

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2016-09
March 2016

Compensation—Stock Compensation (Topic 718)

Improvements to Employee Share-Based Payment Accounting

An Amendment of the FASB Accounting Standards Codification®

Financial Accounting Standards Board

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.

For additional copies of this Accounting Standards Update and information on applicable prices and discount rates contact:

Order Department
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Please ask for our Product Code No. ASU2016-09.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly with the exception of January and October by the Financial Accounting Foundation, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is \$255 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 433**

Copyright © 2016 by Financial Accounting Foundation. All rights reserved. Content copyrighted by Financial Accounting Foundation may not be reproduced, stored in a retrieval system, or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording, or otherwise, without the prior written permission of the Financial Accounting Foundation. Financial Accounting Foundation claims no copyright in any portion hereof that constitutes a work of the United States Government.



Accounting Standards Update

No. 2016-09
March 2016

Compensation—Stock Compensation (Topic 718)

Improvements to Employee Share-Based Payment Accounting

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

Accounting Standards Update 2016-09

Compensation—Stock Compensation (Topic 718)

Improvements to Employee Share-Based Payment Accounting

March 2016

CONTENTS

	Page Numbers
Summary	1–3
Amendments to the <i>FASB Accounting Standards Codification</i> ®	5–105
Appendix: Paragraphs Amended by Multiple Simplification Issues	106–110
Background Information and Basis for Conclusions	111–120
Amendments to the XBRL Taxonomy	121

Summary

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

The Board is issuing this Update as part of its Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of generally accepted accounting principles (GAAP) for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. The areas for simplification in this Update were identified through outreach for the Simplification Initiative, pre-agenda research for the Private Company Council, and the August 2014 *Post-Implementation Review Report on FASB Statement No. 123(R)*, Share-Based Payment.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect all entities that issue share-based payment awards to their employees.

What Are the Main Provisions and How Do They Differ from Current Generally Accepted Accounting Principles (GAAP)?

The areas for simplification in this Update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities.

Current GAAP	Summary of Simplifications
Accounting for Income Taxes: An entity must determine for each award whether the difference between the deduction for tax purposes and the compensation cost recognized for financial reporting purposes results in either an excess tax benefit or a tax deficiency. Excess tax benefits are recognized in additional paid-in capital;	All excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) should be recognized as income tax expense or benefit in the income statement. The tax effects of exercised or vested awards should be treated

Current GAAP	Summary of Simplifications
tax deficiencies are recognized either as an offset to accumulated excess tax benefits, if any, or in the income statement. Excess tax benefits are not recognized until the deduction reduces taxes payable.	as discrete items in the reporting period in which they occur. An entity also should recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period.
Classification of Excess Tax Benefits on the Statement of Cash Flows: Excess tax benefits must be separated from other income tax cash flows and classified as a financing activity.	Excess tax benefits should be classified along with other income tax cash flows as an operating activity.
Forfeitures: Accruals of compensation cost are based on the number of awards that are expected to vest.	An entity can make an entity-wide accounting policy election to either estimate the number of awards that are expected to vest (current GAAP) or account for forfeitures when they occur.
Minimum Statutory Tax Withholding Requirements: One of the requirements for an award to qualify for equity classification is that an entity cannot partially settle the award in cash in excess of the employer's minimum statutory withholding requirements.	The threshold to qualify for equity classification permits withholding up to the maximum statutory tax rates in the applicable jurisdictions.
Classification of Employee Taxes Paid on the Statement of Cash Flows When an Employer Withholds Shares for Tax-Withholding Purposes: There is no guidance on classification of cash paid by an employer to the taxing authorities when directly withholding shares for tax-withholding purposes.	Cash paid by an employer when directly withholding shares for tax-withholding purposes should be classified as a financing activity.
Practical Expedient—Expected Term: Entities are required to estimate the period of time that an option will be outstanding.	A nonpublic entity can make an accounting policy election to apply a practical expedient to estimate the expected term for all awards with performance or service conditions that meet certain conditions.

Current GAAP	Summary of Simplifications
Intrinsic Value: At initial adoption of Topic 718, Compensation—Stock Compensation, nonpublic entities were provided an option to measure all liability-classified awards at intrinsic value. Some nonpublic entities were not aware of that option.	A nonpublic entity can make a one-time accounting policy election to switch from measuring all liability-classified awards at fair value to intrinsic value.

In addition to those simplifications, the amendments eliminate the guidance in Topic 718 that was indefinitely deferred shortly after the issuance of FASB Statement No. 123 (revised 2004), *Share-Based Payment*. This should not result in a change in practice because the guidance that is being superseded was never effective.

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

For public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. Early adoption is permitted for any entity in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in the same period.

Amendments related to the timing of when excess tax benefits are recognized, minimum statutory withholding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted.

Amendments related to the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet the minimum statutory withholding requirement should be applied retrospectively.

Amendments requiring recognition of excess tax benefits and tax deficiencies in the income statement and the practical expedient for estimating expected term should be applied prospectively.

An entity may elect to apply the amendments related to the presentation of excess tax benefits on the statement of cash flows using either a prospective transition method or a retrospective transition method.

Amendments to the *FASB Accounting Standards Codification*[®]

Summary of Amendments to the Accounting Standards Codification

1. The following table is a summary of the amendments to the Codification. The amendments are organized by area. Some of the Codification paragraphs are amended within more than one area. Each area only includes the amendments applicable to that area. The appendix of this Update includes a summary of the paragraphs that were amended within more than one area.

Area for Simplification	Paragraphs
Issue 1: Accounting for Income Taxes	3–21
Issue 2: Classification of Excess Tax Benefits on the Statement of Cash Flows	22–25
Issue 3: Forfeitures	26–39
Issue 4: Minimum Statutory Tax Withholding Requirements	40–42
Issue 5: Classification of Employee Taxes Paid on the Statement of Cash Flows When an Employer Withholds Shares for Tax-Withholding Purposes	43–46
Issue 6: Practical Expedient—Expected Term	47–50
Issue 7: Intrinsic Value	51–53
Issue 8: Eliminating the Indefinite Deferral in Topic 718	54–56

Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–69. 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~~.

Issue 1: Accounting for Income Taxes

3. Under current GAAP, if the deduction for a share-based payment award for tax purposes exceeds the compensation cost for financial reporting purposes, the additional tax benefit is recognized in additional paid-in capital and referred to as an excess tax benefit. Accumulated excess tax benefits are available to offset current-period and subsequent-period tax deficiencies (that is, when the deduction for tax purposes is less than the compensation cost for financial reporting purposes). If the accumulated amount is exhausted, all subsequent tax deficiencies are recognized in the income statement. Those income tax accounting requirements apply to both share-based payment transactions and employee stock ownership plan transactions. The following amendments reflect the Board's decision that all excess tax benefits and all tax deficiencies should be recognized as income tax expense or benefit in the income statement and that those benefits and deficiencies are discrete items in the reporting period in which they occur (that is, entities should not consider them in determining the annual estimated effective tax rate). Because excess tax benefits are no longer recognized in additional paid-in capital, the assumed proceeds from applying the treasury stock method when computing earnings per share is amended to exclude the amount of excess tax benefits that would be recognized in additional paid-in capital. The amendments also reflect the Board's decision to no longer delay recognition of a tax benefit until the tax benefit is realized through a reduction to taxes payable.

Amendments to the Master Glossary

4. Supersede the Master Glossary term *Excess Tax Benefits*, with a link to transition paragraph 718-10-65-4, as follows:

Excess Tax Benefits

~~The realized tax benefit related to the amount (caused by changes in the fair value of the entity's shares after the measurement date for financial reporting) of deductible compensation cost reported on an employer's tax return for equity instruments in excess of the compensation cost for those instruments recognized for financial reporting purposes.~~

Amendments to Subtopic 260-10

5. Amend paragraph 260-10-45-29, with a link to transition paragraph 718-10-65-4, as follows:

Earnings Per Share—Overall

Other Presentation Matters

> > > Share-Based Payment Arrangements

260-10-45-29 In applying the treasury stock method described in paragraph 260-10-45-23, the assumed proceeds shall be the sum of all of the following:

- a. The amount, if any, the employee must pay upon exercise.
 - b. The amount of compensation cost attributed to future services and not yet recognized. (This provision applies only to those share-based awards for which compensation cost will be recognized in the financial statements in accordance with Topic 718.)
 - c. Subparagraph superseded by Accounting Standards Update No. 2016-09. The amount of excess tax benefits, if any, that would be credited to additional paid-in capital assuming exercise of the options. Assumed proceeds shall not include compensation ascribed to past services. The excess tax benefit is the amount resulting from a tax deduction for compensation in excess of compensation expense recognized for financial reporting purposes. That deduction arises from an increase in the market price of the stock under option between the measurement date and the date at which the compensation deduction for income tax purposes is determinable. The amount of the tax benefit shall be determined by a with and without computation. Paragraph 718-740-35-5 states that the amount deductible on an employer's tax return may be less than the cumulative compensation cost recognized for financial reporting purposes. If the deferred tax asset related to that resulting difference would be deducted from additional paid-in capital (or its equivalent) pursuant to that paragraph assuming exercise of the options, that amount shall be treated as a reduction of assumed proceeds.
6. Add paragraph 260-10-55-69A and amend paragraph 260-10-55-70, with a link to transition paragraph 718-10-65-4, as follows:

Implementation Guidance and Illustrations

> > Example 8: Application of the Treasury Stock Method to a Share-Based Payment Arrangement

260-10-55-68 This Example illustrates the guidance in paragraph 260-10-45-28A for the application of the treasury stock method when share options are forfeited.

[Note: Paragraph 260-10-55-69 is amended in Issue 3 and is shown here for context. See the appendix for all amendments to paragraphs 260-10-55-69 through 55-69A.]

260-10-55-69 Entity A adopted a share option plan on January 1, 20X7, and granted 900,000 at-the-money share options with an exercise price of \$30. All share options vest at the end of three years (cliff vesting). At the grant date, Entity A assumes an annual forfeiture rate of 3 percent and therefore expects to receive the requisite service for 821,406 $[900,000 \times (.97 \text{ to the third power})]$ share options. On January 1, 20X7, the fair value of each share option granted is \$14.69. Employees forfeited 15,000 stock options ratably during 20X7. ~~The average stock price during 20X7 is \$44. Net income for the period is \$97,385,602 (inclusive of \$2,614,398 of share based compensation, net of income taxes of \$1,407,753). Entity A's tax rate is 35 percent. For the year ended December 31, 20X7, there are 25,000,000 weighted average common shares outstanding. Entity A has sufficient previously recognized excess tax benefits in additional paid-in capital from prior share-based payment arrangements to offset any write-off of deferred tax assets associated with its grant of share options on January 1, 20X7. All share options are the type that upon exercise give rise to deductible compensation cost for income tax purposes. This guidance also applies if the service inception date precedes the grant date.~~ **[Content amended and moved to paragraph 260-10-55-69A]**

260-10-55-69A ~~The average stock price during 20X7 is \$44. Net income for the period is \$97,385,602 (inclusive of \$2,614,398 of share based compensation, net of income taxes of \$1,407,753). Entity A's tax rate is 35 percent. For the year ended December 31, 20X7, there are 25,000,000 weighted-average common shares outstanding. Entity A has sufficient previously recognized excess tax benefits in additional paid-in capital from prior share-based payment arrangements to offset any write-off of deferred tax assets associated with its grant of share options on January 1, 20X7. All share options are the type that upon exercise give rise to deductible compensation cost for income tax purposes. This guidance also applies if the service inception date precedes the grant date.~~ **[Content amended as shown and moved from paragraph 260-10-55-69]**

260-10-55-70 The following table illustrates computation of basic and diluted EPS for the year ended December 31, 20X7.

Computation of Basic EPS for the Year Ended December 31, 20X7:

Net income ^(e)	\$ 97,385,602
Weighted-average common shares outstanding	25,000,000
Basic earnings per share	<u>\$ 3.90</u>

Computation of assumed proceeds for diluted earnings per share:

Amount employees would pay if the weighted-average number of options outstanding were exercised using the average exercise price $(892,500^{(b)} \times \$30)$	\$ 26,775,000
--	---------------

Average unrecognized compensation cost in 20X7 (see computation)	10,944,050
Tax benefit deficiency that would be offset in paid-in capital (see computation)	<u>(215,539)</u>
Assumed proceeds	\$ 37,503,511
Assumed proceeds	<u>\$ 37,719,050</u>

Computation of average unrecognized compensation cost in 20X7:

Beginning of period	
Unrecognized compensation cost $(900,000 \times \$14.69)$	\$ 13,221,000
End of the period	
Beginning of period	\$ 13,221,000
Annual compensation cost recognized during 20X7, based on estimated forfeitures	<u>(4,022,151) ^(a)</u>

Annual compensation cost not recognized during the period related to outstanding options at December 31, 20X7, for which the requisite service is not expected to be rendered	<u>(311,399) ^(c)</u>
---	---------------------------------

Total compensation cost of actual forfeited options	<u>(220,350) ^(d)</u>
Total unrecognized compensation cost, end of the period, based on actual forfeitures	8,667,100
Subtotal	<u>\$ 21,888,100</u>
Average total unrecognized compensation, based on actual forfeitures	<u>\$ 10,944,050</u>

Computation of tax benefit:

Total compensation cost of average outstanding options	\$ 13,110,825 ^(e)
Intrinsic value of average outstanding options for the year ended December 31, 20X7: $\{892,500 \times (\$44 - \$30)\}$	<u>(12,495,000)</u>

Excess of total compensation cost over estimated tax deduction	\$ 615,825
Tax benefit deficiency $(\$615,825 \times .35)$	<u>\$ 215,539</u>

Assumed repurchase of shares:

Repurchase shares at average market price during the year $(\$37,503,511 \div \$44)$	852,353
Repurchase shares at average market price during the year $(\$37,719,050 \div \$44)$	<u>857,251</u>
Incremental shares $(892,500 - 852,353)$	40,147
Incremental shares $(892,500 - 857,251)$	<u>35,249</u>

Computation of Diluted EPS for the Year Ended December 31, 20X7:

Net income	\$ 97,385,602
Weighted-average common shares outstanding	25,000,000
Incremental shares	40,147
Incremental shares	35,249
Total shares outstanding	25,040,147
Total shares outstanding	<u>25,035,249</u>
Diluted earnings per share	<u>\$ 3.89</u>

(a) Pre-tax annual share-based compensation cost is \$4,022,151 $[(821,406 \times \$14.69) \div 3]$. After-tax share-based compensation cost included in net income is \$2,614,398 $(\$4,022,151 - \$1,407,753)$. $(\$4,022,151 \times .35) = \$1,407,753$.

(b) Share options granted at the beginning of the year plus share options outstanding at the end of the year divided by two equals the weighted-average number of share options outstanding in 20X7: $[(900,000 + 885,000) \div 2] = 892,500$. This example assumes that forfeitures occurred ratably throughout 20X7.

(c) $885,000$ (options outstanding at December 31, 20X7) $- 821,406$ (options for which the requisite service is expected to be rendered) $= 63,594$. $63,594$ options $\times \$14.69$ (grant-date fair value per option) $= \$934,196$ (total fair value). $\$934,196 \div 3 = \$311,399$ (annual share-based compensation cost).

(d) $15,000$ (forfeited options) $\times \$14.69$ (grant-date fair value per option) $= \$220,350$ (total fair value).

(e) $(892,500 \times \$14.69) = \$13,110,825$.

Amendments to Subtopic 718-10

7. Add paragraph 718-10-50-2A, with a link to transition paragraph 718-10-65-4, as follows:

Compensation—Stock Compensation—Overall

Disclosure

[Note: Paragraph 718-10-50-2 is amended in Issue 3 and is shown here for context. See the appendix for all amendments to paragraphs 718-10-50-2 through 50-2A.]

718-10-50-2 The following list indicates the minimum information needed to achieve the objectives in the preceding paragraph and illustrates how the disclosure requirements might be satisfied. In some circumstances, an entity may need to disclose information beyond the following to achieve the disclosure objectives:

- a. A description of the share-based payment arrangement(s), including the general terms of awards under the arrangement(s), such as:
 1. The **requisite service period(s)** and any other substantive conditions (including those related to vesting)
 2. The maximum contractual term of equity (or liability) **share options** or similar instruments
 3. The number of shares authorized for awards of equity share options or other equity instruments.
- b. The method it uses for measuring compensation cost from share-based payment arrangements with **employees**.
- c. For the most recent year for which an income statement is provided, both of the following:
 1. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or **share units**):
 - i. Those outstanding at the beginning of the year
 - ii. Those outstanding at the end of the year
 - iii. Those exercisable or convertible at the end of the year
 - iv. Those that during the year were:
 01. Granted
 02. Exercised or converted
 03. Forfeited
 04. Expired.

2. The number and weighted-average **grant-date** fair value (or **calculated value** for a **nonpublic entity** that uses that method or **intrinsic value** for awards measured pursuant to paragraph 718-10-30-21) of equity instruments not specified in (c)(1), for all of the following groups of equity instruments:
 - i. Those nonvested at the beginning of the year
 - ii. Those nonvested at the end of the year
 - iii. Those that during the year were:
 01. Granted
 02. Vested
 03. Forfeited.
- d. For each year for which an income statement is provided, both of the following:
 1. The weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured at that value pursuant to paragraphs 718-10-30-21 through 30-22) of equity options or other equity instruments granted during the year
 2. The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year.
- e. For fully vested share options (or share units) and share options expected to **vest** at the date of the latest statement of financial position, both of the following:
 1. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) outstanding
 2. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible).
- f. For each year for which an income statement is presented, both of the following (An entity that uses the intrinsic value method pursuant to paragraphs 718-10-30-21 through 30-22 is not required to disclose the following information for awards accounted for under that method):
 1. A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements
 2. A description of the significant assumptions used during the year to estimate the fair value (or calculated value) of share-based compensation awards, including (if applicable):
 - i. Expected term of share options and similar instruments, including a discussion of the method used to incorporate the contractual term of the instruments and employees' expected

- exercise and postvesting employment termination behavior into the fair value (or calculated value) of the instrument.
- ii. Expected **volatility** of the entity's shares and the method used to estimate it. An entity that uses a method that employs different volatilities during the contractual term shall disclose the range of expected volatilities used and the weighted-average expected volatility. A nonpublic entity that uses the calculated value method shall disclose the reasons why it is not practicable for it to estimate the expected volatility of its share price, the appropriate industry sector index that it has selected, the reasons for selecting that particular index, and how it has calculated historical volatility using that index.
 - iii. Expected dividends. An entity that uses a method that employs different dividend rates during the contractual term shall disclose the range of expected dividends used and the weighted-average expected dividends.
 - iv. Risk-free rate(s). An entity that uses a method that employs different risk-free rates shall disclose the range of risk-free rates used.
 - v. Discount for post-vesting restrictions and the method for estimating it.
- g. An entity that grants equity or liability instruments under multiple share-based payment arrangements with employees shall provide the information specified in paragraph (a) through (f) separately for different types of awards to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation. For example, separate disclosure of weighted-average exercise prices (or conversion ratios) at the end of the year for options (or share units) with a fixed exercise price (or conversion ratio) and those with an indexed exercise price (or conversion ratio) could be important. It also could be important to segregate the number of options (or share units) not yet exercisable into those that will become exercisable (or convertible) based solely on fulfilling a **service condition** and those for which a **performance condition** must be met for the options (share units) to become exercisable (convertible). It could be equally important to provide separate disclosures for awards that are classified as equity and those classified as liabilities. In addition, an entity that has multiple share-based payment arrangements with employees shall disclose information separately for different types of awards under those arrangements to the extent that differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation.
- h. For each year for which an income statement is presented, both of the following:
- 1. Total compensation cost for share-based payment arrangements

- i. Recognized in income as well as the total recognized tax benefit related thereto
 - ii. Capitalized as part of the cost of an asset.
- 2. A description of significant **modifications**, including:
 - i. The terms of the modifications
 - ii. The number of employees affected
 - iii. The total incremental compensation cost resulting from the modifications.
- i. As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized
- j. Subparagraph superseded by Accounting Standards Update No. 2016-09. If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit realized from stock options exercised during the annual period. **[Content amended and moved to paragraph 718-10-50-2A]**
- k. If not separately disclosed elsewhere, the amount of cash used to **settle** equity instruments granted under share-based payment arrangements
- l. A description of the entity's policy, if any, for issuing shares upon share option exercise (or share unit conversion), including the source of those shares (that is, new shares or treasury shares). If as a result of its policy, an entity expects to repurchase shares in the following annual period, the entity shall disclose an estimate of the amount (or a range, if more appropriate) of shares to be repurchased during that period.

718-10-50-2A Another item of minimum information needed to achieve the objectives in paragraph 718-10-50-1 is the following:

- a. ~~j.~~ If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit ~~realized~~ from stock options exercised during the annual period. **[Content amended as shown and moved from paragraph 718-10-50-2]**
- 8. Amend paragraph 718-10-55-137, with a link to transition paragraph 718-10-65-4, as follows:

Implementation Guidance and Illustrations

> > > Case B: Performance Share Option Plan

718-10-55-137 The following illustrates disclosure for a performance share option plan.

Under its 20X7 performance share option plan, which is shareholder-approved, each January 1 Entity A grants selected executives and other key employees share option awards whose vesting is contingent upon meeting various departmental and company-wide performance goals, including decreasing time to market for new products, revenue growth in excess of an index of competitors' revenue growth, and sales targets for Segment X. Share options under the performance share option plan are generally granted at-the-money, contingently vest over a period of 1 to 5 years, depending on the nature of the performance goal, and have contractual lives of 7 to 10 years. The number of shares subject to options available for issuance under this plan cannot exceed 5 million.

The fair value of each option grant under the performance share option plan was estimated on the date of grant using the same option valuation model used for options granted under the employee share option plan and assumes that performance goals will be achieved. If such goals are not met, no compensation cost is recognized and any recognized compensation cost is reversed. The inputs for expected volatility, expected dividends, and risk-free rate used in estimating those options' fair value are the same as those noted in the table related to options issued under the employee share option plan. The expected term for options granted under the performance share option plan in 20Y1, 20Y0, and 20X9 is 3.3 to 5.4 years, 2.4 to 6.5 years, and 2.5 to 5.3 years, respectively.

A summary of the activity under the performance share option plan as of December 31, 20Y1, and changes during the year then ended is presented below.

Performance Options	Shares (000)	Weighted- Average Exercise Price	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value (\$000)
Outstanding at January 1, 20Y1	2,533	\$ 44		
Granted	995	60		
Exercised	(100)	36		
Forfeited	(604)	59		
Outstanding at December 31, 20Y1	<u>2,824</u>	<u>\$ 47</u>	<u>7.1</u>	<u>\$ 50,832</u>
Exercisable at December 31, 20Y1	<u>936</u>	<u>\$ 40</u>	<u>5.3</u>	<u>\$ 23,400</u>

The weighted-average grant-date fair value of options granted during the years 20Y1, 20Y0, and 20X9 was \$17.32, \$16.05, and \$14.25, respectively. The total intrinsic value of options exercised during the years ended December 31, 20Y1, 20Y0, and 20X9, was \$5 million, \$8 million, and \$3 million, respectively. As of December 31, 20Y1, there was \$16.9 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the performance share option plan; that cost is expected to be recognized over a period of 4 years.

Cash received from option exercise under all share-based payment arrangements for the years ended December 31, 20Y1, 20Y0, and 20X9, was \$32.4 million, \$28.9 million, and \$18.9 million, respectively. The actual tax benefit ~~realized~~ for the tax deductions from option exercise of the share-based payment arrangements totaled \$11.3 million, \$10.1 million, and \$6.6 million, respectively, for the years ended December 31, 20Y1, 20Y0, and 20X9.

Entity A has a policy of repurchasing shares on the open market to satisfy share option exercises and expects to repurchase approximately 1 million shares during 20Y2, based on estimates of option exercises for that period.

Amendments to Subtopic 718-20

9. Amend paragraphs 718-20-55-6, 718-20-55-12, 718-20-55-20 through 55-21, 718-20-55-23, 718-20-55-74 through 55-75, 718-20-55-87, 718-20-55-132 through 55-133, and 718-20-55-144 and supersede paragraph 718-20-55-22, with a link to transition paragraph 718-10-65-4, as follows:

Compensation—Stock Compensation—Awards Classified as Equity

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Accounting for Share Options with Service Conditions

[Note: Paragraphs 718-20-55-4 through 55-5 are amended in Issue 3.]

718-20-55-4 The following Cases illustrate the guidance in paragraphs 718-10-35-2 through 35-7 and 718-740-25-2 through 25-3, except for the vesting provisions:

- a. Share options with cliff vesting (Case A)
- b. Share options with graded vesting (Case B).

718-20-55-5 Cases A and B share all of the following assumptions.

718-20-55-6 Entity T, a **public entity**, grants at-the-money **employee** share options with a contractual term of 10 years. All share options **vest** at the end of three years (cliff vesting), which is an explicit service (and requisite service) period of three years. The share options do not qualify as incentive stock options for U.S. tax purposes. The enacted tax rate is 35 percent. In each Case, Entity T concludes that it will have sufficient future taxable income to realize the deferred tax benefits from its share-based payment transactions.

[Note: Paragraph 718-20-55-7 is amended in Issue 3.]

718-20-55-7 The following table shows assumptions and information about the share options granted on January 1, 20X5 applicable to both Cases.

Share options granted	900,000
Employees granted options	3,000
Expected forfeitures per year	3.0%
Share price at the grant date	\$ 30
Exercise price	\$ 30
Contractual term of options	10 years
Risk-free interest rate over contractual term	1.5 to 4.3%
Expected volatility over contractual term	40 to 60%
Expected dividend yield over contractual term	1.0%
Suboptimal exercise factor	2

718-20-55-8 A suboptimal exercise factor of two means that exercise is generally expected to occur when the share price reaches two times the **share option's** exercise price. Option-pricing theory generally holds that the optimal (or profit-maximizing) time to exercise an option is at the end of the option's term; therefore, if an option is exercised before the end of its term, that exercise is referred to as suboptimal. Suboptimal exercise also is referred to as early exercise. Suboptimal or early exercise affects the expected term of an option. Early exercise can be incorporated into option-pricing models through various means. In this Case, Entity T has sufficient information to reasonably estimate early exercise and has incorporated it as a function of Entity T's future stock price changes (or the option's **intrinsic value**). In this Case, the factor of 2 indicates that early exercise would be expected to occur, on average, if the stock price reaches \$60 per share ($\30×2). Rather than use its weighted average suboptimal exercise factor, Entity T also may use multiple factors based a distribution of early exercise data in relation to its stock price.

