock, which, in the view of those stakeholders, may be inconsistent with the Board's intent. However, the Board decided not to further limit the entity's own stock price volatility variable because that might result in (a) contracts with certain provisions, such as a prespecified volatility variable, being precluded from meeting indexation even if it is related to an entity's own stock price volatility and (b) instruments issued by private companies being precluded from meeting indexation and required to be classified as a liability because they do not have observable stock price volatility metrics.

The Entity's Own Operations or Activities

BC30. The amendments in this proposed Update would add the entity's own operations or activities to the list of acceptable variables. The Board decided to include this variable in response to stakeholder feedback that settlement adjustments based on the issuer's operations or activities should not preclude an instrument from being considered indexed to the entity's own stock. The Board observed that the concept of an entity's own operations or activities is used in other areas of GAAP. For example:

a. Paragraph 815-10-15-59(e), added by the amendments in Accounting Standards Update No. 2025-07, *Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives*

Scope Refinements and Scope Clarification for Share-Based Noncash Consideration from a Customer in a Revenue Contract, provides a derivatives scope exception for non-exchange-traded contracts if the underlying is based on operations or activities specific to one of the parties to the contract.

b. Step 1 of the indexation guidance in Section 815-40-15 contemplates an issuer's own operations as part of the evaluation of contingent exercise provisions.
c. Topic 718, Compensation—Stock Compensation, evaluates performance conditions defined by reference to the grantor's own operations or activities.

The Board observed that although the concept of an entity's own operations or activities is used in similar ways across these areas of GAAP, it is not used identically. Therefore, the Board decided to clarify what is intended by the entity's own operations or activities variable in proposed paragraph 815-40-15-7K.

BC31. The amendments in this proposed Update would clarify that general market prices (such as the price of a commodity) and indexes (such as the Standard & Poor's S&P 500 Index) are not considered related to an entity's own operations or activities. The Board observed that this clarification would be consistent with the application of the operations or activities concept under the derivatives scope exception in paragraph 815-10-15-59(e), Step 1 of the indexation guidance, and the performance conditions concept in Topic 718. The Board acknowledged that some entities may consider settlement adjustments based on market prices (such as the price of a commodity) to be related to their own operations or activities. For example, an entity that mines gold may consider the market price of gold to be related to its own operations. However, the Board observed that determining which entities could have permissible settlement adjustments based on market prices or indexes would require subjective judgment and would likely introduce diversity in practice. Furthermore, the Board noted that the word *general* is used to clarify that the proposed amendments would be intended to exclude broad market-based measures, such as commodity prices and equity indexes, from the concept of an entity's own operations or activities. The Board does not intend for this clarification to affect the evaluation of variables that are specific to the issuing entity (for example, an entity’s own stock price) or other variables that are otherwise identified as acceptable variables under the proposed amendments (for example, interest rates).

BC32. The amendments in this proposed Update would clarify that an entity does not need to evaluate whether settlement adjustments are within the entity's control. The Board observed that this clarification would be consistent with the application of the derivatives scope exception in paragraph 815-10-15-59(e) and with Step 1 of the indexation guidance, neither of which requires that an entity consider whether the outcome is within its control. The Board observed that certain settlement adjustments may be based on events that are not within the entity's control, such as a change in control or the receipt of regulatory approval, and noted that the entity's own operations or activities variable is intended to include these types of settlement adjustments.

BC33. The amendments in this proposed Update would clarify that adjustments based on the operations or activities of the counterparty are not based on or related to an acceptable variable. The Board observed that this clarification differs from the application of the operations or activities concept under the derivatives scope exception in paragraph 815-10-15-59(e) and the performance conditions concept in Topic 718, both of which contemplate the operations or activities of either party to the contract. Entities apply the guidance in Subtopic 815-40 to evaluate contracts indexed to *an entity's own* equity, and the Board concluded that a contract with a settlement adjustment based on the counterparty's operations or activities was not intended to meet the indexation guidance. Therefore, the Board observed that this clarification would be appropriate given the narrow focus of Subtopic 815-40 on contracts in an entity's own equity.

