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ASU 2021-04
Issuer's Accounting For Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options

On May 03, 2021, the FASB issued Accounting Standards Update (ASU) 2021-04, *Earnings Per Share (Topic 260), Debt— Modifications and Extinguishments (Subtopic 470-50), Compensation—Stock Compensation (Topic 718), and Derivatives and Hedging— Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options*. The FASB issued ASU 2021-04 to clarify and reduce diversity in an issuer's accounting for modifications or exchanges of freestanding equity-classified written call options (for example, warrants) that remain equity classified after modification or exchange.

The amendments in ASU 2021-04 provide the following guidance for a modification or an exchange of a freestanding equity-classified written call option that is not within the scope of another FASB *Accounting Standards Codification* (FABS ASC) topic:

1. An entity should treat a modification of the terms or conditions or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as an exchange of the original instrument for a new instrument.

2. An entity should measure the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange as follows:

a. For a modification or an exchange that is a part of or directly related to a modification or an exchange of an existing debt instrument or line-of-credit or revolving-debt arrangement (hereinafter, referred to as a "debt" or "debt instrument"), as the difference between the fair value of the modified or exchanged written call option and the fair value of that written call option immediately before it is modified or exchanged. Specifically, an entity should consider:

i. An increase or a decrease in the fair value of the modified or exchanged written call option in applying the 10 percent cash flow test and/or calculating the fees between debtor and creditor in accordance with FASB ASC 470-50, *Debt—Modifications and Extinguishments*.

ii. An increase (but not a decrease) in the fair value of the modified or exchanged written call option in calculating the third-party costs in accordance with FASB ASC 470-50.

b. For all other modifications or exchanges, as the excess, if any, of the fair value of the modified or exchanged written call option over the fair value of that written call option immediately before it is modified or exchanged.

3. An entity should recognize the effect of a modification or an exchange of a freestanding equity-classified written call option that remains equity classified after modification or exchange on the basis of the substance of the transaction, in the same manner as if cash had been paid as consideration, as follows:

a. *A financing transaction to raise equity*. The effect should be recognized as an equity issuance cost in accordance with the guidance in FASB ASC 340, *Other Assets and Deferred Costs*.
b. *A financing transaction to raise or modify debt*. The effect should be recognized as a cost in accordance with the guidance in FASB ASC 470, *Debt*, and FASB ASC 835, *Interest*.
c. *Other modifications or exchanges that are not related to financings or compensation for goods or services or other exchange transactions within the scope of another FASB ASC topic*. The effect should be recognized as a dividend. For entities that present earnings per share (EPS) in accordance with FASB ASC 260, that dividend should be an adjustment to net income (or net loss) in the basic EPS calculation.

An entity should recognize the effect of a modification or an exchange of a freestanding equity-classified written call option to compensate for goods or services in accordance with the guidance in FASB ASC 718.

In a multiple-element transaction (for example, one that includes both debt financing and equity financing), the total effect of the modification should be allocated to the respective elements in the transaction.

Effective Date and Transition

The amendments in ASU 2021-04 are effective for all entities for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. An entity should apply the amendments prospectively to modifications or exchanges occurring on or after the effective date of the amendments.

Early adoption is permitted for all entities, including adoption in an interim period. If an entity elects to early adopt the amendments in ASU 2021-04 in an interim period, the guidance should be applied as of the beginning of the fiscal year that includes that interim period.