718-20-55-9 This Case assumes that each employee receives an equal grant of 300 options. Using as inputs the last 7 items from the table in paragraph 718-20-55-7, Entity T's lattice-based valuation model produces a fair value of \$14.69 per option. A **lattice model** uses a suboptimal exercise factor to calculate the expected term (that is, the expected term is an output) rather than the expected term being a separate input. If an entity uses a Black-Scholes-Merton option-pricing formula, the expected term would be used as an input instead of a suboptimal exercise factor.

> > > Case A: Share Options with Cliff Vesting

[Note: Paragraph 718-20-55-10 is amended in Issue 3.]

718-20-55-10 Total compensation cost recognized over the **requisite service period** (which is the vesting period in this Case) shall be the grant-date fair value of all share options that actually vest (that is, all options for which the requisite service is rendered). Paragraph 718-10-35-3 requires an entity to estimate at the **grant date** the number of share options for which the requisite service is expected to be rendered (which, in this Case, is the number of share options for which vesting is deemed **probable**). If that estimate changes, it shall be accounted for as a change in estimate and its cumulative effect (from applying the change retrospectively) recognized in the period of change. Entity T estimates at the grant date the number of share options expected to vest and subsequently adjusts compensation cost for changes in the estimated rate of forfeitures and differences between expectations and actual experience. This Case assumes that none of the compensation cost is capitalized as part of the cost of an asset.

718-20-55-11 The estimate of the number of forfeitures considers historical employee turnover rates and expectations about the future. Entity T has experienced historical turnover rates of approximately 3 percent per year for employees at the grantees' level, and it expects that rate to continue over the requisite service period of the awards. Therefore, at the grant date Entity T estimates the total compensation cost to be recognized over the requisite service period based on an expected forfeiture rate of 3 percent per year. Actual forfeitures are 5 percent in 20X5, but no adjustments to cumulative compensation cost are recognized in 20X5 because Entity T still expects actual forfeitures to average 3 percent per year over the 3-year vesting period. As of December 31, 20X6, management decides that the forfeiture rate will likely increase through 20X7 and changes its estimated forfeiture rate for the entire award to 6 percent per year. Adjustments to cumulative compensation cost to reflect the higher forfeiture rate are made at the end of 20X6. At the end of 20X7 when the award becomes vested, actual forfeitures have averaged 6 percent per year, and no further adjustment is necessary.

718-20-55-12 The first set of calculations illustrates the accounting for the award of share options on January 1, 20X5, assuming that the share options granted vest at the end of three years. (Case B illustrates the accounting for an award assuming graded vesting in which a specified portion of the share options granted vest at the end of each year.) The number of share options expected to vest is estimated at the grant date to be 821,406 ($900,000 \times .97^3$). Thus, the compensation cost to be recognized over the requisite service period at January 1, 20X5, is \$12,066,454 ($821,406 \times \14.69), and the compensation cost to be recognized during each year of the 3-year vesting period is \$4,022,151 ($\$12,066,454 \div 3$). ~~In this Case, Entity T has concluded that it will have sufficient future taxable income to realize the deferred tax benefits from its share-based payment transactions.~~ The journal entries to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows for 20X5.

Compensation cost	\$ 4,022,151	
Additional paid-in capital		\$ 4,022,151

To recognize compensation cost.

Deferred tax asset	\$ 1,407,753	
Deferred tax benefit		\$ 1,407,753

To recognize the deferred tax asset for the temporary difference related to compensation cost ($\$4,022,151 \times .35 = \$1,407,753$).

718-20-55-13 The net after-tax effect on income of recognizing compensation cost for 20X5 is \$2,614,398 ($\$4,022,151 - \$1,407,753$).

718-20-55-14 Absent a change in estimated forfeitures, the same journal entries would be made to recognize compensation cost and related tax effects for 20X6 and 20X7, resulting in a net after-tax cost for each year of \$2,614,398. However, at the end of 20X6, management changes its estimated employee forfeiture rate from 3 percent to 6 percent per year. The revised number of share options expected to vest is 747,526 ($900,000 \times .94^3$). Accordingly, the revised cumulative compensation cost to be recognized by the end of 20X7 is \$10,981,157 ($747,526 \times \14.69). The cumulative adjustment to reflect the effect of adjusting the forfeiture rate is the difference between two-thirds of the revised cost of the award and the cost already recognized for 20X5 and 20X6. The related journal entries and the computations follow.

At December 31, 20X6, to adjust for new forfeiture rate.

Revised total compensation cost	\$ 10,981,157
Revised cumulative cost as of December 31, 20X6 ($\$10,981,157 \times \frac{2}{3}$)	\$ 7,320,771
Cost already recognized in 20X5 and 20X6 ($\$4,022,151 \times 2$)	8,044,302
Adjustment to cost at December 31, 20X6	<u>\$ (723,531)</u>

718-20-55-15 The related journal entries are as follows.

Additional paid-in capital	\$ 723,531	
Compensation cost		\$ 723,531

To adjust previously recognized compensation cost and equity to reflect a higher estimated forfeiture rate.

Deferred tax expense	\$ 253,236	
Deferred tax asset		\$ 253,236

To adjust the deferred tax accounts to reflect the tax effect of increasing the estimated forfeiture rate ($\$723,531 \times .35 = \$253,236$).

718-20-55-16 Journal entries for 20X7 are as follows.

Compensation cost	\$ 3,660,386	
Additional paid-in capital		\$ 3,660,386
To recognize compensation cost ($\$10,981,157 \div 3 = \$3,660,386$).		
Deferred tax asset	\$ 1,281,135	
Deferred tax benefit		\$ 1,281,135

To recognize the deferred tax asset for additional compensation cost ($\$3,660,386 \times .35 = \$1,281,135$).

718-20-55-17 As of December 31, 20X7, the entity would examine its actual forfeitures and make any necessary adjustments to reflect cumulative compensation cost for the number of shares that actually vested.

Share Option—Cliff Vesting			
Year	Total Value of Award	Pretax Cost for Year	Cumulative Pretax Cost
20X5	\$12,066,454 ($821,406 \times \14.69)	\$4,022,151 ($\$12,066,454 \div 3$)	\$ 4,022,151
20X6	\$10,981,157 ($747,526 \times \14.69)	\$3,298,620 ($(\$10,981,157 \times 2/3) - \$4,022,151$)	\$ 7,320,771
20X7	\$10,981,157 ($747,526 \times \14.69)	\$3,660,386 ($\$10,981,157 \div 3$)	\$ 10,981,157

718-20-55-18 All 747,526 vested share options are exercised on the last day of 20Y2. Entity T has already recognized its income tax expense for the year without regard to the effects of the exercise of the employee share options. In other words, current tax expense and current taxes payable were recognized based on income and deductions before consideration of additional deductions from exercise of the employee share options. Upon exercise, the amount credited to common stock (or other appropriate equity accounts) is the sum of the cash proceeds received and the amounts previously credited to additional paid-in capital in the periods the services were received (20X5 through 20X7). In this Case, Entity T has no-par common stock and at exercise, the share price is assumed to be \$60.

718-20-55-19 At exercise the journal entries are as follows.

Cash ($747,526 \times \$30$)	\$	22,425,780	
Additional paid-in capital	\$	10,981,157	
Common stock			\$ 33,406,937

To recognize the issuance of common stock upon exercise of share options and to reclassify previously recorded paid-in capital.

718-20-55-20 In this Case, the difference between the market price of the shares and the exercise price on the date of exercise is deductible for tax purposes pursuant to U.S. tax law in effect in 2004 (the share options do not qualify as incentive stock options). Paragraph 718-740-35-2 requires that the tax effect be recognized as income tax expense or benefit in the income statement for the difference between the deduction for an award for tax purposes and the cumulative compensation cost of that award recognized for financial reporting purposes. ~~Realized benefits of tax return deductions in excess of compensation cost recognized are accounted for as a credit to additional paid-in capital. (See Subtopic 718-740 or additional guidance on tax issues.) As indicated in paragraph 718-740-25-10, a share option exercise may result in a tax deduction before the actual realization of the related tax benefit because the entity, for example, has a net operating loss carryforward. In that situation, a tax benefit and a credit to additional paid-in capital for the excess deduction would not be recognized until that deduction reduces taxes payable. With the share price of \$60 at exercise, the deductible amount is \$22,425,780 [$747,526 \times (\$60 - \$30)$]. Entity T has sufficient taxable income to fully realize that deduction, and the tax benefit realized is \$7,849,023 ($\$22,425,780 \times .35$).~~

718-20-55-21 At exercise the journal entries are as follows.

Deferred tax expense	\$	3,843,405	
Deferred tax asset			\$ 3,843,405

To write off the deferred tax asset related to deductible share options at exercise ($\$10,981,157 \times .35 = \$3,843,405$).

Current taxes payable	\$	7,849,023	
Current tax expense			\$ 3,843,405
<u>Current tax expense</u>			<u>\$ 7,849,023</u>
Additional paid-in capital			\$ 4,005,618

To adjust current tax expense and current taxes payable to recognize the current tax benefit from deductible compensation cost upon exercise of share options.

718-20-55-22 ~~Paragraph superseded by Accounting Standards Update No. 2016-09. The credit to additional paid-in capital is the tax benefit of the excess of the deductible amount over the recognized compensation cost $[(\$22,425,780 - \$10,981,157) \times .35 = \$4,005,618]$.~~

718-20-55-23 ~~If instead the share options expired unexercised, previously recognized compensation cost would not be reversed. There would be no deduction on the tax return and, therefore, the entire deferred tax asset of \$3,843,405 would be charged to income tax expense or additional paid-in capital, to the extent of any remaining additional paid-in capital from **excess tax benefits** from previous awards accounted for in accordance with FASB Statement No. 123 (revised 2004), *Share-Based Payment*, or FASB Statement No. 123, *Accounting for Stock Based Compensation* (see paragraphs 718-740-35-5 through 35-7). If employees terminated with out of the money vested share options, the deferred tax asset related to those share options would be written off when those options expire. A write-off of a deferred tax asset related to a deficiency of deductible compensation cost in relation to recognized compensation cost for financial reporting purposes shall not be reflected in the statement of cash flows because the unit of account for cash flow purposes is an individual award (or portion thereof) as opposed to a portfolio of awards. [Content moved to paragraph 718-20-55-23A]~~

[Note: Paragraph 718-20-55-23A is added in Issue 2 and is shown here for context. See the appendix for all amendments to paragraphs 718-20-55-23 through 55-23A.]

718-20-55-23A ~~If employees terminated with out-of-the-money vested share options, the deferred tax asset related to those share options would be written off when those options expire. A write-off of a deferred tax asset related to a deficiency of deductible compensation cost in relation to recognized compensation cost for financial reporting purposes shall not be reflected in the statement of cash flows because the unit of account for cash flow purposes is an individual award (or portion thereof) as opposed to a portfolio of awards. [Content moved from paragraph 718-20-55-23]~~

> > Example 8: Share Award Granted by a Nonpublic Entity

718-20-55-71 The Example illustrates the guidance in paragraphs 718-10-30-17 through 30-19 and 718-740-25-2 through 25-4. The accounting demonstrated in this Example also would be applicable to a public entity that grants share awards to its employees. The same measurement method and basis is used for both

nonvested share awards and **restricted share** awards (which are a subset of nonvested share awards).

718-20-55-72 On January 1, 20X6, Entity W, a **nonpublic entity**, grants 100 shares of stock to each of its 100 employees. The shares cliff vest at the end of three years. Entity W estimates that the grant-date fair value of 1 share of stock is \$7. The grant-date fair value of the share award is \$70,000 ($100 \times 100 \times \7). The fair value of shares, which is equal to their intrinsic value, is not subsequently remeasured. For simplicity, the example assumes that no forfeitures occur during the vesting period. Because the requisite service period is 3 years, Entity W recognizes \$23,333 ($\$70,000 \div 3$) of compensation cost for each annual period as follows.

Compensation cost	\$	23,333	
Additional paid-in capital			\$ 23,333
To recognize compensation cost.			

Deferred tax asset	\$	8,167	
Deferred tax benefit			\$ 8,167

To recognize the deferred tax asset for the temporary difference related to compensation cost ($\$23,333 \times .35 = \$8,167$).

718-20-55-73 After three years, all shares are vested. For simplicity, this Example assumes that no employees made an Internal Revenue Service (IRS) Code §83(b) election and Entity W has already recognized its income tax expense for the year in which the shares become vested without regard to the effects of the share award. (IRS Code §83(b) permits an employee to elect either the grant date or the vesting date for measuring the fair market value of an award of shares.)

718-20-55-74 The fair value per share on the vesting date, assumed to be \$20, is deductible for tax purposes. Paragraph ~~718-740-35-2718-740-45-2~~ requires that excess the tax effect benefits be recognized as income tax expense or benefit in the income statement for the difference between the deduction for an award for tax purposes and the cumulative compensation cost of that award recognized for financial reporting purposes, a credit to additional paid-in capital. Tax return deductions that are less than compensation cost recognized result in a charge to income tax expense in the period of vesting unless there are any remaining excess tax benefits from previous awards accounted for in accordance with a fair value based method of accounting, in which case, the amount of any tax deficiency is first offset against additional paid-in capital. Paragraphs 718-740-35-5 through 35-9 establish the requirements for the accounting for a tax deficiency. With the share price at \$20 on the vesting date, the deductible amount is \$200,000 ($10,000 \times \20).

~~The entity has sufficient taxable income, and the tax benefit realized is \$70,000 (\$200,000 × .35).~~

718-20-55-75 At vesting the journal entries would be as follows.

Deferred tax expense	\$ 24,500	
Deferred tax asset		\$ 24,500
To write off deferred tax asset related to deductible share award at vesting (\$70,000 × .35 = \$24,500).		

Current taxes payable	\$ 70,000	
Current tax expense		\$ 24,500
<u>Current tax expense</u>		<u>\$ 70,000</u>
Additional paid-in capital		\$ 45,500

To adjust current tax expense and current taxes payable to recognize the current tax benefit from deductible compensation cost upon vesting of share award. ~~The credit to additional paid-in capital is the excess tax benefit: (\$200,000 — \$70,000) × .35 = \$45,500.~~

> > **Example 11: Certain Noncompete Agreements and Requisite Service**

718-20-55-87 Paragraphs 718-10-25-3 through 25-4 require that the accounting for all {**add glossary link**}share-based payment transactions{**add glossary link**} with employees or others reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. Some share-based compensation arrangements with employees may contain noncompete provisions. Those noncompete provisions may be in-substance service conditions because of their nature. Determining whether a noncompete provision or another type of provision represents an in-substance **service condition** is a matter of judgment based on relevant facts and circumstances. This Example illustrates a situation in which a noncompete provision represents an in-substance service condition.

> > **Example 16: Modifications That Change an Award’s Classification**

> > > **Case A: Equity to Liability Modification (Share-Settled Share Options to Cash-Settled Share Options)**

[Note: Paragraph 718-20-55-123 is amended in Issue 3.]

718-20-55-123 Entity T grants the same share options described in Example 1, Case A (see paragraph 718-20-55-10). The number of options for which the requisite service is expected to be rendered is estimated at the grant date to be 821,406 ($900,000 \times .97^3$). For simplicity, this Case assumes that estimated forfeitures equal actual forfeitures. Thus, as shown in the table in paragraph 718-20-55-130, the fair value of the award at January 1, 20X5, is \$12,066,454 ($821,406 \times \14.69), and the compensation cost to be recognized during each year of the 3-year vesting period is \$4,022,151 ($\$12,066,454 \div 3$). The journal entries for 20X5 are the same as those in paragraph 718-20-55-12.

718-20-55-124 On January 1, 20X6, Entity T modifies the share options granted to allow the employee the choice of share settlement or net cash settlement; the options no longer qualify as equity because the holder can require Entity T to settle the options by delivering cash. Because the modification affects no other terms or conditions of the options, the fair value (assumed to be \$7 per share option) of the modified award equals the fair value of the original award immediately before its terms are modified on the date of modification; the modification also does not change the number of share options for which the requisite service is expected to be rendered. On the modification date, Entity T recognizes a liability equal to the portion of the award attributed to past service multiplied by the modified award's fair value. To the extent that the liability equals or is less than the amount recognized in equity for the original award, the offsetting debit is a charge to equity. To the extent that the liability exceeds the amount recognized in equity for the original award, the excess is recognized as compensation cost. In this Case, at the modification date, one-third of the award is attributed to past service (one year of service rendered/three-year requisite service period). The modified award's fair value is \$5,749,842 ($821,406 \times \7), and the liability to be recognized at the modification date is \$1,916,614 ($\$5,749,842 \div 3$). The related journal entry follows.

Additional paid-in capital	\$ 1,916,614	
Share-based compensation liability		\$ 1,916,614
To recognize the share-based compensation liability.		

718-20-55-125 No entry would be made to the deferred tax accounts at the modification date. The amount of remaining additional paid-in capital attributable to compensation cost recognized in 20X5 is \$2,105,537 ($\$4,022,151 - \$1,916,614$).

718-20-55-126 Paragraph 718-20-35-3(b) specifies that total recognized compensation cost for an equity award shall at least equal the fair value of the award at the grant date unless at the date of the modification the service or performance conditions of the original award are not expected to be satisfied. In accordance with that principle, Entity T would ultimately recognize cumulative compensation cost equal to the greater of the following:

- a. The grant-date fair value of the original equity award
- b. The fair value of the modified liability award when it is settled.

718-20-55-127 To the extent that the recognized fair value of the modified liability award is less than the recognized compensation cost associated with the grant-date fair value of the original equity award, changes in that liability award's fair value through its settlement do not affect the amount of compensation cost recognized. To the extent that the fair value of the modified liability award exceeds the recognized compensation cost associated with the grant-date fair value of the original equity award, changes in the liability award's fair value are recognized as compensation cost.

718-20-55-128 At December 31, 20X6, the fair value of the modified award is assumed to be \$25 per share option; hence, the modified award's fair value is \$20,535,150 ($821,406 \times \25), and the corresponding liability at that date is \$13,690,100 ($\$20,535,150 \times 2/3$) because two-thirds of the requisite service period has been rendered. The increase in the fair value of the liability award is \$11,773,486 ($\$13,690,100 - \$1,916,614$). Before any adjustments for 20X6, the amount of remaining additional paid-in capital attributable to compensation cost recognized in 20X5 is \$2,105,537 ($\$4,022,151 - \$1,916,614$). The cumulative compensation cost at December 31, 20X6, associated with the grant-date fair value of the original equity award is \$8,044,302 ($\$4,022,151 \times 2$). Entity T would record the following journal entries for 20X6.

Compensation cost	\$	9,667,949	
Additional paid-in capital	\$	2,105,537	
Share-based compensation liability			\$ 11,773,486

To increase the share-based compensation liability to \$13,690,100 and recognize compensation cost of \$9,667,949 ($\$13,690,100 - \$4,022,151$).

Deferred tax asset	\$	3,383,782	
Deferred tax benefit			\$ 3,383,782

To recognize the deferred tax asset for additional compensation cost ($\$9,667,949 \times .35 = \$3,383,782$).

718-20-55-129 At December 31, 20X7, the fair value is assumed to be \$10 per share option; hence, the modified award's fair value is \$8,214,060 ($821,406 \times \10), and the corresponding liability for the fully vested award at that date is \$8,214,060. The decrease in the fair value of the liability award is \$5,476,040 ($\$8,214,060 - \$13,690,100$). The cumulative compensation cost as of December 31, 20X7, associated with the grant-date fair value of the original equity award is \$12,066,454 (see paragraph 718-20-55-123). Entity T would record the following journal entries for 20X7.

Share-based compensation liability	\$ 5,476,040	
Compensation cost		\$ 1,623,646
Additional paid-in capital		\$ 3,852,394

To recognize a share-based compensation liability of \$8,214,060, a reduction of compensation cost of \$1,623,646 (\$13,690,100 – \$12,066,454), and additional paid-in capital of \$3,852,394 (\$12,066,454 – \$8,214,060).

Deferred tax expense	\$ 568,276	
Deferred tax asset		\$ 568,276

To reduce the deferred tax asset for the reduction in compensation cost (\$1,623,646 × .35 = \$568,276).

718-20-55-130 The modified liability award is as follows.

Modified Liability Award—Cliff Vesting

Year	Total Value of Award	Pretax Cost for Year	Cumulative Pretax Cost
20X5	\$12,066,454 (821,406 × \$14.69)	\$4,022,151 (\$12,066,454 ÷ 3)	\$ 4,022,151
20X6	\$20,535,150 (821,406 × \$25.00)	\$9,667,949 [(\$20,535,150 × ⅔) – \$4,022,151]	\$ 13,690,100
20X7	\$12,066,454 (821,406 × \$14.69)	\$(1,623,646) (\$12,066,454 – \$13,690,100)	\$ 12,066,454

718-20-55-131 For simplicity, this Case assumes that all share option holders elected to be paid in cash on the same day, that the liability award's fair value is \$10 per option, and that Entity T has already recognized its income tax expense for the year without regard to the effects of the settlement of the award. In other words, current tax expense and current taxes payable were recognized based on income and deductions before consideration of additional deductions from settlement of the award.

718-20-55-132 The \$8,214,060 in cash paid to the employees on the date of settlement is deductible for tax purposes. In the period of settlement, tax return deductions that are less than compensation cost recognized result in a charge to income tax expense ~~except to the extent that there is any remaining additional paid-in capital from excess tax benefits from previous share-based payment awards available to offset that deficiency.~~ The entity has sufficient taxable income, ~~and the tax benefit realized is \$2,874,921 (\$8,214,060 × .35).~~ Because As tax return deductions are less than compensation cost recognized, the entity must write off the deferred tax assets recognized in excess of the tax benefit ~~ultimately realized~~ ultimately realized from the exercise of employee stock options to income tax expense in the

~~income statement. Entity T has sufficient paid-in capital available from excess tax benefits from previous share-based payment awards to offset the entire tax deficiency. (See Subtopic 718-740 for guidance on the treatment of income taxes on employee stock compensation.) Therefore, the result is a debit to additional paid-in capital. The journal entries to reflect settlement of the share options are as follows.~~

Share-based compensation liability	\$ 8,214,060	
Cash (\$10 × 821,406)		\$ 8,214,060

To recognize the cash paid to settle share options.

Deferred tax expense	\$ 4,223,259	
Deferred tax asset		\$ 4,223,259

To write off deferred tax asset related to compensation cost
(\$12,066,454 × .35 = \$4,223,259).

Current taxes payable	\$ 2,874,921	
Additional paid-in capital	\$ 1,348,338	
Current tax expense		\$ 4,223,259
Current tax expense		\$ 2,874,921

To adjust current tax expense and current taxes payable for the tax benefit from deductible compensation cost upon settlement of share options.

718-20-55-133 If instead of requesting cash, employees had held their share options and those options had expired worthless, the share-based compensation liability account would have been eliminated over time with a corresponding increase to additional paid-in capital. Previously recognized compensation cost would not be reversed. Similar to the adjustment for the actual tax deduction ~~realized~~ described in the preceding paragraph **718-20-55-132**, all of the deferred tax asset of \$4,223,259 would be charged to income tax expense when the share options expire except to the extent that there was any remaining paid-in capital available from excess tax benefits from previous share-based payment awards available to offset that deficiency when the share options expired.

> > > Case E: Equity to Liability Modification (Share Options to Fixed Cash Payment)

718-20-55-144 Entity T grants the same share options described in Example 1, Case A (see paragraph 718-20-55-10) and records similar journal entries for 20X5 (see paragraphs 718-20-55-12 through 55-16). By January 1, 20X6, Entity T's

share price has fallen, and the fair value per share option is assumed to be \$2 at that date. Entity T provides its employees with an election to convert each share option into an award of a fixed amount of cash equal to the fair value of each share option on the election date (\$2) accrued over the remaining requisite service period, payable upon vesting. The election does not affect vesting; that is, employees must satisfy the original service condition to vest in the award for a fixed amount of cash. This transaction is considered a modification because Entity T continues to have an obligation to its employees that is conditional upon the receipt of future employee services. There is no incremental compensation cost because the fair value of the modified award is the same as that of the original award. At the date of the modification, a liability of \$547,604 $[(821,406 \times \$2) \times (1 \text{ year of requisite service rendered} \div 3\text{-year requisite service period})]$, which is equal to the portion of the award attributed to past service multiplied by the modified award's fair value, is recognized by reclassifying that amount from additional paid-in capital. The total liability of \$1,642,812 $(821,406 \times \$2)$ should be fully accrued by the end of the requisite service period. Because the possible tax deduction of the modified award is capped at \$1,642,812, Entity T also must adjust its deferred tax asset at the date of the modification to the amount that corresponds to the recognized liability of \$547,604. That amount is \$191,661 $(\$547,604 \times .35)$, and the write-off of the deferred tax asset is \$1,216,092 $(\$1,407,753 - \$191,661)$. That write-off would be recognized as income tax expense in the income statement except to the extent that there is any remaining additional paid-in capital from excess tax benefits from previous share-based payment awards available to offset that deficiency. Compensation cost of \$4,022,151 and a corresponding increase in additional paid-in capital would be recognized in each of 20X6 and 20X7 for a cumulative total of \$12,066,454 (as calculated in Case A); of this, \$547,604 would be recognized as an increase to the liability balance, with the remaining \$3,474,547 recognized as an increase in additional paid-in capital. A deferred tax benefit would be recognized in the income statement, and a corresponding increase to the deferred tax asset would be recognized for the tax effect of the increased liability of \$191,661 $(\$547,604 \times .35)$. ~~The~~ however, that compensation cost recognized in additional paid-in capital in this situation has no associated income tax effect (additional deferred tax assets are recognized based only on subsequent increases in the amount of the liability).