The Ability to Maintain a Standard Hedge Position in the Underlying Shares

BC34. The amendments in this proposed Update would eliminate the ability to maintain a standard hedge position in the underlying shares from the list of acceptable variables and supersede the related guidance in paragraph 815-40-15-7G. The Board observed that the principle underlying this variable is tied to the option pricing theory that was the foundation of the fixed-for-fixed assessment. The Board concluded that, beyond the connection to option pricing theory, this variable would not be meaningful in determining whether an instrument was indexed to an entity’s own equity. Therefore, because the proposed amendments would eliminate the requirement to evaluate the fixed-for-fixed assessment, the Board concluded that including this variable would be counterintuitive. The Board also observed that because this would be the

only variable connected to the option pricing theory, retaining this variable could result in it being interpreted more narrowly than the Board's intent for the proposed amendments.

BC35. Paragraph 815-40-15-7G describes the ability to maintain a standard hedge position in the underlying shares as one of the variables that may be a fair value input to a fixed-for-fixed forward or option on equity shares. That paragraph indicates, for example, that a merger announcement may cause an immediate jump in the price of shares underlying an equity-linked option contract, that a holder of that instrument would not be able to continuously adjust its hedge position in the underlying shares because of the discontinuous stock price change, and that provisions that adjust the terms of the instrument to offset the net gain or loss resulting from a merger announcement or similar event do not preclude an equity-linked instrument from being considered indexed. The Board observed that settlement adjustments that offset events that cause stock price discontinuities, such as a merger announcement, or any other events that could affect a counterparty's ability to maintain a standard hedge position in the entity's own shares relate to an entity's own operations or activities. Accordingly, the Board intends that contracts with adjustments related to the ability to maintain a standard hedge position in the underlying shares would continue to not be precluded from being considered indexed to the entity's own stock under the entity's own operations or activities variable.

Illustrative Examples

BC36. The amendments in this proposed Update would supersede the majority of illustrative examples in Section 815-40-55 that address the indexation guidance. The Board considered that the examples were included in current guidance to (a) facilitate application of the complex fixed-for-fixed assessment and (b) reflect views that Board members and EITF members had about the classification of instruments with certain features at the time the guidance was issued. For those reasons, the illustrative examples are a key component of the current guidance and were considered necessary for application purposes. However, considering that the proposed amendments would make the guidance less complex to apply (and would eliminate the fixed-for-fixed assessment that necessitated the examples), the Board decided to remove illustrative examples that are no longer needed to apply the proposed amendments. The Board noted that the removal of those examples should not be interpreted to imply that conclusions reached under the proposed

amendments should be consistent with, or differ from, conclusions reached under current GAAP for the fact patterns illustrated in those examples. Rather, entities should apply the proposed amendments to each arrangement on the basis of its specific facts and circumstances. The Board intended that any illustrative examples included in the proposed amendments should be for illustration purposes only.

BC37. The amendments in this proposed Update would not make any changes to Step 1 of the indexation guidance. Therefore, the Board decided to retain most of the illustrative examples that describe a Step 1 evaluation.

BC38. Feedback from stakeholders generally indicated that it would be helpful to include examples in the amendments in this proposed Update to Subtopic 815-40 that illustrate the evaluation of adjustments related to an entity's own stock price volatility and the entity's own operations or activities. The Board noted that several current examples illustrate fact patterns that involve an entity's own operations or activities (such as settlement adjustments based on revenue or financing events). Therefore, the Board decided to retain a few of those examples and modify them on the basis of the acceptable variable approach. However, there are no examples in Subtopic 815-40 that discuss an entity's own stock price volatility. Based on stakeholder feedback, the proposed amendments would add a new example that describes a contract with a settlement amount that would be calculated on the basis of the "greater of" two stock price volatilities (for example, a prespecified fixed volatility percentage and historical volatility). The Board noted that this would directly address a current practice issue and assist stakeholders in understanding how to interpret the entity's own stock price volatility under the proposed amendments. The illustrative example does not include any specific quantitative volatility percentages because any fixed or prespecified volatility, including a floor or cap on an entity's own stock price volatility, would not preclude indexation.