Amendments to Subtopic 718-30

10. Amend paragraph 718-30-55-9, with a link to transition paragraph 718-10-65-4, as follows:

Compensation—Stock Compensation—Awards Classified as Liabilities

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Cash-Settled Stock Appreciation Right

718-30-55-9 The cash paid to the employees on the date of exercise is deductible for tax purposes. ~~Entity T has sufficient taxable income, and the~~The tax benefit realized is \$5,749,842 ($\$16,428,120 \times .35$).

Amendments to Subtopic 718-40

11. Amend paragraphs 718-40-55-6 and 718-40-55-8, with a link to transition paragraph 718-10-65-4, as follows:

Compensation—Stock Compensation—Employee Stock Ownership Plans

Implementation Guidance and Illustrations

Leveraged Employee Stock Ownership Plans

> Illustrations

> > Example 1: Employee Stock Ownership Plan Leveraged with a Direct or Indirect Loan

> > > Case A: A Common-Stock Leveraged Employee Stock Ownership Plan with a Direct Loan

718-40-55-4 This Case illustrates a common stock leveraged employee stock ownership plan with a direct loan. This Case has the following assumptions:

- a. On January 1, Year 1, Entity A establishes a leveraged employee stock ownership plan.
- b. The employee stock ownership plan borrows \$1,000,000 from an outside lender at 10 percent for 5 years and uses the proceeds to buy 100,000 shares of newly issued common stock of the sponsor for \$10 per share, which is the market price of those shares on the date of issuance.
- c. Debt service is funded by cash contributions and dividends on employer stock held by the employee stock ownership plan.
- d. Dividends on all shares held by the employee stock ownership plan are used for debt service.
- e. Cash contributions are made at the end of each year.

- f. The year-end and average market values of a share of common stock follow.

<u>Year</u>	<u>Year-End</u>	<u>Average</u>
1	\$ 11.50	\$ 10.75
2	9.00	10.25
3	10.00	9.50
4	12.00	11.00
5	14.40	13.20

- g. The common stock pays normal dividends at the end of each quarter of 12.5 cents per share (\$50,000 for the employee stock ownership plan's shares each year). Accordingly, in this Case, the average **fair value** of shares is used to determine the number of shares used to satisfy the employers' obligation to replace dividends on **allocated shares** used for debt service.
- h. Principal and interest are payable in equal annual installments at the end of each year. Debt service is as follows.

<u>Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total Debt Services</u>
1	\$ 163,800	\$ 100,000	\$ 263,800
2	180,200	83,600	263,800
3	198,200	65,600	263,800
4	218,000	45,800	263,800
5	239,800	24,000	263,800
	<u>\$ 1,000,000</u>	<u>\$ 319,000</u>	<u>\$ 1,319,000</u>

- i. The number of shares released each year is as follows.

<u>Year</u>	<u>Dividends</u>	<u>Compensation</u>	<u>Total</u>
1	0	20,000	20,000
2	976	19,024	20,000
3	2,105	17,895	20,000
4	2,727	17,273	20,000
5	3,030	16,970	20,000

- j. The number of shares released for dividends is determined by dividing the amount of dividends on allocated shares by the average fair value of a share of common stock (for Year 2: \$10,000 divided by \$10.25 equals 976 shares). In this illustration, the remaining shares are released for compensation (for Year 2: 20,000 less 976 equals 19,024 shares).
- k. Shares are released from the suspense account for allocation to participants' accounts based on a principal-plus-interest formula. The released shares are allocated to participant accounts the following year. Shares released and allocated follow.

<u>Year</u>	<u>Cumulative Number of Shares</u>		<u>Average Shares Released</u>	<u>Year-End Suspense Shares</u>
	<u>Released</u>	<u>Allocated</u>		
1	20,000	0	10,000	80,000
2	40,000	20,000	30,000	60,000
3	60,000	40,000	50,000	40,000
4	80,000	60,000	70,000	20,000
5	100,000	80,000	90,000	0

- l. Income before employee stock ownership plan related charges is as follows.

<u>Year</u>	<u>Income</u>
1	\$ 1,800,000
2	1,900,000
3	2,000,000
4	2,100,000
5	2,200,000

- m. All interest cost and compensation cost are charged to expense each year.
- n. Excluding employee stock ownership plan shares, 1,000,000 shares are outstanding on average each year.
- o. Entity A follows the guidance in Subtopic 740-10.
- p. Entity A's combined statutory tax rate is 40 percent each year.
- q. Entity A's only book-tax differences are those associated with its employee stock ownership plan.
- r. No valuation allowance is necessary for deferred tax assets.

718-40-55-5 The following table sets forth Entity A's employee stock ownership plan-related information. All amounts represent changes (credits in parentheses) in account balances.

<i>Year</i>	<i>Principal</i>	<i>Unearned Employee Stock Ownership Plan Shares</i>	<i>Paid-In Capital</i>	<i>Dividends</i>	<i>Interest Expense</i>	<i>Compensation Expense</i>	<i>Cash</i>
<i>Notes</i>	(1)	(2)	(3)	(4)	(1)	(5)	(6)
1	\$ 163,800	\$ (200,000)	\$ (15,000)	\$ -	\$ 100,000	\$ 215,000	\$ (263,800)
2	180,200	(200,000)	(5,000)	10,000	83,600	195,000	(263,800)
3	198,200	(200,000)	10,000	20,000	65,600	170,000	(263,800)
4	218,000	(200,000)	(20,000)	30,000	45,800	190,000	(263,800)
5	239,800	(200,000)	(64,000)	40,000	24,000	224,000	(263,800)
Total	<u>\$ 1,000,000</u>	<u>\$ (1,000,000)</u>	<u>\$ (94,000)</u>	<u>\$ 100,000</u>	<u>\$ 319,000</u>	<u>\$ 994,000</u>	<u>\$ (1,319,000)</u>

Notes:

- (1) See the table in (h) of the preceding paragraph.
- (2) Total number of shares released for year (20,000) multiplied by the cost per share to employee stock ownership plan (\$10).
- (3) Total number of shares released for year (20,000) multiplied by the difference between average fair value per share (see the table in [f] of the preceding paragraph) and cost per share to employee stock ownership plan (\$10). [Year 1: 20,000 shares multiplied by (\$10.75-\$10.00)]
- (4) Cumulative number of allocated shares (see the table in [k] of the preceding paragraph) multiplied by the dividend per share. [Year 2: 20,000 shares multiplied by \$.50]
- (5) Number of shares released for compensation (see the table in [i] of the preceding paragraph) multiplied by the average fair value per share for the period (see the table in [f] of the preceding paragraph). The amounts in this column have been rounded.
- (6) The cash disbursed each year is comprised of \$213,800 contribution and \$50,000 in dividends.

718-40-55-6 Entity A would record journal entries from inception through Year 5 as follows.

January 1, Year 1 (inception)		
Cash	\$ 1,000,000	
Debt		\$ 1,000,000
[To record the employee stock ownership plan's loan]		
Unearned employee stock ownership plan shares (equity)	1,000,000	
Common stock and paid-in capital		1,000,000
[To record the issuance of 100,000 shares to the employee stock ownership plan at \$10 per share]		
Year 1		
Interest expense	100,000	
Accrued interest payable		100,000
[To record interest expense]		
Accrued interest payable	100,000	
Debt	163,800	
Cash		263,800
[To record debt payment (The cash disbursement of \$263,800 consists of \$50,000 in dividends, none of which is charged to retained earnings in Year 1, and \$213,800 supplemental cash contribution to the employee stock ownership plan)]		
Compensation expense	215,000	
Paid-in capital		15,000
Unearned employee stock ownership plan shares		200,000
[To record release of 20,000 shares at an average fair value of \$10.75 per share (shares cost employee stock ownership plan \$10)]		
Deferred tax asset	14,480	
Provision for income taxes	600,000	
Income taxes payable		614,480
[To record income taxes for Year 1]		

Year 2

Interest expense	\$	83,600	
Accrued interest payable			\$ 83,600

[To record interest expense]

Accrued interest payable	83,600	
Debt	180,200	
Cash		263,800

[To record debt payment (The cash disbursement of \$263,800 consists of \$50,000 in dividends, \$10,000 of which is charged to retained earnings in Year 2, and \$213,800 supplemental cash contribution to the employee stock ownership plan)]

Retained earnings	10,000	
Dividends payable		10,000

[To record declaration of \$.50 per share dividend on the 20,000 allocated shares]

Compensation expense	195,000	
Dividends payable	10,000	
Paid-in capital		5,000
Unearned employee stock ownership plan shares		200,000

[To record release of 20,000 shares (19,024 for compensation and 976 for dividends) at an average fair value of \$10.25 per share (shares cost employee stock ownership plan \$10 per share)]

Deferred tax asset	7,920	
Provision for income taxes	646,560	
Income taxes payable		654,480

[To record income taxes for Year 2]

Year 3

Interest expense	\$	65,600	
Accrued interest payable			\$ 65,600
[To record interest expense]			

Accrued interest payable	65,600	
Debt	198,200	
Cash		263,800
[To record debt payment]		

Retained earnings	20,000	
Dividends payable		20,000
[To record declaration of \$.50 per share dividend on the 40,000 allocated shares]		

Compensation expense	170,000	
Dividends payable	20,000	
Paid-in capital	10,000	
Unearned employee stock ownership plan shares		200,000

[To record release of 20,000 shares (17,895 for compensation and 2,105 for dividends) at an average fair value of \$9.50 per share (shares cost employee stock ownership plan \$10 per share)]

Deferred tax asset	720	
Provision for income taxes	697,760	
<u>Provision for income taxes</u>	<u>693,760</u>	
Paid-in capital		4,000
Income taxes payable		694,480
[To record income taxes for Year 3]		

Year 4

Interest expense	\$ 45,800	
Accrued interest payable		\$ 45,800
[To record interest expense]		
Accrued interest payable	45,800	
Debt	218,000	
Cash		263,800
[To record debt payment]		
Retained earnings	30,000	
Dividends payable		30,000
[To record declaration of \$.50 per share dividend on the 60,000 allocated shares]		
Compensation expense	190,000	
Dividends payable	30,000	
Paid-in capital		20,000
Unearned employee stock ownership plan shares		200,000
[To record release of 20,000 shares (17,273 for compensation and 2,727 for dividends) at an average fair value of \$11.00 per share (shares cost employee stock ownership plan \$10 per share)]		
Provision for income taxes	737,680	
<u>Provision for income taxes</u>	<u>741,680</u>	
Paid-in capital	4,000	
Deferred tax asset		7,200
Income taxes payable		734,480
[To record income taxes for Year 4]		

Year 5

Interest expense	\$	24,000	
Accrued interest payable			\$ 24,000
[To record interest expense]			
Accrued interest payable		24,000	
Debt		239,800	
Cash			263,800
[To record debt payment]			
Retained earnings		40,000	
Dividends payable			40,000
[To record declaration of \$.50 per share dividend on the 80,000 allocated shares]			
Compensation expense		224,000	
Dividends payable		40,000	
Paid-in capital			64,000
Unearned employee stock ownership plan shares			200,000
[To record release of 20,000 shares (16,970 for compensation and 3,030 for dividends) at an average fair value of \$13.20 per share (shares cost employee stock ownership plan \$10 per share)]			
Provision for income taxes		790,400	
Deferred tax asset			15,920
Income taxes payable			774,480
[To record income taxes for Year 5]			

718-40-55-7 Assuming Entity A terminates its employee stock ownership plan at the end of Year 2 (when the fair value of the **suspense shares** is \$540,000 [60,000 shares multiplied by \$9 per share], the unearned employee stock ownership plan share balance is \$600,000, and the unpaid debt balance is \$656,000), and assuming the suspense shares are sold to pay down the debt, Entity A would make the following journal entry.

Debt	\$	656,000	
Additional paid-in capital		60,000	
Unearned employee stock ownership plan shares			\$ 600,000
Cash			116,000
[To record repayment of the employee stock ownership plan's loan and termination of the plan]			

718-40-55-8 The following tables set forth Entity A's tax (assuming no termination) and earnings per share (EPS) computations.

	Year				
	1	2	3	4	5
Income before employee stock ownership plan	\$ 1,800,000	\$ 1,900,000	\$ 2,000,000	\$ 2,100,000	\$ 2,200,000
Interest expense	(100,000)	(83,600)	(65,600)	(45,800)	(24,000)
Compensation expense	(215,000)	(195,000)	(170,000)	(190,000)	(224,000)
Pretax income	<u>1,485,000</u>	<u>1,621,400</u>	<u>1,764,400</u>	<u>1,864,200</u>	<u>1,952,000</u>
Provision for income tax					
Currently payable	614,480	654,480	694,480	734,480	774,480
Deferred	(14,480)	(7,920)	(720)	7,200	15,920
Shareholders' equity	<u>—</u>	<u>—</u>	<u>4,000^(a)</u>	<u>(4,000)^(a)</u>	<u>—</u>
Total	<u>600,000</u>	<u>646,560</u>	<u>697,760</u>	<u>737,680</u>	<u>790,400</u>
Total	<u>600,000</u>	<u>646,560</u>	<u>693,760</u>	<u>741,680</u>	<u>790,400</u>
Net income	<u>\$ 885,000</u>	<u>\$ 974,840</u>	<u>\$ 1,066,640</u>	<u>\$ 1,126,520</u>	<u>\$ 1,161,600</u>
Net income	<u>\$ 885,000</u>	<u>\$ 974,840</u>	<u>\$ 1,070,640</u>	<u>\$ 1,122,520</u>	<u>\$ 1,161,600</u>
Average shares outstanding	1,010,000	1,030,000	1,050,000	1,070,000	1,090,000
Earnings per share	<u>\$.88</u>	<u>\$.95</u>	<u>\$ 1.02</u>	<u>\$ 1.05</u>	<u>\$ 1.07</u>

(a) See paragraphs 718-740-45-5 through 45-6. In Year 3, the amount is calculated as follows: 20,000 shares released multiplied by \$.50 excess cost over average fair value per share multiplied by 40 percent tax rate.

	Year				
	1	2	3	4	5
Current provision:					
Income before employee stock ownership plan	\$ 1,800,000	\$ 1,900,000	\$ 2,000,000	\$ 2,100,000	\$ 2,200,000
Employee stock ownership plan contribution	(213,800)	(213,800)	(213,800)	(213,800)	(213,800)
Employee stock ownership plan dividends	(50,000)	(50,000)	(50,000)	(50,000)	(50,000)
Taxable income	1,536,200	1,636,200	1,736,200	1,836,200	1,936,200
Multiplied by 40 percent	<u>\$ 614,480</u>	<u>\$ 654,480</u>	<u>\$ 694,480</u>	<u>\$ 734,480</u>	<u>\$ 774,480</u>
Deferred provision:					
Reduction in unearned employee stock ownership plan shares for financial reporting	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000	\$ 200,000
Related tax deduction ^(a)	163,800	180,200	198,200	218,800	239,800
Difference	(36,200)	(19,800)	(1,800)	18,000	39,800
Tax rate	40%	40%	40%	40%	40%
Deferred tax expense + (benefit)	<u>\$ (14,480)</u>	<u>\$ (7,920)</u>	<u>\$ (720)</u>	<u>7,200</u>	<u>15,920</u>

(a) This amount is the principal repayment.

	Year				
	1	2	3	4	5
Pretax income	\$ 1,485,000	\$ 1,621,400	\$ 1,764,400	\$ 1,864,200	\$ 1,952,000
Tax at 40 percent (statutory rate)	594,000	648,560	705,760	745,680	780,800
Benefit of employee stock ownership plan dividends	-	(4,000)	(8,000)	(12,000)	(16,000)
Effect of difference between average fair value and cost of released shares	<u>6,000</u>	<u>2,000</u>	<u>—</u>	<u>4,000</u>	<u>25,600</u>
Effect of difference between average fair value and cost of released shares	<u>6,000</u>	<u>2,000</u>	<u>(4,000)</u>	<u>8,000</u>	<u>25,600</u>
Provision as reported	<u>\$ 600,000</u>	<u>\$ 646,560</u>	<u>\$ 693,760</u>	<u>\$ 741,680</u>	<u>\$ 790,400</u>
Provision as reported	<u>\$ 600,000</u>	<u>\$ 646,560</u>	<u>\$ 693,760</u>	<u>\$ 741,680</u>	<u>\$ 790,400</u>

12. Amend paragraph 718-40-60-1, with a link to transition paragraph 718-10-65-4, as follows:

Relationships

> Compensation—Stock Compensation

718-40-60-1 For guidance on determining the accounting for the effect of income tax factors on **employee stock ownership plans**, see paragraphs 718-740-25-6 and 718-740-45-6 through 45-718-740-45-5.

Amendments to Subtopic 718-740

13. Amend paragraphs 718-740-25-5 through 25-6 and supersede paragraphs 718-740-25-9 through 25-10 and their related heading, with a link to transition paragraph 718-10-65-4, as follows:

Compensation—Stock Compensation—Income Taxes

Recognition

> > Employee Stock Ownership Plans

~~718-740-25-5 Paragraph 740-20-45-11(d) notes that an employee stock ownership plan and a stock option plan are analogous. Both are compensatory arrangements and both sometimes result in tax deductions for amounts that are not presently recognized as compensation expense in the financial statements under existing generally accepted accounting principles (GAAP). The tax benefits of both are reported as a credit to shareholders' equity. The following guidance is therefore incremental in that it addresses elements unique to an employee stock ownership plan. See Subtopic 718-40 for the non-income-tax accounting requirements and terminology applicable to employee stock ownership plans.~~

718-740-25-6 For employers with leveraged employee stock ownership plans, the amount of employee stock ownership plan-related expense reported under the requirements of Subtopic 718-40 for a period may differ from the amount of the employee stock ownership plan-related income tax deduction (prescribed by income tax rules and regulations) for that period. Differences result in either of the following situations:

- a. The **fair value** of shares committed to be released differs from the cost of those shares to the employee stock ownership plan.
- b. The timing of expense recognition is different for income tax and financial reporting purposes.

Such differences shall be reported in accordance with the requirements of Subtopic 740-10. ~~Similar differences arise from employee stock options. Paragraph 740-20-45-11(d) requires that the tax effects of expenses for employee stock options recognized differently for financial reporting and tax purposes be recognized in the related component of shareholders' equity.~~

~~> Tax Benefit Recognition of Excess Deductions Limited to Realized Amounts~~

~~718-740-25-9~~ ~~Paragraph superseded by Accounting Standards Update No. 2016-09. Actual tax deductions for share-based payment arrangements may be greater than compensation cost recognized for book purposes. Sections 718-740-35 and 718-740-45 establish a methodology for measuring the part of an entity's actual tax deduction that results in **excess tax benefits** and require that such benefits be recorded as additional paid-in capital. The requirements for recognition of excess tax benefits are different from those for recognition of the benefit from the compensation cost amount recognized for book purposes.~~

~~718-740-25-10~~ ~~Paragraph superseded by Accounting Standards Update No. 2016-09. A **share option** exercise may result in a tax deduction before the actual realization of the related tax benefit because the entity, for example, has a net operating loss **carryforward**. In that situation, a tax benefit and a credit to additional paid-in capital for the excess deduction would not be recognized until that deduction reduces taxes payable.~~

14. Amend paragraph 718-740-35-2 and supersede paragraphs 718-740-35-3 and 718-740-35-5 through 35-9 and the related headings, with a link to transition paragraph 718-10-65-4, as follows:

Subsequent Measurement

> Treatment of Tax Consequences When Actual Deductions Differ from Recognized Compensation Cost

718-740-35-2 This Section addresses the accounting required in a period when actual tax deductions for compensation expense taken by an entity on its tax return for **share-based payment arrangements** differ in amounts and timing from those recorded in the financial statements. The tax effect of the difference, if any, between the cumulative compensation cost of an **award** recognized for financial reporting purposes and the deduction for an award for tax purposes shall be recognized as income tax expense or benefit in the income statement. The tax effect shall be recognized in the period in which the tax deduction arises or, in the case of an expiration of an award, in the period in which the expiration occurs. The appropriate period depends on the type of award and the incremental guidance under the requirements of Subtopic 740-270 on income taxes—interim reporting. This Section establishes the methodology for identifying those amounts and specifies different treatment for excess tax deductions as compared to deficiencies in tax deductions.

>> **Excess Tax Benefit**

718-740-35-3 Paragraph superseded by Accounting Standards Update No. 2016-09. ~~If a deduction reported on a tax return for an **award** of equity instruments exceeds the cumulative compensation cost for those instruments recognized for financial reporting, any resulting realized tax benefit that exceeds the previously recognized **deferred tax asset** for those instruments is the excess tax benefit. If only a portion of an award is exercised, determination of the **excess tax benefits** shall be based on the portion of the award that is exercised.~~

718-740-35-4 See Examples 1, Case A (paragraph 718-20-55-10); 8 (paragraph 718-20-55-71); 15, Case A (paragraph 718-20-55-123); and Example 1 (paragraph 718-30-55-1), which provide illustrations of accounting for the income tax effects of various awards.

>> **Tax Deficiency**

718-740-35-5 Paragraph superseded by Accounting Standards Update No. 2016-09. ~~The amount deductible for an award of equity instruments on the employer's tax return may be less than the cumulative compensation cost recognized for financial reporting purposes. The write-off of a deferred tax asset related to that deficiency, net of the related **valuation allowance**, if any, shall first be offset to the extent of any remaining additional paid-in capital from excess tax benefits arising from previous awards granted, modified, or settled in cash in fiscal years beginning after December 15, 1994, and measured in accordance with a **fair value** based method of accounting.~~

718-740-35-6 Paragraph superseded by Accounting Standards Update No. 2016-09. An entity may have continued to use a permitted **intrinsic value** method to

~~measure and recognize share-based payment awards after 1994 when the first fair value-based method of accounting and disclosure for share-based payment awards was effective. Use of an intrinsic value method before the adoption of a fair value-based method for recognition purposes may have resulted in amounts actually recorded as additional paid-in capital from excess tax benefits being different from amounts that would have been recorded had such awards been recognized based on their fair values.~~

~~**718-740-35-7** Paragraph superseded by Accounting Standards Update No. 2016-09. An entity that continued to use the intrinsic value method for measuring and recognizing awards permitted prior to the requirements of this Subtopic shall calculate the amount available for offset as the net amount of excess tax benefits that would have qualified as such had it instead adopted the fair value-based method of accounting used in the entity's fair value disclosures for its intrinsic value based awards. In determining that amount, no distinction shall be made between excess tax benefits attributable to different types of equity awards, such as restricted shares or share options. An entity shall exclude from that amount excess tax benefits from share-based payment arrangements that are outside the scope of this Subtopic, excess tax benefits from **employee stock ownership plans**, and excess tax benefits that have not been realized pursuant to the requirements established in paragraph 718-740-25-10. See Examples 1, Case A (paragraph 718-20-55-10); 8 (paragraph 718-20-55-7); 15, Case A (paragraph 718-20-55-123); and Example 1 (paragraph 718-30-55-1), which provide illustrations of accounting for the income tax effects of various awards.~~

~~**718-740-35-8** Paragraph superseded by Accounting Standards Update No. 2016-09. An alternative method for determining the amount available for offset by entities that had continued to use the intrinsic value method for measurement and recognition of awards granted, modified, or settled in cash in fiscal years beginning after December 15, 1994, was available for a limited period of time when entities were required to change to the fair value-based method of accounting for **share-based payment transactions**.~~

~~**718-740-35-9** Paragraph superseded by Accounting Standards Update No. 2016-09. Paragraph 718-740-45-4 addresses the accounting for any deficiency remaining after the offset to additional paid-in capital has exhausted any available excess tax benefits.~~

15. Supersede paragraphs 718-740-45-1 through 45-4 and their related headings, 718-740-45-6, and 718-740-45-9 through 45-12 and amend paragraphs 718-740-45-5 and 718-740-45-7 through 45-8, with a link to transition paragraph 718-10-65-4, as follows:

Other Presentation Matters

~~**> Treatment of Tax Consequences when Actual Deductions Differ from Recognized Compensation Cost**~~

718-740-45-1 Paragraph superseded by Accounting Standards Update No. 2016-09. This Section addresses the presentation required when actual tax deductions for compensation expense taken by an entity on its tax return for **share-based payment arrangements** differ in amounts and timing from those recorded in the financial statements.

>> Excess Tax Benefit

718-740-45-2 Paragraph superseded by Accounting Standards Update No. 2016-09. An excess tax benefit determined pursuant to paragraph 718-740-35-3 shall be recognized as additional paid in capital, except that an excess of a realized tax benefit for an **award over the deferred tax asset** for that award shall be recognized in the income statement to the extent that the excess stems from a reason other than changes in the **fair value** of an entity's shares between the **measurement date** for accounting purposes and a later measurement date for tax purposes.

718-740-45-3 Paragraph superseded by Accounting Standards Update No. 2016-09. See paragraphs 230-10-45-14(e), 230-10-45-17(e), and 230-10-45-25(f) for requirements to treat **excess tax benefits** which have been recorded as additional paid in capital as a financing activity on the statement of cash flows.

>> Tax Deficiency

718-740-45-4 Paragraph superseded by Accounting Standards Update No. 2016-09. Paragraphs 718-740-35-5 through 35-8 contain measurement guidance on how much, if any, of the write-off of a deferred tax asset from a tax deficiency shall be offset against additional paid in capital. The remaining balance, if any, of the write-off of a deferred tax asset related to a tax deficiency shall be recognized in the income statement.

> Employee Stock Ownership Plans

718-740-45-5 The tax effect of the difference, if any, between the cost of shares committed to be released and the **fair value** of the shares shall be recognized as income tax expense or benefit in the income statement. If the cost of shares committed to be released in an **employee stock ownership plan** is greater than their **fair value**, and in accordance with the requirements of paragraph 740-20-45-11(d), the employer shall credit the tax effect of the amount by which the deductible expense exceeds the book expense to shareholders' equity.

718-740-45-6 Paragraph superseded by Accounting Standards Update No. 2016-09. Conversely, if the cost of shares committed to be released is less than their fair value, the employer shall charge the tax effect of the amount by which the book expense exceeds the deductible expense to shareholders' equity to the extent of previous credits to shareholders' equity related to cost exceeding fair value of the employee stock ownership plan shares committed to be released in previous periods.

~~718-740-45-7 Furthermore, the~~The tax benefit of tax-deductible dividends on allocated and unallocated {add glossary link}employee stock ownership plan{add glossary link} shares shall be recognized in the income statement, recorded as a reduction of income tax expense allocated to continuing operations. Under the requirements of paragraph 740-20-45-11(e), the tax benefit of tax-deductible dividends on unallocated employee stock ownership plan shares that are charged to retained earnings shall be credited to shareholders' equity. However, because dividends on unallocated shares would not be charged to retained earnings under the requirements of paragraph 718-40-25-16, the tax benefit of tax-deductible dividends on unallocated employee stock ownership plan shares would not be credited to shareholders' equity.

> Tax Benefits of Dividends on Share-Based Payment Awards to Employees

~~718-740-45-8 A realized~~An income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for any of the following equity classified awards shall be recognized as income tax expense or benefit in the income statement ~~an increase to additional paid-in capital~~:

- a. Nonvested equity shares
- b. Nonvested equity share units
- c. Outstanding equity share options.

~~718-740-45-9 Paragraph superseded by Accounting Standards Update No. 2016-09. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on the awards identified in the preceding paragraph shall be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards (as described in Section 718-740-35 and this Section).~~

~~718-740-45-10 Paragraph superseded by Accounting Standards Update No. 2016-09. Dividends or dividend equivalents paid to employees for the awards identified in paragraph 718-740-45-8 may result in a tax deduction prior to the actual realization of the related tax benefit because the employer, for example, has a net operating loss carryforward. Paragraph 718-740-25-10 requires the income tax benefit of those dividends not be recognized until the deduction reduces income taxes payable. Unrealized income tax benefits from dividends on equity-classified employee share-based payment awards shall be excluded from the pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards.~~

~~718-740-45-11 Paragraph superseded by Accounting Standards Update No. 2016-09. Paragraph 718-40-55-45 requires dividends or dividend equivalents paid to employees on the portion of an award of equity shares or other equity instruments that vests be charged to retained earnings. If the related award is not expected to vest, that paragraph requires the dividends or dividend equivalents to~~

~~be recognized as compensation costs. Dividends and dividend equivalents shall be reclassified between retained earnings and compensation cost in a subsequent period if the entity changes its forfeiture estimates (or actual forfeitures differ from previous estimates).~~

~~**718-740-45-12** Paragraph superseded by Accounting Standards Update No. 2016-09. Adjustments to additional paid-in capital for reclassifications of the tax benefits from dividends on the awards discussed in the preceding paragraph in subsequent periods increase or decrease the entity's pool of excess tax benefits available to absorb tax deficiencies by a corresponding amount. Additionally, the tax benefits from dividends that are reclassified from additional paid-in capital to the income statement (that is, as a reduction of income tax expense or an increase of income tax benefit) if an entity's estimate of forfeitures increases (or actual forfeitures exceed the entity's estimates) shall be limited to the entity's pool of excess tax benefits available to absorb tax deficiencies on the date of the reclassification.~~

Amendments to Subtopic 740-10

16. Amend paragraph 740-10-55-35, with a link to transition paragraph 718-10-65-4, as follows:

Income Taxes—Overall

Implementation Guidance and Illustrations

> > > Recognition of a Tax Benefit for Carryforwards

~~**740-10-55-35** A deferred tax asset, to the extent it meets the recognition requirements of this Subtopic for tax positions and paragraph 718-740-25-10 for certain share option exercises, is recognized for an operating loss or tax credit carryforward. This requirement pertains to all investment tax credit carryforwards regardless of whether the flow-through or deferral method is used to account for investment tax credits.~~

Amendments to Subtopic 740-20

17. Amend paragraphs 740-20-45-8 and 740-20-45-11, with a link to transition paragraph 718-10-65-4, as follows:

Income Taxes—Intraperiod Tax Allocation

Other Presentation Matters

> Allocation to Continuing Operations

740-20-45-8 The amount allocated to continuing operations is the tax effect of the pretax income or loss from continuing operations that occurred during the year, plus or minus income tax effects of:

- a. Changes in circumstances that cause a change in judgment about the realization of deferred tax assets in future years (see paragraph 740-10-45-20 for a discussion of exceptions to this allocation for certain items)
- b. Changes in tax laws or rates (see paragraph 740-10-35-4)
- c. Changes in tax status (see paragraphs 740-10-25-32 and 740-10-40-6)
- d. Tax-deductible dividends paid to shareholders ~~(except as set forth in paragraph 740-20-45-11(e) for dividends paid on unallocated shares held by an employee stock ownership plan or any other stock compensation arrangement).~~

The remainder is allocated to items other than continuing operations in accordance with the provisions of paragraphs 740-20-45-12 and 740-20-45-14.

> Allocations to Items Other Than Continuing Operations

740-20-45-11 The tax effects of the following items occurring during the year shall be charged or credited directly to other comprehensive income or to related components of shareholders' equity:

- a. Adjustments of the opening balance of retained earnings for certain changes in accounting principles or a correction of an error. Paragraph 250-10-45-8 addresses the effects of a change in accounting principle, including any related income tax effects.
- b. **Gains and losses included in comprehensive income but excluded from net income** (for example, translation adjustments accounted for under the requirements of Topic 830 and changes in the unrealized holding gains and losses of securities classified as available-for-sale as required by Topic 320).
- c. An increase or decrease in contributed capital (for example, deductible expenditures reported as a reduction of the proceeds from issuing capital stock).
- d. ~~Subparagraph superseded by Accounting Standards Update No. 2016-09. Expenses for employee stock options recognized differently for financial reporting and tax purposes as required by Subtopic 718-740. An employee stock ownership plan and a stock option plan are analogous. Both are compensatory arrangements and both sometimes result in tax deductions for amounts that are not presently recognized as compensation expense in the financial statements under existing generally accepted accounting principles (GAAP). The tax benefits of both are reported as a credit to shareholders' equity.~~

- e. ~~Subparagraph superseded by Accounting Standards Update No. 2016-09. Dividends that are paid on unallocated shares held by an employee stock ownership plan and that are charged to retained earnings. This is different from a tax deduction received for the payment of dividends on allocated shares held by an employee stock ownership plan that represents, in substance, an exemption from taxation of an equivalent amount of earnings for which the tax benefit shall be recognized as a reduction of tax expense and shall not be allocated directly to shareholders' equity.~~
- f. Deductible temporary differences and carryforwards that existed at the date of a quasi reorganization.
- g. All changes in the tax bases of assets and liabilities caused by transactions among or with shareholders shall be included in equity including the effect of valuation allowances initially required upon recognition of any related deferred tax assets. Changes in valuation allowances occurring in subsequent periods shall be included in the income statement.

18. Amend paragraph 740-20-55-2, with a link to transition paragraph 718-10-65-4, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Allocation to Continuing Operations

740-20-55-1 Paragraph 740-20-45-8 states that the amount of **income tax expense or benefit** allocated to continuing operations is the tax effect of pretax income or loss from continuing operations that occurred during the year plus or minus certain adjustments.

740-20-55-2 The adjustments include the tax effects of:

- a. Changes in circumstances that cause a change in judgment about the realization of deferred tax assets in future years
- b. Changes in tax laws or rates
- c. Changes in tax status
- d. Tax-deductible dividends paid to shareholders ~~(except as set forth in paragraph 740-20-45-11 for dividends paid on unallocated shares held by an employee stock ownership plan or any other stock compensation arrangement).~~

Amendments to Subtopic 740-270

19. Amend paragraphs 740-270-25-12, 740-270-30-4, 740-270-30-8, and 740-270-30-12, with a link to transition paragraph 718-10-65-4, as follows:

Income Taxes—Interim Reporting

Recognition

> Recognition of the Tax Benefit of a Loss in Interim Periods

740-270-25-12 If an entity has a significant unusual or infrequently occurring loss or a loss from discontinued operations, the tax benefit of that loss shall be recognized in an interim period when the tax benefit of the loss is expected to be either:

- a. Realized during the year
- b. Recognizable as a deferred tax asset at the end of the year in accordance with the provisions of Subtopic 740-10.

Realization would appear to be more likely than not if future **taxable income** from (ordinary) income during the current year is expected based on an established seasonal pattern of loss in early interim periods offset by income in later interim periods. The guidance in this paragraph also applies to a tax benefit resulting from an employee share-based payment award within the scope of Topic 718 on stock compensation when the deduction for the award for tax purposes is greater than the cumulative cost of the award recognized for financial reporting purposes.

Initial Measurement

> General Methodology and Use of Estimated Annual Effective Tax Rate

740-270-30-4 Paragraph 740-270-25-2 requires that the **tax (or benefit)** related to **ordinary income (or loss)** be computed at an estimated annual effective tax rate and the tax (or benefit) related to all other items be individually computed and recognized when the items occur (for example, the tax effects resulting from an employee share-based payment award within the scope of Topic 718 when the deduction for the award for tax purposes does not equal the cumulative compensation costs of the award recognized for financial reporting purposes).

740-270-30-8 The estimated effective tax rate ~~shall also~~ shall reflect anticipated investment tax credits, foreign tax rates, percentage depletion, capital gains rates, and other available tax planning alternatives. However, in arriving at this estimated effective tax rate, no effect shall be included for the tax related to an employee

share-based payment award within the scope of Topic 718 when the deduction for the award for tax purposes does not equal the cumulative compensation costs of the award recognized for financial reporting purposes, significant unusual or infrequently occurring items that will be separately reported separately, or for items that will be reported net of their related tax effect in reports for the interim period or for the fiscal year. The rate so determined shall be used in providing for income taxes on a current year-to-date basis.

> Exclusion of Items from Estimated Annual Effective Tax Rate

> > Items Always Excluded from Estimated Annual Effective Tax Rate

740-270-30-12 Taxes related to an employee share-based payment award within the scope of Topic 718 when the deduction for the award for tax purposes does not equal the cumulative compensation costs of the award recognized for financial reporting purposes, significant unusual or infrequently occurring items that will be separately reported separately, or for items that will be reported net of their related tax effect also shall be excluded from the estimated annual effective tax rate calculation.

Amendments to Subtopic 805-740

20. Amend paragraph 805-740-45-5 and supersede paragraph 805-740-45-6, with a link to transition paragraph 718-10-65-4, as follows:

Business Combinations—Income Taxes

Other Presentation Matters

> Tax Deductions for Replacement Awards

805-740-45-5 Paragraph 805-30-30-9 identifies the types of awards that are referred to as replacement awards in this Topic. After the acquisition date, the deduction reported on a tax return for a replacement award classified as equity may be different from ~~exceed~~ the **fair-value**-based measure of the award. The tax effect of that difference shall be recognized as income tax expense or benefit in the income statement of the acquirer. ~~In that situation, the acquirer shall recognize any resulting realized tax benefit that exceeds the previously recognized deferred tax asset for that award related to pre- and postcombination service (the **excess tax benefit**) as additional paid-in capital. That accounting treatment is consistent with the accounting required by paragraphs 718-740-45-2 through 45-3 for an excess tax benefit for a share-based payment award classified as equity that is granted outside of a business combination.~~

805-740-45-6 Paragraph superseded by Accounting Standards Update No. 2016-09. The accounting if the amount deductible on the acquirer's tax return is less than the fair value-based measure of the award also is the same as that prescribed by paragraph 718-740-45-4 for other awards. The write off of a deferred tax asset related to that deficiency, net of any related valuation allowance, shall first be offset to the extent of any remaining additional paid-in capital from excess tax benefits from previous share-based payment awards. The remaining balance, if any, of the write-off of a deferred tax asset related to a tax deficiency shall be recognized in earnings.

Transition and Open Effective Date Information

21. Add paragraph 718-10-65-4 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2016-09,
*Compensation—Stock Compensation (Topic 718): Improvements to
Employee Share-Based Payment Accounting***

718-10-65-4 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*:

- a. The pending content that links to this paragraph shall be effective for **public business entities** for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years.
- b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
- c. Earlier application of the pending content that links to this paragraph is permitted for:
 1. Public business entities for reporting periods for which financial statements have not yet been issued
 2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
- d. An entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- e. An entity shall apply the pending content that links to this paragraph as follows:
 1. On a prospective basis for the tax effects of differences recognized on or after the effective date between the deduction for an award for tax purposes and the cumulative compensation costs of that award recognized for financial reporting purposes. For purposes of computing diluted earnings per share, an entity also shall apply the

- pending content that links to this paragraph to the assumed proceeds of the treasury stock method on a prospective basis.
2. On a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period in which the pending content that links to this paragraph is effective for all tax benefits that were not previously recognized because the related tax deduction had not reduced taxes payable. Deferred tax assets recognized as a result of this transition guidance shall be assessed for realizability in accordance with Topic 740 on income taxes. A valuation allowance recognized for deferred tax assets recognized as a result of this transition guidance shall be recognized through a cumulative-effect adjustment to retained earnings.
 - f. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-5 through 65-10.
 - g. In the first interim and annual period of adoption, an entity shall disclose both of the following:
 1. The nature of and reason for the change in accounting principle
 2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 2: Classification of Excess Tax Benefits on the Statement of Cash Flows

22. The following amendments reflect the Board's decision to remove the requirement that reporting entities should present excess tax benefits as cash inflows from financing activities and cash outflows from operating activities. As a result of removing that requirement, cash flows related to excess tax benefits should be classified in operating activities.

Amendments to Subtopic 230-10

23. Amend paragraphs 230-10-45-14, 230-10-45-17, and 230-10-45-25, with a link to transition paragraph 718-10-65-5, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> > Cash Flows from Financing Activities

230-10-45-14 All of the following are cash inflows from financing activities:

- a. Proceeds from issuing equity instruments
- b. Proceeds from issuing bonds, mortgages, notes, and from other short- or long-term borrowing
- c. Receipts from contributions and investment income that by donor stipulation are restricted for the purposes of acquiring, constructing, or improving property, plant, equipment, or other long-lived assets or establishing or increasing a permanent endowment or term endowment
- d. Proceeds received from derivative instruments that include financing elements at inception, whether the proceeds were received at inception or over the term of the derivative instrument, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments
- e. ~~Subparagraph superseded by Accounting Standards Update No. 2016-09. Cash retained as a result of the tax deductibility of increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services that is recognizable for financial reporting purposes. For this purpose, excess tax benefits shall be determined on an individual award (or portion thereof) basis.~~

> > Cash Flows from Operating Activities

230-10-45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or ~~penalties, penalties and the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services recognizable for financial reporting purposes also had not been deductible in determining taxable income. (This is the same amount reported as a financing cash inflow pursuant to paragraph 230-10-45-14(e).)~~
- d. Cash payments to lenders and other creditors for interest.
- e. Cash payment made to settle an asset retirement obligation.
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

> > Reporting Operating, Investing, and Financing Activities

230-10-45-25 In reporting cash flows from operating activities, entities are encouraged to report major classes of gross cash receipts and gross cash payments and their arithmetic sum—the net cash flow from operating activities (the direct method). (Paragraphs 230-10-55-1 through 55-4 and paragraph 230-10-55-21, respectively, discuss and illustrate a method by which those major classes of gross operating cash receipts and payments generally may be determined indirectly.) Entities that do so shall, at a minimum, separately report the following classes of operating cash receipts and payments:

- a. Cash collected from customers, including lessees, licensees, and the like
- b. Interest and dividends received. Interest and dividends that are donor restricted for long-term purposes as included in the list of **financing activities** and paragraph 230-10-45-14(c) are not part of operating cash receipts.
- c. Other operating cash receipts, if any
- d. Cash paid to employees and other suppliers of goods or services, including suppliers of insurance, advertising, and the like
- e. Interest paid
- f. ~~Income taxes paid and separately, the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included as a cost of goods or services recognizable for accounting purposes also had not been deductible in determining taxable income (see Section 230-10-45-14(e))~~
- g. Other operating cash payments, if any.

Entities are encouraged to provide further breakdowns of operating cash receipts and payments that they consider meaningful and feasible. For example, a retailer or manufacturer might decide to further divide cash paid to employees and suppliers (category (d) in the preceding paragraph) into payments for costs of inventory and payments for selling, general, and administrative expenses.

Amendments to Subtopic 718-20

24. Add paragraph 718-20-55-23A and supersede paragraph 718-20-55-24, with a link to transition paragraph 718-10-65-5, as follows:

Compensation—Stock Compensation—Awards Classified as Equity

Implementation Guidance and Illustrations

> > > Case A: Share Options with Cliff Vesting

[Note: Paragraph 718-20-55-23 was amended in Issue 1 and is shown here for context. See the appendix for all amendments to paragraphs 718-20-55-23 through 55-23A.]

718-20-55-23 If instead the share options expired unexercised, previously recognized compensation cost would not be reversed. There would be no deduction on the tax return and, therefore, the entire deferred tax asset of \$3,843,405 would be charged to income tax expense or additional paid-in capital, to the extent of any remaining additional paid-in capital from **excess tax benefits** from previous awards accounted for in accordance with FASB Statement No. 123 (revised 2004), *Share-Based Payment*, or FASB Statement No. 123, *Accounting for Stock-Based Compensation* (see paragraphs 718-740-35-5 through 35-7).~~If employees terminated with out of the money vested share options, the deferred tax asset related to those share options would be written off when those options expire. A write off of a deferred tax asset related to a deficiency of deductible compensation cost in relation to recognized compensation cost for financial reporting purposes shall not be reflected in the statement of cash flows because the unit of account for cash flow purposes is an individual award (or portion thereof) as opposed to a portfolio of awards.~~ **[Content amended and moved to paragraph 718-20-55-23A]**

718-20-55-23A If employees terminated with out-of-the-money vested share options, the deferred tax asset related to those share options would be written off when those options expire. ~~A write off of a deferred tax asset related to a deficiency of deductible compensation cost in relation to recognized compensation cost for financial reporting purposes shall not be reflected in the statement of cash flows because the unit of account for cash flow purposes is an individual award (or portion thereof) as opposed to a portfolio of awards.~~ **[Content amended as shown and moved from paragraph 718-20-55-23]**

718-20-55-24 Paragraph superseded by Accounting Standards Update No. 2016-09. Topic 230 requires that the realized tax benefit related to the excess of the deductible amount over the compensation cost recognized be classified in the statement of cash flows as a cash inflow from financing activities and a cash outflow from operating activities. Under either the direct or indirect method of reporting cash flows, Entity T would disclose the following activity in its statement of cash flows for the year ended December 31, 20Y2:

Cash outflow from operating activities:	
Excess tax benefits from share-based payment arrangements	\$— (4,005,618)
Cash inflow from financing activities:	
Excess tax benefits from share-based payment arrangements	\$— 4,005,618

Transition and Open Effective Date Information

25. Add paragraph 718-10-65-5 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2016-09,
Compensation—Stock Compensation (Topic 718): Improvements to
Employee Share-Based Payment Accounting**

718-10-65-5 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*:

- a. The pending content that links to this paragraph shall be effective for **public business entities** for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years.
- b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
- c. Earlier application of the pending content that links to this paragraph is permitted for:
 1. Public business entities for reporting periods for which financial statements have not yet been issued
 2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
- d. An entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- e. An entity shall apply the pending content that links to this paragraph in one of the following two ways:
 1. Prospectively
 2. Retrospectively to all periods presented.
- f. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-4 and 718-10-65-6 through 65-10.
- g. In the first interim and annual period of adoption, an entity shall disclose the nature of and reason for the change in accounting principle.
 1. An entity that elects to apply the pending content that links to this paragraph prospectively shall disclose that prior periods have not been adjusted.
 2. An entity that elects to apply the pending content that links to this paragraph retrospectively shall disclose the effect of the change on prior periods retrospectively adjusted.

Issue 3: Forfeitures

26. Current GAAP requires compensation cost to be recognized for awards in which the requisite service period is rendered (that is, for awards with performance or service conditions, compensation cost is recognized only for awards that vest). Current GAAP also requires that an entity estimate the number of awards for which the requisite service period is expected to be rendered and base the accruals of compensation cost on the estimated number of awards that will vest. The following amendments reflect the Board's decision to permit an entity to make an entity-wide accounting policy election either to estimate the number of forfeitures expected to occur or to account for forfeitures in compensation cost when they occur. Many of the examples in current GAAP illustrate the accounting for share-based payment transactions when an entity estimates forfeitures. Those examples are being amended to state that the entity in the examples has an accounting policy to estimate forfeitures. The amendments include the addition of an example about accounting for forfeitures when they occur and other consequential amendments.

Amendments to Subtopic 260-10

27. Amend paragraph 260-10-45-68B, with a link to transition paragraph 718-10-65-6, as follows:

Earnings Per Share—Overall

Other Presentation Matters

> > Participating Securities and the Two-Class Method

260-10-45-68B Paragraph 718-10-55-45 requires that nonrefundable dividends or dividend equivalents paid on awards for which the requisite service is not (or is not expected to be) rendered be recognized as additional compensation cost and that dividends or dividend equivalents paid on awards for which the requisite service is (or is expected to be) rendered be charged to retained earnings. As a result, an entity shall not include dividends or dividend equivalents that are accounted for as compensation cost in the earnings allocation in computing EPS. To do so would include the dividend as a reduction of earnings available to common shareholders from both compensation cost and distributed earnings. *Undistributed* earnings shall be allocated to all ~~outstanding~~ share-based payment awards outstanding during the period, including those for which the requisite service is not expected to be rendered ~~(or is not rendered because of forfeiture during the period, if an entity elects to account for forfeitures when they occur in accordance with paragraph 718-10-35-3).~~ An entity's estimate of the number of awards for which the requisite service is not expected to be rendered ~~(or no estimate, if the entity has elected to account for forfeitures when they occur in accordance with paragraph 718-10-35-3)~~ for the purpose of determining EPS under this Topic shall be consistent with the

estimate used for the purposes of recognizing compensation cost under Topic 718. Paragraph 718-10-35-3 requires that an entity apply a change in the estimate of the number of awards for which the requisite service is not expected to be rendered in the period that the change in estimate occurs. This change in estimate will affect net income in the current period; however, a current-period change in an entity's expected forfeiture rate would not affect prior-period EPS calculations. See Example 9 for an illustration of this guidance.

28. Amend paragraphs 260-10-55-69 and 260-10-55-76A, with a link to transition paragraph 718-10-65-6, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 8: Application of the Treasury Stock Method to a Share-Based Payment Arrangement

260-10-55-68 This Example illustrates the guidance in paragraph 260-10-45-28A for the application of the treasury stock method when share options are forfeited.

260-10-55-69 Entity A adopted a share option plan on January 1, 20X7, and granted 900,000 at-the-money share options with an exercise price of \$30. All share options vest at the end of three years (cliff vesting). Entity A's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3. At the grant date, Entity A assumes an annual forfeiture rate of 3 percent and therefore expects to receive the requisite service for 821,406 $[900,000 \times (.97 \text{ to the third power})]$ share options. On January 1, 20X7, the fair value of each share option granted is \$14.69. Employees forfeited 15,000 stock options ratably during 20X7. ~~The average stock price during 20X7 is \$44. Net income for the period is \$97,385,602 (inclusive of \$2,614,398 of share-based compensation, net of income taxes of \$1,407,753). Entity A's tax rate is 35 percent. For the year ended December 31, 20X7, there are 25,000,000 weighted average common shares outstanding. Entity A has sufficient previously recognized excess tax benefits in additional paid-in capital from prior share-based payment arrangements to offset any write-off of deferred tax assets associated with its grant of share options on January 1, 20X7. All share options are the type that upon exercise give rise to deductible compensation cost for income tax purposes. This guidance also applies if the service inception date precedes the grant date.~~ **[Content amended and moved to paragraph 260-10-55-69A]**

[Note: Paragraph 260-10-55-69A is amended in Issue 1 but is shown here without the amendments for context. See the appendix for all amendments to paragraphs 260-10-55-69 through 55-69A.]

260-10-55-69A The average stock price during 20X7 is \$44. Net income for the period is \$97,385,602 (inclusive of \$2,614,398 of share-based compensation, net of income taxes of \$1,407,753). Entity A's tax rate is 35 percent. For the year

ended December 31, 20X7, there are 25,000,000 weighted-average common shares outstanding. Entity A has sufficient previously recognized excess tax benefits in additional paid-in capital from prior share-based payment arrangements to offset any write-off of deferred tax assets associated with its grant of share options on January 1, 20X7. All share options are the type that upon exercise give rise to deductible compensation cost for income tax purposes. This guidance also applies if the service inception date precedes the grant date.

[Note: Paragraph 260-10-55-70 is amended in Issue 1.]

260-10-55-70 The following table illustrates computation of basic EPS for the year ended December 31, 20X7.