Other Approaches Considered

BC39. During initial deliberations, the Board considered two other approaches: the at-least-in-part approach and the extraneous approach.

a. At-least-in-part approach. This approach would have replaced Step 1 and Step 2 of the indexation guidance in Section 815-40-15. Under this approach, a contract would have been considered indexed to the entity's own stock if the contingent exercise provisions or the settlement amount

of the instrument was based, at least in part, on an entity's own operations, activities, or stock price. Under this approach, a contract would have been considered indexed if any contingent exercise provisions and the instrument's settlement amount were based, at least in part, on an entity's own operations, activities, or stock price. For example, if an instrument has two features, one that settles on the basis of a revenue target related to the issuer and another that settles on the basis of the price of gold, the instrument would be considered indexed to the entity's own stock. Stakeholders noted that this approach would be auditable and operable but that it likely would be too broad, resulting in too many instruments being classified in equity. Many stakeholders noted that this approach would essentially have the same effect as eliminating indexation from Subtopic 815-40. The Board, therefore, agreed that this approach may be too broad because almost all equity contracts would meet indexation.

b. Extraneous approach. This approach would have replaced Step 2 of the indexation guidance. Under this approach, an instrument would have been considered indexed to an entity's own stock as long as the variables that could affect the settlement amount were not extraneous to the entity's own operations, activities, or stock price. This approach was intended to have a broader view of indexation than current GAAP, but a narrower view of indexation than the at-least-in-part approach because it might require contracts with a significant amount of leverage to be liability classified. Some stakeholders supported this approach because it would simplify the analysis and would allow more contracts to meet indexation. Those stakeholders indicated that this approach would provide a consistent principle to evaluate instruments under Step 2 that would be less complex than the fixed-for-fixed assessment and would allow an entity to evaluate its individual facts and circumstances. Other stakeholders indicated that the approach would be similar to the current guidance and, therefore, may not make meaningful improvements. The Board noted that the extraneous approach would require judgment and could replace the complexity of evaluating the fixed-for-fixed assessment with the complexity of evaluating the meaning of extraneous, which could result in inconsistent interpretations and outcomes.

Down Round Features

BC40. The amendments in this proposed Update would eliminate the down round feature scope exception in Subtopic 815-40, including down round feature-specific guidance in Topic 260, Earnings Per Share, and in Topic 505, Equity, for warrants and convertible preferred stock.

BC41. The accounting for financial instruments with down round features was addressed by the amendments in Accounting Standards Update No. 2017-11, *Earnings Per Share (Topic 260), Distinguishing Liabilities from Equity (Topic 480), Derivatives and Hedging (Topic 815): I. Accounting for Certain Financial Instruments with Down Round Features, II. Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests with a Scope Exception*, which were developed in response to feedback from members of the Private Company Council and the American Institute of Certified Public Accountants' Technical Issues Committee. Before those amendments, a down round feature precluded an instrument from being considered indexed to an entity's own stock under Step 2 of the indexation guidance, which generally resulted in liability classification and remeasurement of the instrument at fair value each reporting period with changes in fair value recognized in earnings. Stakeholders observed that this outcome created cost and complexity and did not reflect the economics of the feature. The amendments in Update 2017-11 added the scope exception in paragraph 815-40-15-5D, which excluded a down round feature from the consideration of whether an instrument is indexed to an entity's own stock. To preserve information about the effect of a triggered down round feature, the amendments in Update 2017-11 also added recognition, measurement, and EPS guidance to Topic 260 (under which the value of the effect of a triggered down round feature is treated as a deemed dividend and as a reduction of income available to common stockholders in basic EPS) and related disclosure requirements to Topic 505.

BC42. Stakeholders questioned whether a feature-specific scope exception would remain necessary under the amendments in this proposed Update, noting that retaining a feature-specific scope exception could introduce unnecessary complexity. Additionally, stakeholders questioned whether the down round scope exception creates inconsistent outcomes for economically similar instruments because it does not explicitly include strike price

adjustments that are triggered by the modification of another outstanding equity-linked financial instrument.