Computation of Basic EPS for the Year Ended December 31, 20X7:

Net income ^(a)	\$	97,385,602
Weighted-average common shares outstanding		25,000,000
Basic earnings per share	\$	3.90

Computation of assumed proceeds for diluted earnings per share:

Amount employees would pay if the weighted-average number of options outstanding were exercised using the average exercise price $(892,500 \times \$30)$	\$	26,775,000
Average unrecognized compensation cost in 20X7 (see computation)		10,944,050
Tax benefit deficiency that would be offset in paid-in capital (see computation)		(215,539)
Assumed proceeds	\$	37,503,511

Computation of average unrecognized compensation cost in 20X7:

Beginning of period		
Unrecognized compensation cost $(900,000 \times \$14.69)$	\$	13,221,000
End of the period		
Beginning of period	\$	13,221,000
Annual compensation cost recognized during 20X7, based on estimated forfeitures		(4,022,151) ^(a)
Annual compensation cost not recognized during the period related to outstanding options at December 31, 20X7, for which the requisite service is not expected to be rendered		(311,399) ^(c)
Total compensation cost of actual forfeited options		(220,350) ^(d)

Total unrecognized compensation cost, end of the period, based on actual forfeitures		8,667,100
Subtotal	\$	21,888,100
Average total unrecognized compensation, based on actual forfeitures	\$	10,944,050

Computation of tax benefit:

Total compensation cost of average outstanding options	\$	13,110,825 ^(e)
Intrinsic value of average outstanding options for the year ended December 31, 20X7 $[892,500 \times (\$44 - \$30)]$		(12,495,000)
Excess of total compensation cost over estimated tax deduction	\$	615,825
Tax benefit deficiency $(\$615,825 \times .35)$	\$	215,539

Assumed repurchase of shares:

Repurchase shares at average market price during the year $(\$37,503,511 \div \$44)$		852,353
Incremental shares $(892,500 - 852,353)$		40,147

Computation of Diluted EPS for the Year Ended December 31, 20X7:

Net income	\$	97,385,602
Weighted-average common shares outstanding		25,000,000
Incremental shares		40,147
Total shares outstanding		25,040,147
Diluted earnings per share	\$	3.89

- (a) Pre-tax annual share-based compensation cost is $\$4,022,151 [(821,406 \times \$14.69) + 3]$. After-tax share-based compensation cost included in net income is $\$2,614,398 (\$4,022,151 - \$1,407,753)$. $(\$4,022,151 \times .35) = \$1,407,753$.
- (b) Share options granted at the beginning of the year plus share options outstanding at the end of the year divided by two equals the weighted-average number of share options outstanding in 20X7: $[(900,000 + 885,000) \div 2] = 892,500$. This example assumes that forfeitures occurred ratably throughout 20X7.
- (c) $885,000$ (options outstanding at December 31, 20X7) $- 821,406$ (options for which the requisite service is expected to be rendered) $= 63,594$. $63,594$ options $\times \$14.69$ (grant-date fair value per option) $= \$934,196$ (total fair value). $\$934,196 \div 3 = \$311,399$ (annual share-based compensation cost).
- (d) $15,000$ (forfeited options) $\times \$14.69$ (grant-date fair value per option) $= \$220,350$ (total fair value).
- (e) $(892,500 \times \$14.69) = \$13,110,825$.

> > Example 9: Participating Securities and the Two-Class Method

260-10-55-71 Participating securities should be included in the computation of **basic earnings per share** using the two-class method. The following Cases illustrate the guidance in paragraphs 260-10-45-59A through 45-70 for the application of the two-class method of computing basic earnings per share when:

- a. An entity has participating convertible preferred stock (Case A).
- b. An entity has participating convertible bonds (Case B).
- c. An entity has participating warrants (Case C).
- d. An entity has participating share-based payment awards (Case D).

260-10-55-72 The application of the two-class method in each of Cases A, B, and C presents an EPS calculation for both the common stock and the participating security. This presentation is for illustrative purposes only. The presentation of EPS is only required for each class of common stock (as clarified by this Example). However, the presentation of basic and diluted EPS for a participating security other than common stock is not precluded. Cases A, B, and C share both of the following assumptions:

- a. 10,000 shares of Class A common stock
- b. Reported net income of \$65,000 for 20X1.

> > > Case D: Participating Share-Based Payment Awards

260-10-55-76A Assume that Entity A had 25,000 shares of common stock and 5,000 unvested share-based payment awards outstanding during 20X8 and reported net income of \$100,000. The share-based payment awards participate in any dividends on a 1:1 per-share ratio with common stock, and the dividends are nonforfeitable by the holder of the share-based payment awards. Entity A's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3.

260-10-55-76B As of the beginning of 20X8, Entity A estimated that the requisite service will not be provided for 200 of the 5,000 share-based payment awards outstanding. At the end of 20X8, Entity A adjusts its estimate to reflect an increased expected forfeiture rate and now expects that the requisite service will not be provided for 300 awards. It recognizes the cumulative effect of this change in compensation cost in the current period.

260-10-55-76C Entity A paid a \$1.50 per-share dividend at the end of 20X8. Net income includes an expense of \$450 related to dividends paid to the awards for which the requisite service is not expected to be rendered in accordance with paragraph 718-10-55-45. Basic EPS under the two-class method for 20X8 would be computed as follows:

Net income		\$	100,000
Less dividends paid:			
Common stock	\$	37,500	
Unvested share-based payment awards	\$	<u>7,050</u> (a)	
		\$	<u>44,550</u>
Undistributed earnings		\$	<u>55,450</u>

- (a) Reflects the dividends paid to unvested share-based payment awards (\$7,500 = 5,000 unvested share-based payment awards × \$1.50 dividend per share) less the dividends paid to awards for which the requisite service is not expected to be rendered (\$450 = 300 share-based payment awards for which the requisite service is not expected to be rendered × \$1.50 dividend per share). Dividends paid on awards for which the requisite service is not expected to be rendered are already recognized in net income as additional compensation cost.

Allocation of undistributed earnings:

To unvested share-based payment awards:

$$5,000 \div (5,000 + 25,000) \times \$55,450 = \$9,242$$

$$\$9,242 \div 5,000 \text{ total unvested share-based payment awards} = \$1.85 \text{ per share}$$

To common:

$$25,000 \div (5,000 + 25,000) \times \$55,450 = \$46,208$$

$$\$46,208 \div 25,000 \text{ shares of common stock} = \$1.85 \text{ per share}$$

Or, to simplify, because the common shareholders and the share-based payment award holders share in dividends on a 1:1 basis, undistributed earnings could also be calculated as follows:

$$\$55,450 \div 30,000 \text{ shares}^{(b)} = \$1.85 \text{ per common share and share-based payment award}$$

- (b) 25,000 shares of common stock + 5,000 total unvested share-based payment awards

Basic earnings per share amounts:

	Unvested Share-Based Payment Awards	Common Stock
Distributed earnings	\$ 1.41 ^(c)	\$ 1.50
Undistributed earnings	<u>1.85</u>	<u>1.85</u>
	<u>\$ 3.26</u>	<u>\$ 3.35</u>

- (c) \$7,050 of distributed earnings allocated to the unvested share-based payment awards divided by 5,000 total unvested share-based payment awards. Although all unvested share-based payment awards received a payment of \$1.50 per share, totaling \$7,500, only dividends to awards for which the requisite service is expected to be rendered are considered distributed earnings as that term is used in paragraph 260-10-55-19(a). Dividends paid on awards for which the requisite service is not expected to be rendered are recognized in net income as additional compensation cost.

260-10-55-76D Note that in this illustrative example, application of the two-class method presents an EPS calculation for both the common stock and the participating security, that is, the unvested share-based payment awards. This presentation is for illustrative purposes only. The presentation of EPS is only required for each class of common stock. However, the presentation of basic and diluted EPS for a participating security other than common stock is not precluded. The disclosure in the notes to financial statements of actual distributions to unvested share-based payment awards, rather than the amount presented as distributed earnings, also is not precluded to reconcile earnings per common share and per unvested share-based payment awards. For example, Entity A in the example above may disclose that actual distributions to unvested share-based payment awards were \$7,500 and that \$450 of those distributions was included in net income as compensation cost related to awards for which the requisite service is not expected to be rendered. Disclosure on a per-share basis also is not precluded.

Amendments to Subtopic 323-10

29. Amend paragraph 323-10-55-19, with a link to transition paragraph 718-10-65-6, as follows:

Investments—Equity Method and Joint Ventures—Overall

Implementation Guidance and Illustrations

> Illustrations

> > Example 2: Stock-Based Compensation Granted to Employees of an Equity Method Investee

323-10-55-19 This Example illustrates the guidance in paragraphs 323-10-25-3 and 323-10-30-3 for stock-based compensation by an investor granted to employees of an equity method investee. ~~This Example assumes that no estimate was made of forfeiture of awards before vesting; Topic 718 requires an estimate of forfeitures to be made.~~

Amendments to Subtopic 718-10

30. Amend paragraph 718-10-30-28, with a link to transition paragraph 718-10-65-6, as follows:

Compensation—Stock Compensation—Overall

Initial Measurement

> Market, Performance, and Service Conditions

718-10-30-28 In some cases, the terms of an award may provide that a performance target that affects vesting could be achieved after an employee completes the requisite service period. That is, the employee would be eligible to vest in the award regardless of whether the employee is rendering service on the date the performance target is achieved. A performance target that affects vesting and that could be achieved after an employee's requisite service period shall be accounted for as a performance condition. As such, the performance target shall not be reflected in estimating the fair value of the award at the grant date. Compensation cost shall be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service already has been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost for which requisite service has not yet been rendered shall be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period shall reflect the number of awards that are expected to vest based on the performance target and shall be adjusted to reflect those awards that ultimately vest. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-3 shall reverse compensation cost previously recognized, in the period the award is forfeited, for an award that is forfeited before completion of the requisite service period. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period.

31. Amend paragraph 718-10-35-3, with a link to transition paragraph 718-10-65-6, as follows:

Subsequent Measurement

> Recognition of Compensation Costs over the Requisite Service Period

718-10-35-3 The total amount of compensation cost recognized at the end of the requisite service period for an award of share-based compensation shall be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed). ~~An entity shall base initial accruals of compensation cost on the estimated number of instruments for which the requisite service is expected to be rendered. That estimate shall be revised if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimated number of instruments for which the requisite~~

~~service is expected to be or has been rendered shall be recognized in compensation cost in the period of the change. Previously recognized compensation cost shall not be reversed if an employee **share option** (or **share unit**) for which the requisite service has been rendered expires unexercised (or unconverted). To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all share-based payment awards to do either of the following:~~

- ~~a. Estimate the number of awards for which the requisite service will not be rendered (that is, estimate the number of forfeitures expected to occur). The entity shall base initial accruals of compensation cost on the estimated number of instruments for which the requisite service is expected to be rendered. The entity shall revise that estimate if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimated number of instruments for which the requisite service is expected to be or has been rendered shall be recognized in compensation cost in the period of the change.~~
- ~~b. Recognize the effect of awards for which the requisite service is not rendered when the award is forfeited (that is, recognize the effect of forfeitures in compensation cost when they occur). Previously recognized compensation cost for an award shall be reversed in the period that the award is forfeited.~~

32. Amend paragraph 718-10-45-1, with a link to transition paragraph 718-10-65-6, as follows:

Other Presentation Matters

> Earnings per Share

718-10-45-1 Topic 260 requires that **employee** equity share options, **nonvested shares**, and similar equity instruments granted to employees be treated as potential common shares in computing diluted earnings per share (EPS). Diluted EPS shall be based on the actual number of options or shares granted and not yet forfeited regardless of the entity's accounting policy for forfeitures in accordance with paragraph 718-10-35-3, unless doing so would be antidilutive. If **vesting** in or the ability to exercise (or retain) an **award** is contingent on a performance or **market condition**, such as the level of future earnings, the shares or share options shall be treated as contingently issuable shares in accordance with paragraphs 260-10-45-48 through 45-57. If equity share options or other equity instruments are outstanding for only part of a period, the shares issuable shall be weighted to reflect the portion of the period during which the equity instruments are outstanding.

33. Amend paragraph 718-10-50-2, with a link to transition paragraph 718-10-65-6, as follows:

Disclosure

718-10-50-2 The following list indicates the minimum information needed to achieve the objectives in the preceding paragraph and illustrates how the disclosure requirements might be satisfied. In some circumstances, an entity may need to disclose information beyond the following to achieve the disclosure objectives:

- a. A description of the share-based payment arrangement(s), including the general terms of awards under the arrangement(s), such as:
 1. The **requisite service period(s)** and any other substantive conditions (including those related to vesting)
 2. The maximum contractual term of equity (or liability) **share options** or similar instruments
 3. The number of shares authorized for awards of equity share options or other equity instruments.
- b. The method it uses for measuring compensation cost from share-based payment arrangements with **employees**.
- c. For the most recent year for which an income statement is provided, both of the following:
 1. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or **share units**):
 - i. Those outstanding at the beginning of the year
 - ii. Those outstanding at the end of the year
 - iii. Those exercisable or convertible at the end of the year
 - iv. Those that during the year were:
 01. Granted
 02. Exercised or converted
 03. Forfeited
 04. Expired.
 2. The number and weighted-average **grant-date** fair value (or **calculated value** for a **nonpublic entity** that uses that method or **intrinsic value** for awards measured pursuant to paragraph 718-10-30-21) of equity instruments not specified in (c)(1), for all of the following groups of equity instruments:
 - i. Those nonvested at the beginning of the year
 - ii. Those nonvested at the end of the year
 - iii. Those that during the year were:
 01. Granted
 02. Vested
 03. Forfeited.

- d. For each year for which an income statement is provided, both of the following:
 1. The weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured at that value pursuant to paragraphs 718-10-30-21 through 30-22) of equity options or other equity instruments granted during the year
 2. The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year.
- e. For fully vested share options (or share units) and share options expected to **vest** (or unvested share options for which the requisite service period has not been rendered but that are expected to vest based on the achievement of a performance condition, if an entity accounts for forfeitures when they occur in accordance with paragraph 718-10-35-3) at the date of the latest statement of financial position, both of the following:
 1. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) outstanding
 2. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible).
- f. For each year for which an income statement is presented, both of the following (An entity that uses the intrinsic value method pursuant to paragraphs 718-10-30-21 through 30-22 is not required to disclose the following information for awards accounted for under that method):
 1. A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements
 2. A description of the significant assumptions used during the year to estimate the fair value (or calculated value) of share-based compensation awards, including (if applicable):
 - i. Expected term of share options and similar instruments, including a discussion of the method used to incorporate the contractual term of the instruments and employees' expected exercise and postvesting employment termination behavior into the fair value (or calculated value) of the instrument.
 - ii. Expected **volatility** of the entity's shares and the method used to estimate it. An entity that uses a method that employs different volatilities during the contractual term shall disclose the range of expected volatilities used and the weighted-average expected volatility. A nonpublic entity that uses the calculated value method shall disclose the reasons why it is not practicable for it

- to estimate the expected volatility of its share price, the appropriate industry sector index that it has selected, the reasons for selecting that particular index, and how it has calculated historical volatility using that index.
- iii. Expected dividends. An entity that uses a method that employs different dividend rates during the contractual term shall disclose the range of expected dividends used and the weighted-average expected dividends.
 - iv. Risk-free rate(s). An entity that uses a method that employs different risk-free rates shall disclose the range of risk-free rates used.
 - v. Discount for post-vesting restrictions and the method for estimating it.
- g. An entity that grants equity or liability instruments under multiple share-based payment arrangements with employees shall provide the information specified in paragraph (a) through (f) separately for different types of awards to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation. For example, separate disclosure of weighted-average exercise prices (or conversion ratios) at the end of the year for options (or share units) with a fixed exercise price (or conversion ratio) and those with an indexed exercise price (or conversion ratio) could be important. It also could be important to segregate the number of options (or share units) not yet exercisable into those that will become exercisable (or convertible) based solely on fulfilling a **service condition** and those for which a **performance condition** must be met for the options (share units) to become exercisable (convertible). It could be equally important to provide separate disclosures for awards that are classified as equity and those classified as liabilities. In addition, an entity that has multiple share-based payment arrangements with employees shall disclose information separately for different types of awards under those arrangements to the extent that differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation.
- h. For each year for which an income statement is presented, both of the following:
1. Total compensation cost for share-based payment arrangements
 - i. Recognized in income as well as the total recognized tax benefit related thereto
 - ii. Capitalized as part of the cost of an asset.
 2. A description of significant **modifications**, including:
 - i. The terms of the modifications
 - ii. The number of employees affected
 - iii. The total incremental compensation cost resulting from the modifications.

- i. As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized
- j. Subparagraph superseded by Accounting Standards Update No. 2016-09. If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit realized from stock options exercised during the annual period **[Content amended and moved to paragraph 718-10-50-2A]**
- k. If not separately disclosed elsewhere, the amount of cash used to settle equity instruments granted under share-based payment arrangements
- l. A description of the entity's policy, if any, for issuing shares upon share option exercise (or share unit conversion), including the source of those shares (that is, new shares or treasury shares). If as a result of its policy, an entity expects to repurchase shares in the following annual period, the entity shall disclose an estimate of the amount (or a range, if more appropriate) of shares to be repurchased during that period.
- m. If not separately disclosed elsewhere, the policy for estimating expected forfeitures or recognizing forfeitures as they occur.

[Note: Paragraph 718-10-50-2A is amended in Issue 1 but is shown here without the amendment for context. See the appendix for all amendments to paragraphs 718-10-50-2 through 50-2A.]

718-10-50-2A Another item of minimum information needed to achieve the objectives in paragraph 718-10-50-1 is the following:

- a. If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit from stock options exercised during the annual period.

34. Amend paragraphs 718-10-55-45 and 718-10-55-76, with a link to transition paragraph 718-10-65-6, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Dividend Protected Awards

718-10-55-45 In certain situations, employees may receive the dividends paid on the underlying equity shares while the option is outstanding. Dividends or dividend equivalents paid to employees on the portion of an award of equity shares or other

equity instruments that vests shall be charged to retained earnings. If employees are not required to return the dividends or dividend equivalents received if they forfeit their awards, dividends or dividend equivalents paid on instruments that do not vest shall be recognized as additional compensation cost. If an entity's accounting policy is to estimate the number of awards expected to be forfeited in accordance with paragraph 718-10-35-3, the~~The~~ estimate of compensation cost for dividends or dividend equivalents paid on instruments that are not expected to vest shall be consistent with an entity's estimates of forfeitures ~~(see paragraph 718-10-35-3)~~. Dividends and dividend equivalents shall be reclassified between retained earnings and compensation cost in a subsequent period if the entity changes its forfeiture estimates (or actual forfeitures differ from previous estimates). If an entity's accounting policy is to account for forfeitures when they occur in accordance with paragraph 718-10-35-3, the entity shall reclassify to compensation cost in the period in which the forfeitures occur the amount of dividends and dividend equivalents previously charged to retained earnings relating to awards that are forfeited.

> > **Explicit, Implicit, and Derived Requisite Service Periods**

718-10-55-76 If an award vests upon the satisfaction of both a service condition and the satisfaction of one or more performance conditions, the entity also must initially determine which outcomes are probable of achievement. For example, an award contains a four-year service condition and two performance conditions, all of which need to be satisfied. If initially the four-year service condition is probable of achievement and no performance condition is probable of achievement, then no compensation cost would be recognized unless the two performance conditions and the service condition subsequently become probable of achievement. If both performance conditions become probable of achievement one year after the grant date and the entity estimates that both performance conditions will be achieved by the end of the second year, the requisite service period would be four years as that is the longest period of both the explicit service period and the implicit service periods. Because the performance conditions are now probable of achievement ~~requisite service is now expected to be rendered~~, compensation cost will be recognized in the period of the change in estimate (see paragraph 718-10-35-3) as the cumulative effect on current and prior periods of the change in the estimated number of awards for which the requisite service is expected to be rendered. Therefore, compensation cost for the first year will be recognized immediately at the time of the change in estimate for the awards for which the requisite service is expected to be rendered. The remaining unrecognized compensation cost for those awards would be recognized prospectively over the remaining requisite service period. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-3 would assume that the achievement of a service condition is probable when determining the amount of compensation cost to recognize unless the award has been forfeited.

Amendments to Subtopic 718-20

35. Add paragraph 718-20-35-3A, with a link to transition paragraph 718-10-65-6, as follows:

Compensation—Stock Compensation—Awards Classified as Equity

Subsequent Measurement

> Modification of an Award

718-20-35-3 A **modification** of the terms or conditions of an equity award shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of equal or greater value, incurring additional compensation cost for any incremental value. The effects of a modification shall be measured as follows:

- a. Incremental compensation cost shall be measured as the excess, if any, of the fair value of the modified award determined in accordance with the provisions of this Topic over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. As indicated in paragraph 718-10-30-20, references to fair value throughout this Topic shall be read also to encompass **calculated value**. The effect of the modification on the number of instruments expected to **vest** also shall be reflected in determining incremental compensation cost. The estimate at the modification date of the portion of the award expected to vest shall be subsequently adjusted, if necessary, in accordance with paragraph 718-10-35-3 and other guidance in Examples 14 through 15 (see paragraphs 718-20-55-107 through 55-121).
- b. Total recognized compensation cost for an equity award shall at least equal the fair value of the award at the grant date unless at the date of the modification the performance or service conditions of the original award are not expected to be satisfied. Thus, the total compensation cost measured at the date of a modification shall be the sum of the following:
 1. The portion of the grant-date fair value of the original award for which the requisite service is expected to be rendered (or has already been rendered) at that date
 2. The incremental cost resulting from the modification.Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 718-10-35-3 and other guidance in Examples 14 through 15 (see paragraph 718-20-55-107 through 55-121).
- c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 718-20-35-1 shall be measured by

comparing the intrinsic value of the modified award, if any, with the intrinsic value of the original award, if any, immediately before the modification.

718-20-35-3A An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-3 shall assess at the date of the modification whether the performance or service conditions of the original award are expected to be satisfied when measuring the effects of the modification in accordance with paragraph 718-20-35-3. However, the entity shall apply its accounting policy to account for forfeitures when they occur when subsequently accounting for the modified award.

36. Amend paragraphs 718-20-55-4 through 55-5, 718-20-55-7, 718-20-55-10 and its related heading, 718-20-55-60, 718-20-55-121, and 718-20-55-123 and add paragraphs 718-20-55-34A through 55-34G and their related heading, with a link to transition paragraph 718-10-65-6, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Accounting for Share Options with Service Conditions

718-20-55-4 The following Cases illustrate the guidance in paragraphs 718-10-35-2 through 35-7 and 718-740-25-2 through 25-3, except for the vesting provisions:

- a. Share options with cliff vesting and forfeitures estimated in initial accruals of compensation cost (Case A)
- b. Share options with graded vesting and forfeitures estimated in initial accruals of compensation cost (Case B).
- c. Share options with cliff vesting and forfeitures recognized when they occur (Case C).

718-20-55-5 ~~Cases A and BA, B, and C share all of the following assumptions.~~assumptions in paragraphs 718-20-55-6 through 55-34G, with the following exceptions:

- a. In Case C, Entity T has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-3.
- b. In Cases A and B, Entity T has an accounting policy to estimate the number of forfeitures expected to occur, also in accordance with paragraph 718-10-35-3.
- c. In Case B, the share options have graded vesting.
- d. In Cases A and C, the share options have cliff vesting.

[Note: Paragraph 718-20-55-6 is amended in Issue 1.]

718-20-55-6 Entity T, a **public entity**, grants at-the-money **employee** share options with a contractual term of 10 years. All share options **vest** at the end of three years (cliff vesting), which is an explicit service (and requisite service) period of three years. The share options do not qualify as incentive stock options for U.S. tax purposes. The enacted tax rate is 35 percent.

718-20-55-7 The following table shows assumptions and information about the share options granted on January 1, 20X5 applicable to both all Cases, except for expected forfeitures per year, which does not apply in Case C.

Share options granted	900,000
Employees granted options	3,000
Expected forfeitures per year	3.0%
Share price at the grant date	\$ 30
Exercise price	\$ 30
Contractual term of options	10 years
Risk-free interest rate over contractual term	1.5 to 4.3%
Expected volatility over contractual term	40 to 60%
Expected dividend yield over contractual term	1.0%
Suboptimal exercise factor	2

718-20-55-8 A suboptimal exercise factor of two means that exercise is generally expected to occur when the share price reaches two times the **share option's** exercise price. Option-pricing theory generally holds that the optimal (or profit-maximizing) time to exercise an option is at the end of the option's term; therefore, if an option is exercised before the end of its term, that exercise is referred to as suboptimal. Suboptimal exercise also is referred to as early exercise. Suboptimal or early exercise affects the expected term of an option. Early exercise can be incorporated into option-pricing models through various means. In this Case, Entity T has sufficient information to reasonably estimate early exercise and has incorporated it as a function of Entity T's future stock price changes (or the option's **intrinsic value**). In this Case, the factor of 2 indicates that early exercise would be expected to occur, on average, if the stock price reaches \$60 per share ($\30×2). Rather than use its weighted average suboptimal exercise factor, Entity T also may use multiple factors based a distribution of early exercise data in relation to its stock price.

718-20-55-9 This Case assumes that each employee receives an equal grant of 300 options. Using as inputs the last 7 items from the table in paragraph 718-20-55-7, Entity T's lattice-based valuation model produces a fair value of \$14.69 per option. A **lattice model** uses a suboptimal exercise factor to calculate the expected term (that is, the expected term is an output) rather than the expected term being

a separate input. If an entity uses a Black-Scholes-Merton option-pricing formula, the expected term would be used as an input instead of a suboptimal exercise factor.

> > > Case A: Share Options with Cliff Vesting and Forfeitures Estimated in Initial Accruals of Compensation Cost

718-20-55-10 Total compensation cost recognized over the **requisite service period** (which is the vesting period in this Case) shall be the grant-date fair value of all share options that actually vest (that is, all options for which the requisite service is rendered). This Case assumes that Entity T's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3. As a result, Entity T is required~~Paragraph 718-10-35-3 requires an entity~~ to estimate at the **grant date** the number of share options for which the requisite service is expected to be rendered (which, in this Case, is the number of share options for which vesting is deemed **probable**). If that estimate changes, it shall be accounted for as a change in estimate and its cumulative effect (from applying the change retrospectively) recognized in the period of change. Entity T estimates at the grant date the number of share options expected to vest and subsequently adjusts compensation cost for changes in the estimated rate of forfeitures and differences between expectations and actual experience. This Case also assumes that none of the compensation cost is capitalized as part of the cost of an asset.

718-20-55-11 The estimate of the number of forfeitures considers historical employee turnover rates and expectations about the future. Entity T has experienced historical turnover rates of approximately 3 percent per year for employees at the grantees' level, and it expects that rate to continue over the requisite service period of the awards. Therefore, at the grant date Entity T estimates the total compensation cost to be recognized over the requisite service period based on an expected forfeiture rate of 3 percent per year. Actual forfeitures are 5 percent in 20X5, but no adjustments to cumulative compensation cost are recognized in 20X5 because Entity T still expects actual forfeitures to average 3 percent per year over the 3-year vesting period. As of December 31, 20X6, management decides that the forfeiture rate will likely increase through 20X7 and changes its estimated forfeiture rate for the entire award to 6 percent per year. Adjustments to cumulative compensation cost to reflect the higher forfeiture rate are made at the end of 20X6. At the end of 20X7 when the award becomes vested, actual forfeitures have averaged 6 percent per year, and no further adjustment is necessary.

[Note: Paragraph 718-20-55-12 is amended in Issue 1.]

718-20-55-12 The first set of calculations illustrates the accounting for the award of share options on January 1, 20X5, assuming that the share options granted vest at the end of three years. (Case B illustrates the accounting for an award assuming graded vesting in which a specified portion of the share options granted vest at the end of each year.) The number of share options expected to vest is estimated at

the grant date to be 821,406 ($900,000 \times .97^3$). Thus, the compensation cost to be recognized over the requisite service period at January 1, 20X5, is \$12,066,454 ($821,406 \times \14.69), and the compensation cost to be recognized during each year of the 3-year vesting period is \$4,022,151 ($\$12,066,454 \div 3$). In this Case, Entity T has concluded that it will have sufficient future taxable income to realize the deferred tax benefits from its **share-based payment transactions**. The journal entries to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows for 20X5.

Compensation cost	\$ 4,022,151	
Additional paid-in capital		\$ 4,022,151
To recognize compensation cost.		

Deferred tax asset	\$ 1,407,753	
Deferred tax benefit		\$ 1,407,753

To recognize the deferred tax asset for the temporary difference related to compensation cost ($\$4,022,151 \times .35 = \$1,407,753$).

718-20-55-13 The net after-tax effect on income of recognizing compensation cost for 20X5 is \$2,614,398 ($\$4,022,151 - \$1,407,753$).

718-20-55-14 Absent a change in estimated forfeitures, the same journal entries would be made to recognize compensation cost and related tax effects for 20X6 and 20X7, resulting in a net after-tax cost for each year of \$2,614,398. However, at the end of 20X6, management changes its estimated employee forfeiture rate from 3 percent to 6 percent per year. The revised number of share options expected to vest is 747,526 ($900,000 \times .94^3$). Accordingly, the revised cumulative compensation cost to be recognized by the end of 20X7 is \$10,981,157 ($747,526 \times \14.69). The cumulative adjustment to reflect the effect of adjusting the forfeiture rate is the difference between two-thirds of the revised cost of the award and the cost already recognized for 20X5 and 20X6. The related journal entries and the computations follow.

At December 31, 20X6, to adjust for new forfeiture rate.

Revised total compensation cost	<u>\$ 10,981,157</u>
Revised cumulative cost as of December 31, 20X6 ($\$10,981,157 \times \frac{2}{3}$)	\$ 7,320,771
Cost already recognized in 20X5 and 20X6 ($\$4,022,151 \times 2$)	<u>8,044,302</u>
Adjustment to cost at December 31, 20X6	<u>\$ (723,531)</u>

718-20-55-15 The related journal entries are as follows.

Additional paid-in capital	\$	723,531	
Compensation cost			\$ 723,531

To adjust previously recognized compensation cost and equity to reflect a higher estimated forfeiture rate.

Deferred tax expense	\$	253,236	
Deferred tax asset			\$ 253,236

To adjust the deferred tax accounts to reflect the tax effect of increasing the estimated forfeiture rate ($\$723,531 \times .35 = \$253,236$).

718-20-55-16 Journal entries for 20X7 are as follows.

Compensation cost	\$	3,660,386	
Additional paid-in capital			\$ 3,660,386

To recognize compensation cost ($\$10,981,157 \div 3 = \$3,660,386$).

Deferred tax asset	\$	1,281,135	
Deferred tax benefit			\$ 1,281,135

To recognize the deferred tax asset for additional compensation cost ($\$3,660,386 \times .35 = \$1,281,135$).

718-20-55-17 As of December 31, 20X7, the entity would examine its actual forfeitures and make any necessary adjustments to reflect cumulative compensation cost for the number of shares that actually vested.

Share Option—Cliff Vesting			
Year	Total Value of Award	Pretax Cost for Year	Cumulative Pretax Cost
20X5	\$12,066,454 ($821,406 \times \14.69)	\$4,022,151 ($\$12,066,454 \div 3$)	\$ 4,022,151
20X6	\$10,981,157 ($747,526 \times \14.69)	\$3,298,620 [$(\$10,981,157 \times 2/3) - \$4,022,151$]	\$ 7,320,771
20X7	\$10,981,157 ($747,526 \times \14.69)	\$3,660,386 ($\$10,981,157 \div 3$)	\$ 10,981,157

718-20-55-18 All 747,526 vested share options are exercised on the last day of 20Y2. Entity T has already recognized its income tax expense for the year without regard to the effects of the exercise of the employee share options. In other words, current tax expense and current taxes payable were recognized based on income and deductions before consideration of additional deductions from exercise of the employee share options. Upon exercise, the amount credited to common stock (or other appropriate equity accounts) is the sum of the cash proceeds received and the amounts previously credited to additional paid-in capital in the periods the

services were received (20X5 through 20X7). In this Case, Entity T has no-par common stock and at exercise, the share price is assumed to be \$60.

718-20-55-19 At exercise the journal entries are as follows.

Cash ($747,526 \times \$30$)	\$	22,425,780	
Additional paid-in capital	\$	10,981,157	
Common stock			\$ 33,406,937

To recognize the issuance of common stock upon exercise of share options and to reclassify previously recorded paid-in capital.

[Note: Paragraphs 718-20-55-20 through 55-21 are amended in Issue 1.]

718-20-55-20 In this Case, the difference between the market price of the shares and the exercise price on the date of exercise is deductible for tax purposes pursuant to U.S. tax law in effect in 2004 (the share options do not qualify as incentive stock options). Realized benefits of tax return deductions in excess of compensation cost recognized are accounted for as a credit to additional paid-in capital. (See Subtopic 718-740 for additional guidance on tax issues.) As indicated in paragraph 718-740-25-10, a share option exercise may result in a tax deduction before the actual realization of the related tax benefit because the entity, for example, has a net operating loss carryforward. In that situation, a tax benefit and a credit to additional paid-in capital for the excess deduction would not be recognized until that deduction reduces taxes payable. With the share price of \$60 at exercise, the deductible amount is \$22,425,780 [$747,526 \times (\$60 - \$30)$]. Entity T has sufficient taxable income to fully realize that deduction, and the tax benefit realized is \$7,849,023 ($\$22,425,780 \times .35$).

718-20-55-21 At exercise the journal entries are as follows.

Deferred tax expense	\$	3,843,405	
Deferred tax asset			\$ 3,843,405

To write off the deferred tax asset related to deductible share options at exercise ($\$10,981,157 \times .35 = \$3,843,405$).

Current taxes payable	\$	7,849,023	
Current tax expense			\$ 3,843,405
Additional paid-in capital			\$ 4,005,618

To adjust current tax expense and current taxes payable to recognize the current tax benefit from deductible compensation cost upon exercise of share options.

[Note: Paragraphs 718-20-55-22 and 718-20-50-24 are superseded in Issues 1 and 2, respectively, and are not shown here.]

[Note: Paragraphs 718-20-55-23 through 55-23A are amended in Issues 1 and 2 but are shown here without the amendments for context. See the appendix for all amendments to paragraphs 718-20-55-23 through 55-23A.]

718-20-55-23 If instead the share options expired unexercised, previously recognized compensation cost would not be reversed. There would be no deduction on the tax return and, therefore, the entire deferred tax asset of \$3,843,405 would be charged to income tax expense or additional paid-in capital, to the extent of any remaining additional paid-in capital from **excess tax benefits** from previous awards accounted for in accordance with FASB Statement No. 123 (revised 2004), *Share-Based Payment*, or FASB Statement No. 123, *Accounting for Stock-Based Compensation* (see paragraphs 718-740-35-5 through 35-7).

718-20-55-23A If employees terminated with out-of-the-money vested share options, the deferred tax asset related to those share options would be written off when those options expire. A write-off of a deferred tax asset related to a deficiency of deductible compensation cost in relation to recognized compensation cost for financial reporting purposes shall not be reflected in the statement of cash flows because the unit of account for cash flow purposes is an individual award (or portion thereof) as opposed to a portfolio of awards.

> > > Case C: Share Options with Cliff Vesting and Forfeitures Recognized When They Occur

718-20-55-34A This Case uses the same assumptions as Case A except that Entity T's accounting policy is to account for forfeitures when they occur in accordance with paragraph 718-10-35-3. Consequently, compensation cost previously recognized for an employee share option is reversed in the period in which forfeiture of the award occurs. Previously recognized compensation cost is not reversed if an employee share option for which the requisite service has been rendered expires unexercised. This Case also assumes that none of the compensation cost is capitalized as part of the cost of an asset.

718-20-55-34B In 20X5, 20X6, and 20X7, share option forfeitures are 45,000, 47,344, and 60,130, respectively.

718-20-55-34C The compensation cost to be recognized over the requisite service period at January 1, 20X5, is \$13,221,000 ($900,000 \times \14.69), and the compensation cost to be recognized (excluding the effect of forfeitures) during each year of the 3-year vesting period is \$4,407,000 ($\$13,221,000 \div 3$). The journal entries for 20X5 to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows.

<u>Compensation cost</u>	<u>\$ 4,407,000</u>	
<u>Additional paid-in capital</u>		<u>\$ 4,407,000</u>
<u>To recognize compensation cost excluding the effect of forfeitures for 20X5.</u>		

<u>Deferred tax asset</u>	<u>\$ 1,542,450</u>	
<u>Deferred tax benefit</u>		<u>\$ 1,542,450</u>

To recognize the deferred tax asset for the temporary difference related to compensation cost (\$4,407,000 × .35).

718-20-55-34D During 20X5, 45,000 share options are forfeited; accordingly, Entity T remeasures compensation cost to reflect the effect of forfeitures when they occur and recognizes compensation costs for 855,000 (900,000 – 45,000) share options (net of forfeitures) at an amount of \$12,559,950 (855,000 × \$14.69) over the 3-year vesting period, or \$4,186,650 each year (\$12,559,950 ÷ 3). Therefore, Entity T reverses recognized compensation cost of \$220,350 (45,000 share options × \$14.69 ÷ 3) to account for forfeitures that occurred during 20X5. The journal entries to recognize the effect of forfeitures during 20X5 and the related reduction in the deferred tax benefit are as follows.

<u>Additional paid-in capital</u>	<u>\$ 220,350</u>	
<u>Compensation cost</u>		<u>\$ 220,350</u>

To recognize the effect of forfeitures on compensation cost when they occur for 20X5.

<u>Deferred tax benefit</u>	<u>\$ 77,123</u>	
<u>Deferred tax asset</u>		<u>\$ 77,123</u>

To reverse the deferred tax asset related to the forfeited awards (\$220,350 × .35).

718-20-55-34E As of January 1, 20X6, Entity T determines the compensation cost and related tax effects to recognize during 20X6. The journal entries for 20X6 to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows (excluding the effect of forfeitures in 20X6).

<u>Compensation cost</u>	<u>\$ 4,186,650</u>	
<u>Additional paid-in capital</u>		<u>\$ 4,186,650</u>

To recognize compensation cost excluding the effect of awards that forfeited during 20X6.

<u>Deferred tax asset</u>	<u>\$ 1,465,328</u>	
<u>Deferred tax benefit</u>		<u>\$ 1,465,328</u>

To recognize the deferred tax asset for the temporary difference related to compensation cost (\$4,186,650 × .35).

718-20-55-34F In 20X6, 47,344 share options are forfeited (that is, 92,344 share options in total have been forfeited by December 31, 20X6); accordingly, Entity T would recognize compensation cost for 807,656 share options over the 3-year vesting period. On the basis of actual forfeitures in 20X5 and 20X6, Entity T should recognize a cumulative compensation cost of \$11,864,467 ($807,656 \times \14.69) for the 3-year vesting period, or \$3,954,822 a year ($\$11,864,467 \div 3$ years). Therefore, Entity T reverses recognized compensation cost of \$231,828 ($\$4,186,650 - \$3,954,822$) for 20X5 and 20X6, or \$463,656 in total, to account for forfeitures that occurred during 20X6. The journal entries to recognize the effect of forfeitures during 20X6 and the related reduction in the deferred tax benefit are as follows.

<u>Additional paid-capital</u>	<u>\$ 463,656</u>	
<u>Compensation cost</u>		<u>\$ 463,656</u>

To recognize the effect of the forfeitures on compensation cost when they occur for 20X6.

<u>Deferred tax benefit</u>	<u>\$ 162,280</u>	
<u>Deferred tax asset</u>		<u>\$ 162,280</u>

To reverse the deferred tax asset related to the forfeited awards (\$463,656 × .35).

718-20-55-34G Entity T follows the same approach in 20X7 as it applied in 20X6 to recognize compensation cost and related tax effects.

> > Example 5: Share Option with a Market Condition—Indexed Exercise Price

718-20-55-60 The indexed share options have a three-year explicit service period. The market condition affects the grant-date fair value of the award and its exercisability; however, vesting is based solely on the explicit service period of

three years. The at-the-money nature of the award makes the **derived service period** irrelevant in determining the requisite service period in this Example; therefore, the requisite service period of the award is three years based on the explicit service period. The accrual of compensation cost would be based on the number of options for which the requisite service is rendered or is expected to be rendered, depending on an entity's accounting policy in accordance with paragraph 718-10-35-3 (which is not addressed in this Example). That cost would be recognized over the requisite service period as shown in Example 1 (see paragraph 718-20-55-4).

> > **Example 15: Illustration of a Type III Improbable to Probable Modification**

718-20-55-120 This Example illustrates the guidance in paragraph 718-20-35-3.

718-20-55-121 On January 1, 20X7, Entity Z issues 1,000 at-the-money options with a 4-year explicit service condition to each of 50 employees that work in Plant J. On December 12, 20X7, Entity Z decides to close Plant J and notifies the 50 Plant J employees that their employment relationship will be terminated effective June 30, 20X8. On June 30, 20X8, Entity Z accelerates vesting of all options. The grant-date fair value of each option is \$20 on January 1, 20X7, and \$10 on June 30, 20X8, the modification date. At the date Entity Z decides to close Plant J and terminate the employees, the service condition of the original award is not expected to be satisfied because the employees cannot render the requisite ~~service; therefore, service~~. Because Entity Z's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3, any compensation cost recognized before December 12, 20X7, for the original award would be reversed. At the date of the modification, the fair value of the original award, which is \$0 ($\10×0 options expected to vest under the original terms of the award), is subtracted from the fair value of the modified award \$500,000 ($\$10 \times 50,000$ options expected to vest under the modified award). The total recognized compensation cost of \$500,000 will be less than the fair value of the award at the grant date (\$1 million) because at the date of the modification, the original vesting conditions were not expected to be satisfied. If Entity Z's accounting policy was to account for forfeitures when they occur in accordance with paragraph 718-10-35-3, then compensation cost recognized before December 12, 20X7, would not be reversed until the award is forfeited. However, Entity Z would be required to assess at the date of the modification whether the performance or service conditions of the original award are expected to be satisfied.

> > **Example 16: Modifications That Change an Award's Classification**

> > > **Case A: Equity to Liability Modification (Share-Settled Share Options to Cash-Settled Share Options)**

718-20-55-123 Entity T grants the same share options described in Example 1, Case A (see paragraph 718-20-55-10). As in Example 1, Case A, Entity T has an accounting policy to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3. The number of options for which the requisite service is expected to be rendered is estimated at the grant date to be 821,406 ($900,000 \times .97^3$). For simplicity, this Case assumes that estimated forfeitures equal actual forfeitures. Thus, as shown in the table in paragraph 718-20-55-130, the fair value of the award at January 1, 20X5, is \$12,066,454 ($821,406 \times \14.69), and the compensation cost to be recognized during each year of the 3-year vesting period is \$4,022,151 ($\$12,066,454 \div 3$). The journal entries for 20X5 are the same as those in paragraph 718-20-55-12.

Amendments to Subtopic 718-30

37. Amend paragraph 718-30-55-2, with a link to transition paragraph 718-10-65-6, as follows:

Compensation—Stock Compensation—Awards Classified as Liabilities

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Cash-Settled Stock Appreciation Right

718-30-55-2 Entity T, a **public entity**, grants share appreciation rights with the same terms and conditions as those described in Example 1 (see paragraph 718-20-55-4). As in Example 1, Case A, Entity T makes an accounting policy election in accordance with paragraph 718-10-35-3 to estimate the number of forfeitures expected to occur and includes that estimate in its initial accrual of compensation costs. Each stock appreciation right entitles the holder to receive an amount in cash equal to the increase in value of 1 share of Entity T stock over \$30. Entity T determines the grant-date **fair value** of each stock appreciation right in the same manner as a **share option** and uses the same assumptions and option-pricing model used to estimate the fair value of the share options in that Example; consequently, the grant-date fair value of each stock appreciation right is \$14.69 (see paragraphs 718-20-55-7 through 55-9). The awards cliff-**vest** at the end of three years of service (an explicit and requisite service period of three years). The number of stock appreciation rights for which the requisite service is expected to be rendered is estimated at the **grant date** to be 821,406 ($900,000 \times .97^3$). Thus, the fair value of the **award** as of January 1, 20X5, is \$12,066,454 ($821,406 \times$

\$14.69). For simplicity, this Example assumes that estimated forfeitures equal actual forfeitures.

Amendments to Subtopic 805-30

38. Amend paragraph 805-30-55-11, with a link to transition paragraph 718-10-65-6, as follows:

Business Combinations—Goodwill or Gain from Bargain Purchase, Including Consideration Transferred

Implementation Guidance and Illustrations

> Implementation Guidance

> > Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Employees of the Acquiree

805-30-55-6 If the acquirer is obligated to replace the acquiree's share-based payment awards, paragraph 805-30-30-9 requires the acquirer to include either all or a portion of the fair-value-based measure of the replacement awards in the consideration transferred in the business combination. Paragraphs 805-30-55-7 through 55-13, 805-740-25-10 through 25-11, 805-740-45-5 through 45-6, and Example 2 (see paragraph 805-30-55-17) provide additional guidance on and illustrate how to determine the portion of an award to include in consideration transferred in a business combination and the portion to recognize as compensation cost in the acquirer's postcombination financial statements.

805-30-55-7 To determine the portion of a replacement award that is part of the consideration exchanged for the acquiree and the portion that is compensation for postcombination service, the acquirer first measures both the replacement awards and the acquiree awards as of the **acquisition date** in accordance with the requirements of Topic 718. In most situations, those requirements result in use of the fair-value-based measurement method, but that Topic permits use of the calculated value method or the intrinsic value method in specified circumstances. This discussion focuses on the fair-value-based method, but the guidance in paragraphs 805-30-30-9 through 30-13 and the additional guidance cited in the preceding paragraph also apply in situations in which Topic 718 permits use of either the calculated value method or the intrinsic value method for both the acquiree awards and the replacement awards.

805-30-55-8 The portion of the replacement award attributable to precombination service is the fair-value-based measure of the acquiree award multiplied by the ratio of the precombination service period to the greater of the total service period

or the original service period of the acquiree award. (Example 2, Cases C and D [see paragraphs 805-30-55-21 through 55-24] illustrate that calculation.) The total service period is the sum of the following amounts:

- a. The part of the **requisite service period** for the acquiree award that was completed before the acquisition date
- b. The postcombination requisite service period, if any, for the replacement award.

805-30-55-9 The requisite service period includes explicit, implicit, and derived service periods during which employees are required to provide service in exchange for the award (consistent with the requirements of Topic 718).

805-30-55-10 The portion of a nonvested replacement award attributable to postcombination service, and therefore recognized as compensation cost in the postcombination financial statements, equals the total fair-value-based measure of the replacement award less the amount attributed to precombination service. Therefore, the acquirer attributes any excess of the fair-value-based measure of the replacement award over the fair value of the acquiree award to postcombination service and recognizes that excess as compensation cost in the postcombination financial statements.

805-30-55-11 Regardless of the accounting policy elected in accordance with paragraph 718-10-35-3, the portion of a nonvested replacement award included in consideration transferred attributable to precombination service, as well as the portion attributable to postcombination service, shall reflect the acquirer's estimate of the number of replacement awards for which the requisite service is expected to be rendered (that is, an acquirer that has elected an accounting policy to recognize forfeitures as they occur in accordance with paragraph 718-10-35-3 should estimate the number of replacement awards for which the requisite service is expected to be rendered when determining the portion of a nonvested replacement award included in consideration transferred). For example, if the fair-value-based measure of the portion of a replacement award attributed to precombination service is \$100 and the acquirer expects that the requisite service will be rendered for only 95 percent of the instruments awarded, the amount included in consideration transferred in the business combination is \$95. Changes in the number of replacement awards for which the requisite service is expected to be rendered are reflected in compensation cost for the periods in which the changes or forfeitures occur—not as adjustments to the consideration transferred in the business combination. If an acquirer's accounting policy is to account for forfeitures as they occur, the amount excluded from consideration transferred (because the requisite service is not expected to be rendered) should be attributed to the postcombination service and recognized in compensation cost over the requisite service period.

805-30-55-12 Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the

acquisition date are accounted for in accordance with Topic 718 in determining compensation cost for the period in which an event occurs. If the replacement award has a graded vesting schedule, the acquirer shall recognize the related compensation cost in accordance with its policy election for other awards with graded vesting in accordance with paragraph 718-10-35-8.

805-30-55-13 The same requirements for determining the portions of a replacement award attributable to precombination and postcombination service apply regardless of whether a replacement award is classified as a liability or an equity instrument in accordance with the provisions of paragraphs 718-10-25-6 through 25-19. All changes in the fair-value-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognized in the acquirer's postcombination financial statements in the period(s) in which the changes occur.

Transition and Open Effective Date Information

39. Add paragraph 718-10-65-6 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2016-09,
Compensation—Stock Compensation (Topic 718): Improvements to
Employee Share-Based Payment Accounting**

718-10-65-6 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting:

- a. The pending content that links to this paragraph shall be effective for **public business entities** for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years.
- b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
- c. Earlier application of the pending content that links to this paragraph is permitted for:
 1. Public business entities for reporting periods for which financial statements have not yet been issued
 2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
- d. An entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- e. An entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to

- retained earnings as of the beginning of the period in which the pending content that is linked to this paragraph is effective.
- f. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-4 through 65-5 and 718-10-65-7 through 65-10.
 - g. In the first interim and annual period of adoption, an entity shall disclose both of the following:
 - 1. The nature of and reason for the change in accounting principle
 - 2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 4: Minimum Statutory Tax Withholding Requirements

40. Current GAAP requires an award to be classified and accounted for as a liability if shares in an amount in excess of the minimum statutory tax withholding requirements are withheld or may be withheld at the employee's discretion. The following amendments reflect the Board's decision to modify the current GAAP exception to liability classification such that partial cash settlement of an award for tax-withholding purposes would not result, by itself, in liability classification of the award provided the amount withheld does not exceed the maximum statutory tax rate for an employee in the applicable jurisdictions.

Amendments to Subtopic 718-10

41. Amend paragraphs 718-10-25-6 and 718-10-25-18 and supersede paragraph 718-10-25-19, with a link to transition paragraph 718-10-65-7, as follows:

Compensation—Stock Compensation—Overall

Recognition

> Determining Whether to Classify a Financial Instrument as a Liability or as Equity

718-10-25-6 This paragraph through paragraph ~~718-10-25-19~~718-10-25-19A provide guidance for determining whether certain financial instruments awarded in share-based payment transactions are liabilities. In determining whether an instrument not specifically discussed in those paragraphs shall be classified as a liability or as equity, an entity shall apply generally accepted accounting principles (GAAP) applicable to financial instruments issued in transactions not involving share-based payment.

718-10-25-18 Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of **nonvested shares**), with any payment due employees withheld to meet the employer's ~~minimum~~ statutory withholding requirements resulting from the exercise, does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. However, if the amount that is withheld, or may be withheld at the employee's discretion, is in excess of the maximum statutory tax rates in the employees' applicable jurisdictions, minimum statutory requirement is withheld, or may be withheld at the employee's discretion, the entire award shall be classified and accounted for as a liability. That is, to qualify for equity classification, the employer must have a statutory obligation to withhold taxes on the employee's behalf, and the amount withheld cannot exceed the maximum statutory tax rates in the employees' applicable jurisdictions. The maximum statutory tax rates are based on the applicable rates of the relevant tax authorities (for example, federal, state, and local), including the employee's share of payroll or similar taxes, as provided in tax law, regulations, or the authority's administrative practices, not to exceed the highest statutory rate in that jurisdiction, even if that rate exceeds the highest rate that may be applicable to the specific award grantee.

718-10-25-19 Paragraph superseded by Accounting Standards Update No. 2016-09. ~~Minimum statutory withholding requirements are to be based on the applicable minimum statutory withholding rates required by the relevant tax authority (or authorities, for example, federal, state, and local), including the employee's share of payroll taxes that are applicable to such supplemental taxable income.~~

Transition and Open Effective Date Information

42. Add paragraph 718-10-65-7 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

718-10-65-7 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*:

- a. The pending content that links to this paragraph shall be effective for **public business entities** for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years.
- b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.

- c. Earlier application of the pending content that links to this paragraph is permitted for:
 - 1. Public business entities for reporting periods for which financial statements have not yet been issued
 - 2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
- d. An entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- e. An entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period in which the pending content that links to this paragraph is effective. When determining the cumulative-effect adjustment, an entity shall assess only liability classified awards that have not been settled by the effective date.
- f. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-4 through 65-6 and 718-10-65-8 through 65-10.
- g. In the first interim and annual period of adoption, an entity shall disclose:
 - 1. The nature of and reason for the change in accounting principle
 - 2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 5: Classification of Employee Taxes Paid on the Statement of Cash Flows When an Employer Withholds Shares for Tax-Withholding Purposes

43. The following amendments reflect the Board's decision that cash paid by an employer to a taxing authority when directly withholding shares for tax-withholding purposes should be classified as a financing activity on the statement of cash flows. Current GAAP does not directly address the cash flow classification for those transactions.