BC43. On the basis of that stakeholder feedback, the Board decided to eliminate the down round scope exception because the exception would no longer be necessary under the amendments in this proposed Update. A feature such as a down round that adjusts an instrument's strike price upon the sale of shares or issuance or modification of another equity-linked financial instrument at a price below the instrument's currently stated strike price is a financing event that relates to the entity's own operations or activities, as described in proposed paragraph 815-40-15-7K. Accordingly, a settlement adjustment resulting from a down round feature would not preclude an instrument from being considered indexed to an entity's own stock, eliminating the need for a separate scope exception. The Board emphasized that an instrument with a typical down round feature that is considered indexed to an entity's own stock under current guidance would continue to be considered indexed under the proposed amendments—that is, eliminating the scope exception would not change the classification outcome for those instruments. Thus, the Board observed that the down round exception would no longer accomplish the same objective as when it was added by the amendments in Update 2017-11. Furthermore, the Board observed that retaining a feature-specific scope exception could imply that down round features would otherwise preclude an instrument from being considered indexed to the entity’s own stock under the proposed amendments, which could create confusion and lead to inconsistent interpretations.

BC44. The amendments in this proposed Update would supersede the related recognition, measurement, presentation, and illustrative guidance in Topic 260 and the related disclosure requirements in Topic 505 on down round features for warrants and convertible preferred stock. The Board acknowledges that superseding that guidance would eliminate the requirement to recognize the value of the effect of a triggered down round feature as a deemed dividend and the related reduction of income available to common stockholders in basic EPS, which provides information about the value transferred to the holders of instruments with down round features. Specifically, paragraph 260-10-30-1 indicates that the resulting basic EPS adjustment is measured as the difference between (a) the fair value of the financial instrument (excluding the down round feature) using the current stated strike price and (b) the fair value of the instrument (excluding the down round feature) using the reduced strike price

upon triggering of the down round feature. The Board observed that the guidance added by the amendments in Update 2017-11 was developed to accompany a feature-specific scope exception, rather than as part of a broader model for recognizing the effects of settlement adjustments, and that, under the proposed amendments, settlement adjustments that relate to the acceptable variables should be treated consistently. As noted in paragraph BC11, investors generally indicated that changes in fair value of equity-linked instruments are not decision useful and that understanding the terms and features of those instruments is more useful to their analyses. Accordingly, the Board observed that the basic EPS adjustment may no longer be warranted if investors do not consider that fair value information to be decision useful. Therefore, the Board decided not to retain incremental EPS guidance for a single type of settlement adjustment. However, to ensure that investors continue to receive transparent information about settlement adjustments, including down round features, the Board decided to clarify current disclosure requirements (see paragraphs BC46–BC49), which would provide investors with information about variables (or contingent events) that could have a significant effect on the contract's settlement amount or actual changes to variables (or contingent events that occurred) that had a significant effect on the contract's settlement amount (including a strike price reduction resulting from a triggered down round feature and the trigger that caused it).

BC45. The Board considered but dismissed other alternatives that would have retained the current down round guidance. The Board observed that retaining the scope exception and the related recognition, EPS, and disclosure requirements would be inconsistent with the amendments in this proposed Update in which settlement adjustments relating to an entity's own operations or activities do not preclude indexation. Retaining the current guidance would retain the cost and complexity of measuring and recognizing the effect of a triggered down round feature. Furthermore, the Board noted that an entity would still need to evaluate down round features against the settlement criteria in Section 815-40-25 after they were triggered, which could potentially preclude equity classification. For example, a down round feature that is triggered could result in the issuance of additional shares, which could violate the criterion for an entity to have sufficient authorized and unissued shares available to settle a contract after considering all of the entity's commitments that may require the issuance of stock during the period that the instrument is outstanding. Additionally, an entity would still have to evaluate all the other features in an instrument against both the indexation guidance and the equity classification

guidance in Subtopic 815-40, including whether the issuer or holder has the ability to determine settlement in cash or shares.

Disclosures

BC46. The Board considered whether the amendments in this proposed Update should include incremental disclosure requirements. Investors have consistently indicated that they are most interested in understanding the contractual terms and settlement features, including dilutive effects, of equity-linked contracts and that the current disclosures in Subtopic 815-40 generally provide sufficient information about those terms and features. Accordingly, the Board decided not to add incremental disclosure requirements. However, because the proposed amendments would be expected to result in more contracts being classified as equity, the Board decided to clarify current disclosure requirements about the terms or features of equity-classified instruments.

BC47. Specifically, the amendments in this proposed Update would require that an entity disclose on an annual basis the following information for equity-classified contracts:

a. Variables (or contingent events) described in paragraph 815-40-15-7E that could have a significant effect on the contract's settlement amount (for example, adjustments related to the entity's own stock price volatility that contain a leverage factor)
b. Actual changes to variables (or contingent events that occurred) described in paragraph 815-40-15-7E that had a significant effect on the contract's settlement amount, including a description of those changes and what caused them to occur (for example, the strike price of the entity's warrants was reduced because of a financing event or because of a change in control).