Amendments to Subtopic 230-10

44. Amend paragraph 230-10-45-15, with a link to transition paragraph 718-10-65-8, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > Cash Flows from Financing Activities

230-10-45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by an employer when withholding shares from an employee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.

Amendments to Subtopic 718-10

45. Add paragraph 718-10-25-19A, with a link to transition paragraph 718-10-65-8, as follows:

Compensation—Stock Compensation—Overall

Recognition

> Determining Whether to Classify a Financial Instrument as a Liability or as Equity

[Note: Paragraph 718-10-25-18 is amended in Issue 4.]

718-10-25-18 Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of **nonvested shares**), with any payment due employees withheld to meet the employer's minimum statutory withholding requirements resulting from the exercise, does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. However, if an amount in excess of the minimum statutory requirement is withheld, or may be withheld at the employee's discretion, the entire award shall be classified and accounted for as a liability.

[Note: Paragraph 718-10-25-19 is superseded in Issue 4.]

718-10-25-19 Minimum statutory withholding requirements are to be based on the applicable minimum statutory withholding rates required by the relevant tax authority (or authorities, for example, federal, state, and local), including the employee's share of payroll taxes that are applicable to such supplemental taxable income.

718-10-25-19A Paragraph 230-10-45-15 provides guidance on the classification on the statement of cash flows for cash paid to a tax authority by an employer when withholding shares from an employee's award for tax-withholding purposes.

Transition and Open Effective Date Information

46. Add paragraph 718-10-65-8 and its related heading as follows:

**> Transition Related to Accounting Standards Update No. 2016-09,
*Compensation—Stock Compensation (Topic 718): Improvements to
Employee Share-Based Payment Accounting***

718-10-65-8 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*:

- a. The pending content that links to this paragraph shall be effective for **public business entities** for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years.
- b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
- c. Earlier application of the pending content that links to this paragraph is permitted for:
 1. Public business entities for reporting periods for which financial statements have not yet been issued
 2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
- d. An entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- e. An entity shall apply the pending content that links to this paragraph retrospectively to all periods presented.
- f. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-4 through 65-7 and 718-10-65-9 through 65-10.

- g. In the first interim and annual period of adoption, an entity shall disclose the nature of and reason for the change in accounting principle and the effect of the change on prior periods retrospectively adjusted.

Issue 6: Practical Expedient—Expected Term

47. In the absence of observable market prices to determine the fair value of an employee share option or similar instrument, current GAAP requires an entity to use a valuation technique that takes into account the expected term of the employee share option or similar instrument. The expected term is the period of time for which the award is expected to be outstanding assuming that the award vests. The following amendments reflect the Board's decision to allow nonpublic entities to use a practical expedient for estimating the expected term of certain share-based payment awards. A nonpublic entity is defined in Topic 718 generally as an entity whose equity securities do not trade in a public market.

Amendments to Subtopic 718-10

48. Add paragraphs 718-10-30-20A through 30-20B and their related heading, with a link to transition paragraph 718-10-65-9, as follows:

Compensation—Stock Compensation—Overall

Initial Measurement

> Nonpublic Entity—Practical Expedient for Expected Term

718-10-30-20A For an award that meets the conditions in paragraph 718-10-30-20B, a nonpublic entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

- a. If vesting is only dependent upon a service condition, a nonpublic entity shall estimate the expected term as the midpoint between the requisite service period and the contractual term of the award.
- b. If vesting is dependent upon satisfying a performance condition, a nonpublic entity first would determine whether the performance condition is **probable** of being achieved.
 - 1. If the nonpublic entity concludes that the performance condition is probable of being achieved, the nonpublic entity shall estimate the expected term as the midpoint between the requisite service period (a nonpublic entity shall consider the guidance in paragraphs 718-10-55-69 through 55-79 when determining the requisite service period of the award) and the contractual term.

2. If the nonpublic entity concludes that the performance condition is not probable of being achieved, the nonpublic entity shall estimate the expected term as either:
 - i. The contractual term if the service period is implied (that is, the requisite service period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future)
 - ii. The midpoint between the requisite service period and the contractual term if the requisite service period is stated explicitly.

Paragraph 718-10-55-50A provides implementation guidance on the practical expedient.

718-10-30-20B A nonpublic entity that elects to apply the practical expedient in paragraph 718-10-30-20A shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

- a. The share option or similar award is granted at the money.
- b. The employee has only a limited time to exercise the award (typically 30–90 days) if the employee terminates service after vesting.
- c. The employee can only exercise the award. The employee cannot sell or hedge the award.
- d. The award does not include a market condition.

49. Amend paragraphs 718-10-55-2 and 718-10-55-30 and add paragraphs 718-10-55-34A and 718-10-55-50A and its related heading, with a link to transition paragraph 718-10-65-9, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

718-10-55-2 Implementation guidance is provided on the following matters:

- a. **Fair value** measurement objectives and application
- b. Fair-value-based instruments in a share-based transaction
- c. Valuation techniques
- d. Selecting assumptions for use in an option pricing model
 1. Consistent use of valuation techniques and methods for selecting assumptions
 2. Selecting or estimating the risk-free rate for the expected term
 3. Selecting or estimating the expected term
 4. Selecting or estimating the expected **volatility**
 5. Selecting or estimating expected dividends
 6. Dividend protected awards

7. Selecting or considering credit risk
8. Contingency features that affect the option pricing model
9. Consider dilution.
- dd. Nonpublic entity—practical expedient for expected term
- e. **Calculated value** for certain nonpublic entities
- f. **Market, performance, and service conditions**
 1. Market, performance, and service conditions that affect vesting and exercisability
 2. Market, performance, and service conditions that affect factors other than vesting and exercisability
 3. Estimating the **requisite service period**
 4. Explicit, implicit, and derived requisite service periods.
- g. Determination of **grant date**
- h. **Service inception date** and grant date
- i. **Equity restructuring**
- j. Classification of certain awards with repurchase features
- k. Employee of a physician practice.

> > > Selecting or Estimating the Expected Term

718-10-55-30 The expected term of an employee share option or similar instrument is the period of time for which the instrument is expected to be outstanding (that is, the period of time from the service inception date to the date of expected exercise or other expected settlement). The expected term is an assumption in a closed-form model. However, if an entity uses a lattice model that has been modified to take into account an option's contractual term and employees' expected exercise and post-vesting employment termination behavior, the expected term is estimated based on the resulting output of the lattice. For example, an entity's experience might indicate that option holders tend to exercise their options when the share price reaches 200 percent of the exercise price. If so, that entity might use a lattice model that assumes exercise of the option at each node along each share price path in a lattice at which the early exercise expectation is met, provided that the option is vested and exercisable at that point. Moreover, such a model would assume exercise at the end of the contractual term on price paths along which the exercise expectation is not met but the options are in-the-money at the end of the contractual term. The terms *at-the-money*, *in-the-money*, and *out-of-the-money* are used to describe share options whose exercise price is equal to, less than, or greater than the market price of the underlying share, respectively. The valuation approach described recognizes that employees' exercise behavior is correlated with the price of the underlying share. Employees' expected post-vesting employment termination behavior also would be factored in. Expected term, which is a required disclosure (see paragraphs 718-10-50-2 through 50-2A), then could be estimated based on the output of the resulting lattice. An example of an acceptable method for purposes of financial statement disclosures of estimating the expected term based on the results of a lattice model

is to use the lattice model's estimated fair value of a share option as an input to a closed-form model, and then to solve the closed-form model for the expected term. Other methods also are available to estimate expected term.

718-10-55-31 Other factors that may affect expectations about employees' exercise and post-vesting employment termination behavior include the following:

- a. The vesting period of the award. An option's expected term must at least include the vesting period. Under some share option arrangements, an option holder may exercise an option prior to vesting (usually to obtain a specific tax treatment); however, such arrangements generally require that any shares received upon exercise be returned to the entity (with or without a return of the exercise price to the holder) if the vesting conditions are not satisfied. Such an exercise is not substantive for accounting purposes.
- b. Employees' historical exercise and post-vesting employment termination behavior for similar grants.
- c. Expected volatility of the price of the underlying share. An entity also might consider whether the evolution of the share price affects an employee's exercise behavior (for example, an employee may be more likely to exercise a share option shortly after it becomes in-the-money if the option had been out-of-the-money for a long period of time).
- d. Blackout periods and other coexisting arrangements such as agreements that allow for exercise to automatically occur during blackout periods if certain conditions are satisfied.
- e. Employees' ages, lengths of service, and home jurisdictions (that is, domestic or foreign).

718-10-55-32 If sufficient information about employees' expected exercise and post-vesting employment termination behavior is available, a method like the one described in paragraph 718-10-55-30 might be used because that method reflects more information about the instrument being valued (see paragraph 718-10-55-18). However, expected term might be estimated in some other manner, taking into account whatever relevant and supportable information is available, including industry averages and other pertinent evidence such as published academic research.

718-10-55-33 Option value increases at a decreasing rate as the term lengthens (for most, if not all, options). For example, a two-year option is worth less than twice as much as a one-year option, other things equal. Accordingly, estimating the fair value of an option based on a single expected term that effectively averages the differing exercise and postvesting employment termination behaviors of identifiable groups of employees will potentially misstate the value of the entire award.

718-10-55-34 Aggregating individual awards into relatively homogeneous groups with respect to exercise and postvesting employment termination behaviors and estimating the fair value of the options granted to each group separately reduces

such potential misstatement. An entity shall aggregate individual awards into relatively homogeneous groups with respect to exercise and postvesting employment termination behaviors regardless of the valuation technique or model used to estimate the fair value. For example, the historical experience of an employer that grants options broadly to all levels of employees might indicate that hourly employees tend to exercise for a smaller percentage gain than do salaried employees.

718-10-55-34A A nonpublic entity may make an accounting policy election to apply a practical expedient to estimate the expected term for certain awards that do not include a **market condition** (see paragraphs 718-10-30-20A through 30-20B). Paragraph 718-10-55-50A provides implementation guidance on the practical expedient.

> > Nonpublic Entity—Practical Expedient for Expected Term

718-10-55-50A In accordance with paragraph 718-10-30-20A, a nonpublic entity may elect a practical expedient to estimate the expected term. For liability-classified awards, an entity would update the estimate of the expected term each reporting period until settlement. The updated estimate should reflect the loss of time value associated with the award and any change in the assessment of whether a performance condition is probable of being achieved.

Transition and Open Effective Date Information

50. Add paragraph 718-10-65-9 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

718-10-65-9 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*:

- a. The pending content that links to this paragraph shall be effective for **public business entities** for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years.
- b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
- c. Earlier application of the pending content that links to this paragraph is permitted for:

1. Public business entities for reporting periods for which financial statements have not yet been issued
2. All other entities for reporting periods for which financial statements have not yet been made available for issuance.
- d. An entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- e. An entity that elects the practical expedient to determine the expected term of an award shall apply the pending content that links to this paragraph prospectively (that is, apply the practical expedient to all awards that are measured at fair value after the effective date).
- f. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-4 through 65-8 and 718-10-65-10.
- g. In the first interim and annual period of adoption, an entity shall disclose the nature of and reason for the change in accounting principle.

Issue 7: Intrinsic Value

51. The amendments to paragraph 718-30-30-2A and transition paragraph 718-10-65-10 reflect the Board's decision to allow a nonpublic entity (which is defined in Topic 718 as an entity whose equity securities generally do not trade in a public market) to make an accounting policy election as of the effective date to change its measurement of all liability-classified awards from fair value to intrinsic value without evaluating whether intrinsic value is preferable to fair value.

Amendments to Subtopic 718-30

52. Add paragraph 718-30-30-2A, with a link to transition paragraph 718-10-65-10, as follows:

Compensation—Stock Compensation—Awards Classified as Liabilities

Initial Measurement

> Measurement Objective and Measurement Date

> > Nonpublic Entity

718-30-30-2A A nonpublic entity can make the accounting policy election in paragraph 718-30-30-2 to change its measurement of all liability-classified awards from fair value to intrinsic value in accordance with the transition provisions in

paragraph 718-10-65-10. Those transition provisions do not require a nonpublic entity to evaluate whether the change in accounting policy is preferable under Topic 250 on accounting changes and error corrections.

Transition and Open Effective Date Information

53. Add paragraph 718-10-65-10 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting

718-10-65-10 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*:

- a. The pending content that links to this paragraph shall be effective for nonpublic entities for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018.
- b. Earlier application of the pending content that links to this paragraph is permitted for nonpublic entities for reporting periods for which financial statements have not yet been made available for issuance.
- c. A nonpublic entity that elects earlier application of the pending content that links to this paragraph in an interim period shall reflect any adjustments as of the beginning of the annual period that includes that interim period.
- d. A nonpublic entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the period in which the pending content that links to this paragraph is effective by adjusting the carrying amount of liability-classified awards that have not been settled as of the effective date from fair value to intrinsic value.
- e. A nonpublic entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-4 through 65-9.
- f. In the first interim and annual period of adoption, a nonpublic entity shall disclose:
 1. The nature of and reason for the change in accounting principle
 2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 8: Eliminating the Indefinite Deferral in Topic 718

54. The following amendments reflect the Board's decision to eliminate the guidance that was indefinitely deferred in Topic 718. The effect of this amendment results in no change to current GAAP; rather, it only improves the usability of the Accounting Standards Codification. Transition and effective date guidance are not applicable for these amendments because the amendments do not change the application of current GAAP.

Amendments to Subtopic 718-10

55. Amend paragraph 718-10-35-12 and supersede paragraph 718-10-35-13, with no link to a transition paragraph, as follows:

Compensation—Stock Compensation—Overall

Subsequent Measurement

> Awards May Become Subject to Other Guidance

718-10-35-9 Paragraphs 718-10-35-10 through 35-14 are intended to apply to those instruments issued in **share-based payment transactions** with employees accounted for under this Topic, and to instruments exchanged in a business combination for share-based payment awards of the acquired business that were originally granted to employees of the acquired business and are outstanding as of the date of the business combination. Instruments issued, in whole or in part, as consideration for goods or services other than employee service shall not be considered to have been issued in exchange for employee service when applying the guidance in those paragraphs, irrespective of the employment status of the recipient of the award on the grant date.

718-10-35-10 A **freestanding financial instrument** issued to an employee in exchange for past or future employee services that is subject to initial recognition and measurement guidance within this Topic shall continue to be subject to the recognition and measurement provisions of this Topic throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. Only for purposes of this paragraph, a **modification** does not include a change to the terms of an award if that change is made solely to reflect an **equity restructuring** provided that both of the following conditions are met:

- a. There is no increase in fair value of the award (or the ratio of **intrinsic value** to the exercise price of the award is preserved, that is, the holder is made whole) or the antidilution provision is not added to the terms of the award in contemplation of an equity restructuring.

- b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

718-10-35-11 Other modifications of that instrument that take place when the holder is no longer an employee shall be subject to the modification guidance in paragraph 718-10-35-14. Following modification, recognition and measurement of the instrument should be determined through reference to other applicable generally accepted accounting principles (GAAP).

718-10-35-12 Once the classification of an instrument is determined, the recognition and measurement provisions of this Topic shall be applied until the instrument ceases to be subject to the requirements discussed in ~~paragraphs~~paragraph 718-10-35-10 ~~and 718-10-35-13~~. Topic 480 or other applicable GAAP, such as Topic 815, applies to a freestanding financial instrument that was issued under a share-based payment arrangement but that is no longer subject to this Topic. This guidance is not intended to suggest that all freestanding financial instruments shall be accounted for as liabilities pursuant to Topic 480, but rather that freestanding financial instruments issued in share-based payment transactions may become subject to that Topic or other applicable GAAP depending on their substantive characteristics and when certain criteria are met.

718-10-35-13 Paragraph superseded by Accounting Standards Update No. 2016-09. ~~A freestanding financial instrument ceases to be subject to this Topic and becomes subject to the recognition and measurement requirements of Topic 480 or other applicable GAAP when the rights conveyed by the instrument to the holder are no longer dependent on the holder being an employee of the entity (that is, no longer dependent on providing service). That principle shall be applied to specific types of instruments subject to that Topic or other applicable GAAP as illustrated by the following examples:~~

- ~~a. A mandatorily redeemable share becomes subject to that Topic or other applicable GAAP when an employee has rendered the requisite service in exchange for the instrument and could terminate the employment relationship and receive that share.~~
- ~~b. A share option or similar instrument that is not transferable and whose contractual term is shortened upon employment termination continues to be subject to this Topic until the rights conveyed by the instrument to the holder are no longer dependent on the holder being an employee of the entity (generally, when the instrument is exercised). A share option or similar instrument may become subject to that Topic or other applicable GAAP before its settlement. For instance, if a vested share option becomes exercisable for one year after employment termination, the rights conveyed by the instrument to the holder would no longer be dependent on the holder being an employee of the entity upon the employee's termination. Vested share options are typically exercisable for a short period of time (generally, 60 to 90 days) after the termination of the employment relationship. Notwithstanding the requirements of this~~

paragraph, such a provision, in and of itself, shall not cause the award to become subject to other applicable GAAP for that short period of time.

56. Supersede paragraph 718-10-65-1 and its related heading as follows:

[Note: As a result of this change, the pending content that links to paragraph 718-10-65-1 will become effective upon issuance of this Update.]

~~> Transition Related to FASB Staff Position FAS 123(R) 1, Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R).~~

~~718-10-65-1~~ Paragraph superseded on 03/30/16 by Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. The requirements of paragraphs 718-10-35-12 through 35-13, which make a freestanding financial instrument subject to the recognition and measurement requirements of other GAAP when the rights conveyed by the instrument are no longer dependent on the holder being an employee, have been indefinitely deferred by FASB Staff Position FAS 123(R) 1, *Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)*.

Amendments to Status Sections

57. Amend paragraph 230-10-00-1, by adding the following items to the table, as follows:

230-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
230-10-45-14	Amended	2016-09	03/30/2016
230-10-45-15	Amended	2016-09	03/30/2016
230-10-45-17	Amended	2016-09	03/30/2016
230-10-45-25	Amended	2016-09	03/30/2016

58. Amend paragraph 260-10-00-1, by adding the following items to the table, as follows:

260-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
260-10-45-29	Amended	2016-09	03/30/2016
260-10-45-68B	Amended	2016-09	03/30/2016
260-10-55-69	Amended	2016-09	03/30/2016
260-10-55-69A	Added	2016-09	03/30/2016
260-10-55-70	Amended	2016-09	03/30/2016
260-10-55-76A	Amended	2016-09	03/30/2016

59. Amend paragraph 323-10-00-1, by adding the following item to the table, as follows:

323-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
323-10-55-19	Amended	2016-09	03/30/2016

60. Amend paragraph 718-10-00-1, by adding the following items to the table, as follows:

718-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Public Business Entity	Added	2016-09	03/30/2016
718-10-25-6	Amended	2016-09	03/30/2016
718-10-25-18	Amended	2016-09	03/30/2016
718-10-25-19	Superseded	2016-09	03/30/2016
718-10-25-19A	Added	2016-09	03/30/2016
718-10-30-20A	Added	2016-09	03/30/2016
718-10-30-20B	Added	2016-09	03/30/2016
718-10-30-28	Amended	2016-09	03/30/2016
718-10-35-3	Amended	2016-09	03/30/2016
718-10-35-12	Amended	2016-09	03/30/2016
718-10-35-13	Superseded	2016-09	03/30/2016
718-10-45-1	Amended	2016-09	03/30/2016
718-10-50-2	Amended	2016-09	03/30/2016

Paragraph	Action	Accounting Standards Update	Date
718-10-50-2A	Added	2016-09	03/30/2016
718-10-55-2	Amended	2016-09	03/30/2016
718-10-55-30	Amended	2016-09	03/30/2016
718-10-55-34A	Added	2016-09	03/30/2016
718-10-55-45	Amended	2016-09	03/30/2016
718-10-55-50A	Added	2016-09	03/30/2016
718-10-55-76	Amended	2016-09	03/30/2016
718-10-55-137	Amended	2016-09	03/30/2016
718-10-65-1	Superseded	2016-09	03/30/2016
718-10-65-4 through 65-10	Added	2016-09	03/30/2016

61. Add paragraph 718-20-00-1 as follows:

718-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Excess Tax Benefits	Superseded	2016-09	03/30/2016
718-20-35-3A	Added	2016-09	03/30/2016
718-20-55-4 through 55-7	Amended	2016-09	03/30/2016
718-20-55-10	Amended	2016-09	03/30/2016
718-20-55-12	Amended	2016-09	03/30/2016
718-20-55-20	Amended	2016-09	03/30/2016
718-20-55-21	Amended	2016-09	03/30/2016
718-20-55-22	Superseded	2016-09	03/30/2016
718-20-55-23	Amended	2016-09	03/30/2016
718-20-55-23A	Added		
718-20-55-24	Superseded	2016-09	03/30/2016
718-20-55-34A through 55-34G	Added	2016-09	03/30/2016
718-20-55-60	Amended	2016-09	03/30/2016
718-20-55-74	Amended	2016-09	03/30/2016
718-20-55-75	Amended	2016-09	03/30/2016
718-20-55-87	Amended	2016-09	03/30/2016
718-20-55-121	Amended	2016-09	03/30/2016
718-20-55-123	Amended	2016-09	03/30/2016

Paragraph	Action	Accounting Standards Update	Date
718-20-55-132	Amended	2016-09	03/30/2016
718-20-55-133	Amended	2016-09	03/30/2016
718-20-55-144	Amended	2016-09	03/30/2016

62. Add paragraph 718-30-00-1 as follows:

718-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
718-30-30-2A	Added	2016-09	03/30/2016
718-30-55-2	Amended	2016-09	03/30/2016
718-30-55-9	Amended	2016-09	03/30/2016

63. Amend paragraph 718-40-00-1, by adding the following items to the table, as follows:

718-40-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
718-40-55-6	Amended	2016-09	03/30/2016
718-40-55-8	Amended	2016-09	03/30/2016
718-40-60-1	Amended	2016-09	03/30/2016

64. Amend paragraph 718-740-00-1, by adding the following items to the table, as follows:

718-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Carryforward	Superseded	2016-09	03/30/2016
Excess Tax Benefits	Superseded	2016-09	03/30/2016
Measurement Date	Superseded	2016-09	03/30/2016

Paragraph	Action	Accounting Standards Update	Date
718-740-25-5	Amended	2016-09	03/30/2016
718-740-25-6	Amended	2016-09	03/30/2016
718-740-25-9	Superseded	2016-09	03/30/2016
718-740-25-10	Superseded	2016-09	03/30/2016
718-740-35-2	Amended	2016-09	03/30/2016
718-740-35-3	Superseded	2016-09	03/30/2016
718-740-35-5 through 35-9	Superseded	2016-09	03/30/2016
718-740-45-1 through 45-4	Superseded	2016-09	03/30/2016
718-740-45-5	Amended	2016-09	03/30/2016
718-740-45-6	Superseded	2016-09	03/30/2016
718-740-45-7	Amended	2016-09	03/30/2016
718-740-45-8	Amended	2016-09	03/30/2016
718-740-45-9 through 45-12	Superseded	2016-09	03/30/2016

65. Amend paragraph 740-10-00-1, by adding the following item to the table, as follows:

740-10-00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
740-10-55-35	Amended	2016-09	03/30/2016

66. Amend paragraph 740-20-00-1, by adding the following items to the table, as follows:

740-20-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
740-20-45-8	Amended	2016-09	03/30/2016
740-20-45-11	Amended	2016-09	03/30/2016
740-20-55-2	Amended	2016-09	03/30/2016

67. Amend paragraph 740-270-00-1, by adding the following items to the table, as follows:

740-270-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
740-270-25-12	Amended	2016-09	03/30/2016
740-270-30-4	Amended	2016-09	03/30/2016
740-270-30-8	Amended	2016-09	03/30/2016
740-270-30-12	Amended	2016-09	03/30/2016

68. Amend paragraph 805-30-00-1, by adding the following item to the table, as follows:

805-30-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
805-30-55-11	Amended	2016-09	03/30/2016

69. Amend paragraph 805-740-00-1, by adding the following items to the table, as follows:

805-740-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Excess Tax Benefits	Superseded	2016-09	03/30/2016
805-740-45-5	Amended	2016-09	03/30/2016
805-740-45-6	Superseded	2016-09	03/30/2016

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Appendix: Paragraphs Amended by Multiple Simplification Issues

A1. This appendix provides the complete amendments for those paragraphs that are amended by more than one issue in this Update. No new amendments are included in this appendix.

Paragraphs 260-10-55-69 through 55-69A

[Note: Content from paragraph 260-10-55-69 that was moved to paragraph 260-10-55-69A is not struck out and shown here.]

260-10-55-69 Entity A adopted a share option plan on January 1, 20X7, and granted 900,000 at-the-money share options with an exercise price of \$30. All share options vest at the end of three years (cliff vesting). Entity A's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3. At the grant date, Entity A assumes an annual forfeiture rate of 3 percent and therefore expects to receive the requisite service for 821,406 $[900,000 \times (.97 \text{ to the third power})]$ share options. On January 1, 20X7, the fair value of each share option granted is \$14.69. Employees forfeited 15,000 stock options ratably during 20X7.

260-10-55-69A The average stock price during 20X7 is \$44. Net income for the period is \$97,385,602 ~~(inclusive of \$2,614,398 of share based compensation, net of income taxes of \$1,407,753).~~ Entity A's tax rate is 35 percent. For the year ended December 31, 20X7, there are 25,000,000 weighted-average common shares outstanding. ~~Entity A has sufficient previously recognized excess tax benefits in additional paid-in capital from prior share-based payment arrangements to offset any write-off of deferred tax assets associated with its grant of share options on January 1, 20X7. All share options are the type that upon exercise give rise to deductible compensation cost for income tax purposes.~~ This guidance also applies if the service inception date precedes the grant date.