BC48. The disclosure requirement in paragraph BC47 would be consistent with the guidance in paragraph 505-10-50-3. Subtopic 815-40 establishes the disclosure requirements for entities that are within the scope of that guidance, including how the disclosure requirements in Section 505-10-50 apply to contracts within the scope of Subtopic 815-40. However, Subtopic 815-40 does not explicitly state that the disclosures in paragraph BC47(a) and (b) from paragraph 505-10-50-3 must be provided. Therefore, the amendments in this proposed Update would specify that those disclosures are required.

BC49. The disclosure improvements included in the amendments in this proposed Update would be required for annual reporting periods, consistent with the disclosure frequency of almost all the disclosure requirements in Subtopic 815-40. The Board noted that the interim disclosure principle in Topic 270, Interim Reporting, would require that an entity consider whether additional disclosures are required in interim periods. In accordance with that principle, an entity would be required to disclose information about events that have occurred since the end of the last annual reporting period that have a material impact on the entity.

Effective Date and Transition

BC50. The Board will determine the effective date and whether early adoption should be permitted after it considers stakeholder feedback on the amendments in this proposed Update.

BC51. The amendments in this proposed Update would be required to be applied on a modified prospective basis. Under that transition approach, an entity would apply the proposed amendments prospectively to contracts outstanding as of the date of adoption and to new contracts that are entered into on or after the date of adoption. For an outstanding contract that had been classified as an asset or a liability prior to the date of adoption because of the current indexation requirements and, upon application of the proposed amendments, meets the indexation requirements (and all other criteria for equity classification in Subtopic 815-40 are met), an entity would reclassify the contract to equity at the date of adoption using its fair value immediately before reclassification (consistent with current guidance in paragraph 815-40-35-10). Under the modified prospective approach, there would be no retained earnings adjustment upon reclassifying an instrument from asset or liability to equity. This is consistent with paragraph 815-40-35-10, which does not allow for the reversal of prior gains or losses recorded to account for the instrument at fair value prior to the reclassification.

BC52. For example, if a warrant would be considered indexed under the amendments in this proposed Update but is not considered indexed under current GAAP, an entity would mark the warrant to fair value and immediately reclassify the new carrying value of the warrant to equity at the date of adoption. None of the previous gains or losses recorded from mark-to-market adjustments prior to the reclassification would be reversed (including the final

mark-to-market adjustment immediately before the reclassification). Furthermore, an embedded feature previously separated from its host contract and accounted for as a derivative that, upon application of the proposed amendments, meets the indexation requirement (and all other criteria of the derivatives scope exception in Subtopic 815-10 are met) would be similarly reclassified to equity at its fair value and would not be recombined with its host contract (in accordance with the current guidance in paragraph 815-40-35-10). Finally, contracts that were settled (or expired) prior to the date of adoption would be unaffected by the proposed amendments.

BC53. The Board noted that a modified prospective transition approach would be the least complex and costly approach for an entity to apply. Furthermore, the Board noted that the modified prospective transition approach is responsive to feedback received from outreach participants indicating that it may be challenging to determine the original basis of an instrument when applying a retrospective approach to transition. Considering that investors have indicated that fair value information related to these instruments is not critical for their analyses, the Board noted that a modified prospective transition approach should not affect the decision usefulness of information provided to investors.

BC54. The Board considered but dismissed modified retrospective, full retrospective, and prospective transition approaches. The Board ultimately decided against requiring or permitting modified or full retrospective transition because of the cost and complexity of applying the amendments in this proposed Update under those approaches, since investors generally do not find fair value information related to these instruments to be decision useful. In addition, the Board did not support the prospective approach to transition because of the inconsistency in the accounting models that would be applied for new contracts versus those outstanding as of the adoption date, as well as the potential complexities in applying a purely prospective approach.

BC55. The amendments in this proposed Update would require that, upon adoption, entities disclose (a) the nature of and reason for the change in accounting principle and (b) any amount(s) reclassified from assets or liabilities to equity as a result of the proposed amendments.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.