Paragraphs 718-10-50-2 through 50-2A

718-10-50-2 The following list indicates the minimum information needed to achieve the objectives in the preceding paragraph and illustrates how the disclosure requirements might be satisfied. In some circumstances, an entity may need to disclose information beyond the following to achieve the disclosure objectives:

- a. A description of the share-based payment arrangement(s), including the general terms of awards under the arrangement(s), such as:
 1. The **requisite service period(s)** and any other substantive conditions (including those related to vesting)
 2. The maximum contractual term of equity (or liability) **share options** or similar instruments

3. The number of shares authorized for awards of equity share options or other equity instruments.
- b. The method it uses for measuring compensation cost from share-based payment arrangements with **employees**.
- c. For the most recent year for which an income statement is provided, both of the following:
 1. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or **share units**):
 - i. Those outstanding at the beginning of the year
 - ii. Those outstanding at the end of the year
 - iii. Those exercisable or convertible at the end of the year
 - iv. Those that during the year were:
 01. Granted
 02. Exercised or converted
 03. Forfeited
 04. Expired.
 2. The number and weighted-average **grant-date** fair value (or **calculated value** for a **nonpublic entity** that uses that method or **intrinsic value** for awards measured pursuant to paragraph 718-10-30-21) of equity instruments not specified in (c)(1), for all of the following groups of equity instruments:
 - i. Those nonvested at the beginning of the year
 - ii. Those nonvested at the end of the year
 - iii. Those that during the year were:
 01. Granted
 02. Vested
 03. Forfeited.
- d. For each year for which an income statement is provided, both of the following:
 1. The weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured at that value pursuant to paragraphs 718-10-30-21 through 30-22) of equity options or other equity instruments granted during the year
 2. The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year.
- e. For fully vested share options (or share units) and share options expected to **vest** (or unvested share options for which the requisite service period has not been rendered but that are expected to vest based on the achievement of a performance condition, if an entity accounts for forfeitures when they occur in accordance with paragraph 718-10-35-3) at the date of the latest statement of financial position, both of the following:

1. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) outstanding
 2. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible).
- f. For each year for which an income statement is presented, both of the following (An entity that uses the intrinsic value method pursuant to paragraphs 718-10-30-21 through 30-22 is not required to disclose the following information for awards accounted for under that method):
1. A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements
 2. A description of the significant assumptions used during the year to estimate the fair value (or calculated value) of share-based compensation awards, including (if applicable):
 - i. Expected term of share options and similar instruments, including a discussion of the method used to incorporate the contractual term of the instruments and employees' expected exercise and postvesting employment termination behavior into the fair value (or calculated value) of the instrument.
 - ii. Expected **volatility** of the entity's shares and the method used to estimate it. An entity that uses a method that employs different volatilities during the contractual term shall disclose the range of expected volatilities used and the weighted-average expected volatility. A nonpublic entity that uses the calculated value method shall disclose the reasons why it is not practicable for it to estimate the expected volatility of its share price, the appropriate industry sector index that it has selected, the reasons for selecting that particular index, and how it has calculated historical volatility using that index.
 - iii. Expected dividends. An entity that uses a method that employs different dividend rates during the contractual term shall disclose the range of expected dividends used and the weighted-average expected dividends.
 - iv. Risk-free rate(s). An entity that uses a method that employs different risk-free rates shall disclose the range of risk-free rates used.
 - v. Discount for post-vesting restrictions and the method for estimating it.
- g. An entity that grants equity or liability instruments under multiple share-based payment arrangements with employees shall provide the information specified in paragraph (a) through (f) separately for different types of awards to the extent that the differences in the characteristics of

the awards make separate disclosure important to an understanding of the entity's use of share-based compensation. For example, separate disclosure of weighted-average exercise prices (or conversion ratios) at the end of the year for options (or share units) with a fixed exercise price (or conversion ratio) and those with an indexed exercise price (or conversion ratio) could be important. It also could be important to segregate the number of options (or share units) not yet exercisable into those that will become exercisable (or convertible) based solely on fulfilling a **service condition** and those for which a **performance condition** must be met for the options (share units) to become exercisable (convertible). It could be equally important to provide separate disclosures for awards that are classified as equity and those classified as liabilities. In addition, an entity that has multiple share-based payment arrangements with employees shall disclose information separately for different types of awards under those arrangements to the extent that differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation.

- h. For each year for which an income statement is presented, both of the following:
 1. Total compensation cost for share-based payment arrangements
 - i. Recognized in income as well as the total recognized tax benefit related thereto
 - ii. Capitalized as part of the cost of an asset.
 2. A description of significant **modifications**, including:
 - i. The terms of the modifications
 - ii. The number of employees affected
 - iii. The total incremental compensation cost resulting from the modifications.
- i. As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized
- j. Subparagraph superseded by Accounting Standards Update No. 2016-09. If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit realized from stock options exercised during the annual period **[Content amended and moved to paragraph 718-10-50-2A]**
- k. If not separately disclosed elsewhere, the amount of cash used to **settle** equity instruments granted under share-based payment arrangements
- l. A description of the entity's policy, if any, for issuing shares upon share option exercise (or share unit conversion), including the source of those shares (that is, new shares or treasury shares). If as a result of its policy, an entity expects to repurchase shares in the following annual period, the entity shall disclose an estimate of the amount (or a range, if more appropriate) of shares to be repurchased during that period

- m. If not separately disclosed elsewhere, the policy for estimating expected forfeitures or recognizing forfeitures as they occur.

718-10-50-2A Another item of minimum information needed to achieve the objectives in paragraph 718-10-50-1 is the following:

- a.j- If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit ~~realized~~ from stock options exercised during the annual period. **[Content amended as shown and moved from paragraph 718-10-50-2]**

Paragraphs 718-20-55-23 through 55-23A

[Note: Content from paragraph 718-20-55-23 that was moved to paragraph 718-20-55-23A is not struck out and shown here.]

718-20-55-23 If instead the share options expired unexercised, previously recognized compensation cost would not be reversed. There would be no deduction on the tax return and, therefore, the entire deferred tax asset of \$3,843,405 would be charged to income tax expense ~~or additional paid-in capital, to the extent of any remaining additional paid in capital from excess tax benefits from previous awards accounted for in accordance with FASB Statement No. 123 (revised 2004), *Share-Based Payment*, or FASB Statement No. 123, *Accounting for Stock-Based Compensation* (see paragraphs 718-740-35-5 through 35-7).~~

718-20-55-23A If employees terminated with out-of-the-money vested share options, the deferred tax asset related to those share options would be written off when those options expire. ~~A write-off of a deferred tax asset related to a deficiency of deductible compensation cost in relation to recognized compensation cost for financial reporting purposes shall not be reflected in the statement of cash flows because the unit of account for cash flow purposes is an individual award (or portion thereof) as opposed to a portfolio of awards.~~

Background Information and Basis for Conclusions

Introduction

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

BC2. On June 8, 2015, the Board issued proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*, as part of its Simplification Initiative. The objective of the Simplification Initiative is to identify, evaluate, and improve areas of GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements.

BC3. The Board received 69 comment letters in response to the proposed Update. Respondents largely were supportive of the Board's efforts to reduce complexity in accounting for share-based payment transactions. Those respondents commented that most of the proposed amendments would simplify the accounting for share-based payments in a meaningful way without sacrificing the usefulness of information provided to users of financial statements. The Board considered respondents' comments and concerns in reaching the conclusions in this Update, as discussed further in the remainder of this basis for conclusions.

Background Information

BC4. The areas for simplification in this Update involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification in the statement of cash flows. Some amendments apply only to nonpublic entities. A *nonpublic entity* generally is defined in Topic 718 as an entity whose equity securities do not trade in a public market. The areas for simplification in this Update were identified through outreach for the Simplification Initiative, pre-agenda research for the Private Company Council, and the August 2014 Post-Implementation Review Report on Statement 123(R).

Accounting for Income Taxes

BC5. To simplify the accounting for the income tax consequences of share-based payment transactions, the amendments in this Update require that all excess tax benefits and tax deficiencies be recognized as income tax expense or benefit in the income statement. Under current GAAP, if the deduction for a share-based payment award for tax purposes exceeds the compensation cost for financial reporting purposes, the corresponding amount of tax benefit is recognized in additional paid-in capital (APIC) and referred to as an excess tax benefit. The amount of excess tax benefits recognized is accumulated and available to offset current-period and subsequent-period tax deficiencies (that is, when the deduction for tax purposes is less than the compensation cost for financial reporting purposes). If the accumulated amount (commonly referred to as the APIC pool) is exhausted, all subsequent tax deficiencies are recognized as income tax expense in the income statement. In addition, the amendments require that an entity recognize an excess tax benefit even if the entity cannot use the deduction to reduce taxes payable in the current period (for example, when the entity has a net operating loss). An entity would need to evaluate whether the deferred tax asset associated with the recognized excess tax benefit should be reduced by a valuation allowance in accordance with Topic 740 on income taxes. Under current GAAP, an entity cannot recognize an excess tax benefit resulting from a current-period tax deduction if the benefit does not result in a reduction in taxes payable in that period.

BC6. The Board decided that all excess tax benefits and tax deficiencies should be recognized as income tax expense or benefit in the income statement, which eliminates the accounting for APIC pools. The Board concluded that the tax effects of a compensatory arrangement (such as share-based payment awards) should be reflected in an entity's results of operations. In response to stakeholder feedback on the amendments in the proposed Update, the Board decided to state explicitly that the tax effects are discrete items in the reporting period in which the deduction occurs (that is, entities should not consider them in determining the annual estimated effective tax rate). The Board observed that an entity's reported income tax expense and effective tax rate may be more volatile (consistent with the underlying economic volatility) because of the amendments but concluded that existing income tax disclosures generally should provide users with information to understand the reason for that volatility.

BC7. Many respondents to the amendments in the proposed Update expressed support for an approach whereby all excess tax benefits and tax deficiencies would be recognized as part of APIC. Those respondents indicated that such an approach would be a greater simplification, would maintain or improve the usefulness of reported results, and would be conceptually consistent with the basis in Statement 123(R). The Board considered, but ultimately did not support, such an approach. That alternative approach is partly based on a view that share-based payment awards are considered two transactions—a compensatory transaction at

the grant date and an equity transaction that relates to changes in the fair value of the award after the grant date. Some Board members agree with the respondents' views cited above and support the two-transaction view. However, a majority of the Board decided that the income tax consequences of share-based payment awards should be recognized in the statement of comprehensive income along with all other income taxes.

BC8. The Board also concluded that there was no basis for delaying the recognition of a deferred tax asset for an excess tax benefit resulting from a current-period tax deduction that cannot reduce taxes payable in that period. The Board noted that the current requirement to delay recognition is an exception to the overall principle in income tax accounting to recognize the effects of a temporary difference as a deferred tax asset or liability. The Board also noted that this will simplify the overall accounting for the income tax consequences of share-based payments.

Classification of Excess Tax Benefits on the Statement of Cash Flows

BC9. The amendments in this Update simplify the classification on the statement of cash flows of the income tax effects of certain share-based payment transactions. The amendments remove the requirement that employers shall present excess tax benefits as hypothetical cash inflows from financing activities and hypothetical cash outflows from operating activities. The Board concluded that excess tax benefits are not separate cash flows and should be classified in the same manner as other cash flows related to income taxes (that is, as operating activities).

Forfeitures

BC10. The amendments in this Update simplify the accounting for forfeitures by allowing an entity to make an entity-wide accounting policy election either to estimate its initial accrual of compensation cost on the basis of the number of awards for which the requisite service period will be rendered (that is, estimate the number of forfeitures expected to occur) or to recognize in compensation cost the effects of forfeitures when they occur. Under current GAAP, an entity is required to estimate the number of awards for which the requisite service period is expected to be rendered (that is, awards that will vest) and base the accruals of compensation cost on the estimated number of awards that will vest.

BC11. The Board concluded that estimating the number of forfeitures can be highly subjective in certain circumstances and, regardless of whether an entity estimates the effects of forfeitures in its initial accrual of compensation cost or accounts for forfeitures in compensation costs when they occur, the entity will ultimately recognize compensation cost for all awards that vest. Therefore, the

Board concluded that an accounting policy election was an appropriate balance between the benefits of making the estimate on a recurring basis and the associated costs.

BC12. The Board concluded that the accounting policy election for forfeitures only applies to service conditions. For an award with a performance condition, an entity would continue to assess at each reporting period whether it is probable that the performance condition will be achieved.

BC13. The Board considered, but ultimately rejected, an alternative that would require all entities to account for forfeitures when they occur. Although some Board members would prefer to limit optionality, the Board rejected this alternative because estimating forfeitures generally provides a more accurate reflection of periodic compensation cost.

BC14. Topic 235, Notes to Financial Statements, requires disclosure of significant accounting policies in the notes to financial statements. The Board decided that no additional disclosures are necessary as a result of the amendments in this Update.

Minimum Statutory Tax Withholding Requirements

BC15. The amendments in this Update simplify the current exception to liability classification when an employer uses a net settlement feature to withhold shares to meet an employer's tax withholding requirements. Specifically, the partial cash settlement of an award for tax-withholding purposes, by itself, would not result in liability classification of an award, provided the amount withheld or the amount that may be withheld at the employee's discretion does not exceed the maximum statutory tax rates in the applicable jurisdictions. To qualify for equity classification, the employer must have a statutory obligation to withhold taxes on the employee's behalf and the amount withheld cannot exceed the maximum statutory rates in the applicable jurisdictions. To qualify for the current exception, the amount withheld is not limited to the highest tax rates paid by the specific award grantee. Instead, it is limited to the maximum tax rates in the applicable jurisdictions (for example, federal, state, and local), even if that maximum rate is more than the highest rate paid by the specific award grantee. Current GAAP requires an award to be classified and accounted for as a liability if an amount in excess of the employer's minimum statutory tax withholding requirements is withheld or may be withheld at the employee's discretion.

BC16. The Board concluded that the current exception to liability classification is complex. The Board observed that the exception causes a tension between complying with GAAP, which requires no more than the minimum statutory amount of tax to be withheld, and complying with tax law, which legally requires at least the minimum to be withheld and submitted to the tax authorities. The Board observed that the amendments would require an entity to determine only one maximum rate in each jurisdiction rather than determining a rate for each employee under the existing exception.

BC17. The Board considered extending the exception to liability classification to all awards that are partially or fully cash settled, solely for the purposes of tax withholdings that are remitted to a tax jurisdiction. However, the Board rejected that alternative because of its potential for abuse. That is, an employee could withhold 100 percent of the award for tax purposes and effectively settle the award for cash, even though the award would qualify for equity classification by the employer. The Board also considered an alternative that would allow for equity classification if the amount withheld was reasonably consistent with the minimum statutory tax withholding requirements. However, the Board rejected that alternative because it did not sufficiently reduce the complexity of complying with the existing exception.

Classification of Employee Taxes Paid on Statement of Cash Flows When an Employer Withholds Shares for Tax-Withholding Purposes

BC18. The amendments in this Update require an employer to classify the cash paid to a taxing authority on the employee's behalf when directly withholding shares for tax-withholding purposes as a financing activity on the statement of cash flows. Current GAAP does not include specific guidance about the cash flow classification for those transactions.

BC19. The Board concluded that the cash flows associated with shares withheld by an employer for tax-withholding purposes is similar to a share repurchase. In substance, the employer issues a gross number of shares to the employee and then repurchases a portion of those shares. The cash related to the in substance repurchase is remitted to the taxing authorities on behalf of the employee. Therefore, because the economics of the withholding are similar to a repurchase of an entity's equity instruments, the cash outflow is required to be classified as a financing activity consistent with other repurchases of an entity's equity instruments.

BC20. The Board considered whether this cash outflow should be classified as part of operating activities. The Board rejected this alternative because there are no income effects that result from an employer directly withholding shares for tax-withholding purposes; therefore, classification as an operating activity would be inconsistent with the Accounting Standard Codification's Master Glossary definition of the term *operating activities* that states, in part, that operating activities are "generally the cash effects of transactions and other events that enter into the determination of net income."

Classification of Awards with Repurchase Features

BC21. The Board proposed to align the classification guidance between put and call rights (repurchase features) that are contingent on an event within the employee's control. In response to the amendments in the proposed Update, some stakeholders asserted that the proposal would not reduce complexity in classifying awards as equity or liabilities because it would require an entity to assess whether it is probable that an employee will terminate (potentially many years in the future) with immature shares. The Board decided not to amend that guidance because the feedback indicated that it would not achieve the objective of reducing complexity in classifying awards as equity or liabilities. The Board noted that it is considering a more comprehensive approach to amending the guidance for liabilities and equity rather than addressing only the accounting for repurchase features related to employee-specific transactions. The FASB plans to issue an Invitation to Comment soliciting feedback on potential future agenda items, including a potential project to address the distinction between liabilities and equity.

Practical Expedient—Expected Term

BC22. The amendments in this Update allow a nonpublic entity to make an accounting policy election to apply a practical expedient for estimating the expected term of certain awards. If an entity elects the practical expedient, the entity must apply it to all qualifying awards. If a qualifying award only includes a service condition, the entity should estimate the expected term as the midpoint between the vesting date and the contractual term. If vesting for a qualifying award is dependent upon satisfying a performance condition, the entity must first assess at the grant date whether it is probable that the performance condition will be achieved. If it is probable, the entity should estimate the expected term as the midpoint between the requisite service period and the contractual term. If it is not probable, the entity should estimate the expected term as (a) the contractual term if the requisite service period is implied (that is, the requisite service period is not explicitly stated, but inferred based on the achievement of the performance condition at some undetermined point in the future) or (b) the midpoint between the requisite service period and the contractual term if the requisite service period is explicitly stated.

BC23. The Board observed that estimating the expected term as the midpoint between the vesting date and the contractual term is currently allowed in certain circumstances as a practical expedient for SEC registrants and those planning an initial public offering under SEC Staff Accounting Bulletins (SABs) No. 107 on the valuation of share-based payment arrangements for public companies and No. 110 on the use of a simplified method in developing an estimate of expected term of "plain vanilla" share options (now codified in SAB Topic 14.D, *Share-Based Payment—Certain Assumptions Used in Valuation Methods*). This alternative to estimating the expected term is commonly referred to as the simplified method.

The Board also noted that many stakeholders have stated that nonpublic entities analogize to the simplified method and apply that approach to various awards. Stakeholders acknowledge the limitations of the simplified method; however, they stated that the approach is practical given that many entities do not have relevant historical data to objectively support a different estimate of the expected term.

BC24. The Board concluded that, consistent with SAB Topic 14.D, the practical expedient should apply only if (a) the share option or similar award is granted at the money, (b) the employee has only a limited time to exercise the award if the employee terminates service after vesting, (c) the employee cannot sell or hedge the option (the employee can only exercise the option), and (d) the award does not contain a market condition. However, the Board concluded that the practical expedient also could be applied to awards with repurchase features and awards with performance conditions. The Board also decided that subsequent remeasurement of a liability-classified award to an amount that ceases to be at the money would not prohibit an entity from continuing to use the practical expedient. The Board did not extend the practical expedient to awards with a market condition because awards with a market condition generally cannot be valued using an option-pricing model that uses a single estimate for the expected term (for example, the Black-Scholes option-pricing model).

BC25. The Board concluded that (a) if vesting of an award is dependent upon satisfying a performance condition, (b) the service period is not stated explicitly but inferred based on the achievement of the performance condition at some undetermined point in the future, and (c) the entity concludes that it is not probable that the performance condition will be achieved, it is more likely that the award would be outstanding for the entire contractual term. Therefore, the Board concluded that, in that situation, the contractual term is an appropriate estimate. The Board noted that although a longer expected term would result in a higher fair value, the compensation cost should not be recognized until the contingent event becomes probable.

BC26. The Board also considered an alternative that would allow an entity to broadly use the contractual term as the estimate of the expected term. The Board rejected this alternative because it would overstate the fair value of many awards. The fair value of a traded (or transferable) share option generally is based on its contractual term because it is rarely economically advantageous to exercise, rather than sell, a transferable share option before the end of its contractual term. Employee share options generally cannot be transferred or hedged, which reduces the fair value of the option. That reduction in fair value is reflected by estimating the expected term of the award (which would generally be a shorter time period than the contractual term of the award).

Intrinsic Value

BC27. The amendments in this Update permit a nonpublic entity to make an election upon adoption of the guidance in this Update to change its measurement of all liability-classified awards from fair value to intrinsic value.

BC28. Under current GAAP, a nonpublic entity is required to make a policy election to either measure all liability-classified awards at fair value or measure all such awards at intrinsic value. Stakeholders told the Board that certain nonpublic entities and practitioners are (or were) not aware that this practical expedient exists in GAAP. Consequently, those entities measure liability-classified awards using fair value rather than intrinsic value. Because Topic 718 states that fair value is preferable to intrinsic value, it may not be possible for a nonpublic entity to demonstrate that a change in accounting policy from fair value to intrinsic value is preferable under Topic 250. While Topic 718 will continue to state that fair value is preferable to intrinsic value, the amendments in this Update allow a nonpublic entity to change its accounting policy upon adoption of the guidance in this Update without needing to evaluate whether the change in accounting policy is preferable.

BC29. The Board considered an alternative that would have provided nonpublic entities with an ongoing election of the intrinsic value method. However, the Board concluded that an ongoing election would be inconsistent with recent decisions made by the Board and the Private Company Council during deliberations of amendments in Accounting Standards Update No. 2016-03, *Intangibles—Goodwill and Other (Topic 350)*, *Business Combinations (Topic 805)*, *Consolidation (Topic 810)*, and *Derivatives and Hedging (Topic 815): Effective Date and Transition Guidance*, which remove the effective dates of certain Private Company Council accounting alternatives. During deliberations of the amendments in that Update, the Board decided that the scope of the issue should not include nonpublic entity accounting alternatives that were developed before the issuance of the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*. Statement 123(R), including this policy election for nonpublic entities, was issued before the Private Company Decision-Making Framework.

Eliminating the Indefinite Deferral in Topic 718

BC30. The amendments in this Update eliminate the indefinitely deferred guidance requiring that an instrument originally subject to Statement 123(R) become subject to other applicable GAAP when the rights conveyed by the instrument are no longer dependent on the holder being an employee.

BC31. Shortly after the issuance of Statement 123(R), the Board permanently deferred that guidance with the intent of reviewing the deferral after completing the then-active liabilities and equity project. There is currently no active project on the Board's agenda to broadly address the distinction between liabilities and equity.

BC32. The Board noted that the removal of this guidance should not change current practice because the amendments do not change GAAP that is currently effective. For example, the removal of this guidance would not prohibit an entity that analogizes to the indefinitely deferred guidance to continue doing so. The primary benefit of this amendment is to improve the readability of the Accounting Standards Codification. Because there is no expected change in practice as a result of this amendment, transition and effective date guidance is not applicable for the amendment.

Transition and Effective Date

BC33. The Board decided that amendments on the timing of when excess tax benefits are recognized, minimum statutory holding requirements, forfeitures, and intrinsic value should be applied using a modified retrospective transition method by means of a cumulative-effect adjustment to equity as of the beginning of the period in which the guidance is adopted. However, the Board concluded that the cost to determine the cumulative-effect adjustment between APIC and retained earnings for the amount of excess tax benefits and tax deficiencies recognized in APIC would not be justified by potential benefits. Accordingly, those amendments should be applied prospectively. The Board also decided that the practical expedient for estimating the expected term should be applied prospectively to all instances in which an award must be measured at fair value after the effective date. With a prospective adoption, an entity would not incur the cost to determine a cumulative-effect adjustment to the previous estimate for the value of an option using a practical expedient that the Board decided should result in a reasonable estimate of the expected term.

BC34. The Board decided that the presentation of employee taxes paid on the statement of cash flows when an employer withholds shares to meet minimum statutory withholding requirements should be adopted retrospectively because an entity is not expected to incur significant costs to adjust prior periods and because retrospective presentation provides consistent classification of cash flows that provides useful information to users of financial statements. Some respondents disagreed with the retrospective transition approach proposed for the classification of excess tax benefits on the statement of cash flows. Those respondents stated that it is inconsistent to require prospective transition of excess tax benefits in the income statement and to require retrospective classification of excess tax benefits as cash flows from operating activities. Accordingly, the Board decided to provide an option to use either a prospective transition method or a retrospective transition method for presentation of excess tax benefits on the statement of cash flows.

BC35. The Board considered retrospective application for all amendments but concluded that for issues affecting recognition and measurement, retrospective application would require an entity to incur potentially significant costs relative to the benefits. This seems contrary to one of the objectives of the Simplification Initiative, which is to reduce cost and complexity.

BC36. The Board decided that upon adoption of the amendments in this Update, an entity should provide disclosures similar to those for other changes in accounting principle in paragraphs 250-10-50-1 through 50-3 with a key exception—an entity is not required to quantify the income statement effect of a change (direct and indirect) in the period of adoption. The Board observed that determining the effect of the change on the income statement would require an entity to keep two sets of records in the year of adoption. The Board decided that the costs outweighed the benefits for that particular disclosure.

BC37. The Board decided that for public business entities, the amendments in this Update are effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after December 15, 2017, and interim periods within annual periods beginning after December 15, 2018. The Board decided that early adoption should be permitted in any interim or annual period. If an entity early adopts the amendments in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. An entity that elects early adoption must adopt all of the amendments in this Update in the same period.

BC38. The Board decided to use the term *public business entity* as defined in Accounting Standards Update No. 2013-12, *Definition of a Public Business Entity: An Addition to the Master Glossary*, for only the transition provisions in this Update rather than the existing definition of the term *public entity* in Topic 718.

Benefits and Costs

BC39. 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 costs and benefits 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.

BC40. The Board anticipates that the amendments in this Update will reduce the costs of applying Topic 718 by providing relief to those areas of the guidance that stakeholders have indicated are complex to apply in practice and do not provide incremental benefit to users of financial statements. The Board expects that these simplifications will decrease costs and complexity in current GAAP without significantly changing the usefulness of the information provided to users of financial statements.

Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification*® in this Accounting Standards Update require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those changes, which will be incorporated into the proposed 2017 Taxonomy, are available for public comment through ASU Taxonomy Changes provided at www.fasb.org, and finalized as part of the annual release process.