

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2017-09
May 2017

Compensation—Stock Compensation (Topic 718)

Scope of Modification Accounting

An Amendment of the *FASB Accounting Standards Codification*®

Financial Accounting Standards Board

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Norwalk, CT 06856-5116

Please ask for our Product Code No. ASU2017-09.

FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published monthly with the exception of May, July, September, 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 Series, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 453**

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Summary

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

The Board is issuing this Update to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Topic 718, Compensation—Stock Compensation, to a change to the terms or conditions of a share-based payment award.

An entity may change the terms or conditions of a share-based payment award for many different reasons, and the nature and effect of the change can vary significantly. The Master Glossary of the *FASB Accounting Standards Codification*[®] currently defines the term *modification* as “a change in any of the terms or conditions of a share-based payment award.”

Stakeholders observed that the definition of the term *modification* is broad and that its interpretation results in diversity in practice. Some entities evaluate whether a change to the terms or conditions of an award is substantive. When those entities conclude that a change is substantive, they apply modification accounting in Topic 718. When those entities conclude that a change is not substantive, they do not apply modification accounting. Topic 718 does not contain guidance about what changes are substantive.

Other entities apply modification accounting for any change to an award, except for a change they deem to be purely administrative in nature. However, Topic 718 does not provide guidance about what changes are purely administrative. Still, other entities apply modification accounting when a change to an award changes the fair value, the vesting, or the classification of the award. In those cases, it appears that an evaluation of a change in fair value, vesting, or classification may be used in practice to evaluate whether a change is substantive.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect any entity that changes the terms or conditions of a share-based payment award.

What Are the Main Provisions?

The amendments in this Update provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718.

An entity should account for the effects of a modification unless all the following are met:

1. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.
2. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
3. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The current disclosure requirements in Topic 718 apply regardless of whether an entity is required to apply modification accounting under the amendments in this Update.

When Will the Amendments Be Effective?

The amendments in this Update are effective for all entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for (1) public business entities for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance.

The amendments in this Update should be applied prospectively to an award modified on or after the adoption date.

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

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–10. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Master Glossary

2. Amend the Master Glossary term *Modification*, with a link to transition paragraph 718-20-65-1, as follows:

Modification

A change in ~~any of~~ the terms or conditions of a share-based payment award.

Amendments to Subtopic 718-10

3. Amend paragraph 718-10-50-2(h), with a link to transition paragraph 718-20-65-1, as follows:

Compensation—Stock Compensation—Overall

Disclosure

718-10-50-1 An entity with one or more **share-based payment arrangements** shall disclose information that enables users of the financial statements to understand all of the following:

- a. The nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders
- b. The effect of compensation cost arising from share-based payment arrangements on the income statement
- c. The method of estimating the **fair value** of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period
- d. The cash flow effects resulting from share-based payment arrangements.

This disclosure is not required for interim reporting. For interim reporting see Topic 270. See Example 9 (paragraphs 718-10-55-134 through 55-137) for an illustration of this guidance.

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:

- 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 (or lack of) incremental compensation cost resulting from the modifications.

Amendments to Subtopic 718-20

- 4. Add paragraph 718-20-35-2A and amend paragraphs 718-20-35-3, 718-20-35-5 through 35-6, and 718-20-35-8, with a link to transition paragraph 718-20-65-1, as follows:

Compensation—Stock Compensation—Awards Classified as Equity

Subsequent Measurement

> Modification of an Award

718-20-35-2A An entity shall account for the effects of a **modification** as described in paragraphs 718-20-35-3 through 35-9, unless all the following are met:

- a. The fair value (or **calculated value** or **intrinsic value**, if such an alternative measurement method is used) of the modified **award** is the same as the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.

- b. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
- c. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

The disclosure requirements in paragraphs 718-10-50-1 through 50-2A and 718-10-50-4 apply regardless of whether an entity is required to apply modification accounting.

718-20-35-3 Except as described in paragraph 718-20-35-2A, aA **{remove glossary link}modification{remove glossary link}** 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 **{remove glossary link}calculated value{remove glossary link}**. 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 paragraphs 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.

718-20-35-4 Examples 12 through 16 (see paragraphs 718-20-55-93 through 55-144) provide additional guidance on, and illustrate the accounting for, modifications of both vested and nonvested awards, including a modification that changes the classification of the related financial instruments from equity to liability or vice versa, and modifications of vesting conditions. Paragraphs 718-10-35-9 through 35-14 provide additional guidance on accounting for modifications of certain freestanding financial instruments that initially were subject to this Topic but subsequently became subject to other applicable generally accepted accounting principles (GAAP).

> > **Short-Term Inducements**

718-20-35-5 Except as described in paragraph 718-20-35-2A, a short-term inducement shall be accounted for as a modification of the terms of only the awards of employees who accept the inducement. Other inducement, and other inducements shall be accounted for as modifications of the terms of all awards subject to them and shall be accounted for as such.

> > **Equity Restructuring or Business Combination**

718-20-35-6 Exchanges of share options or other equity instruments or changes to their terms in conjunction with an **equity restructuring** or a business combination are modifications for purposes of this Subtopic. An entity shall apply the guidance in paragraph 718-20-35-2A to those exchanges or changes to determine whether it shall account for the effects of those modifications. Except for a modification to add an antidilution provision that is not made in contemplation of an equity restructuring, accounting for a modification in conjunction with an equity restructuring requires a comparison of the fair value of the modified award with the fair value of the original award immediately before the modification in accordance with paragraph 718-20-35-3. If those amounts are the same, for instance, because the modification is designed to equalize the fair value of an award before and after an equity restructuring, no incremental compensation cost is recognized. Example 13 (see paragraph 718-20-55-103) provides further guidance on applying the

provisions of this paragraph. See paragraph 718-10-35-10 for an ~~additional~~ exception.

> > **Repurchase or Cancellation**

718-20-35-7 The amount of cash or other assets transferred (or liabilities incurred) to repurchase an equity award shall be charged to equity, to the extent that the amount paid does not exceed the fair value of the equity instruments repurchased at the repurchase date. Any excess of the repurchase price over the fair value of the instruments repurchased shall be recognized as additional compensation cost. An entity that repurchases an award for which the requisite service has not been rendered has, in effect, modified the requisite service period to the period for which service already has been rendered, and thus the amount of compensation cost measured at the grant date but not yet recognized shall be recognized at the repurchase date.

> > **Cancellation and Replacement**

718-20-35-8 Except as described in paragraph 718-20-35-2A, cancellation Cancellation of an award accompanied by the concurrent grant of (or offer to grant) a **replacement award** or other valuable consideration shall be accounted for as a modification of the terms of the cancelled award. (The phrase *offer to grant* is intended to cover situations in which the **service inception date** precedes the grant date.) Therefore, incremental compensation cost shall be measured as the excess of the fair value of the replacement award or other valuable consideration over the fair value of the cancelled award at the cancellation date in accordance with paragraph 718-20-35-3. Thus, the total compensation cost measured at the date of a cancellation and replacement shall be 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 plus the incremental cost resulting from the cancellation and replacement.

718-20-35-9 A cancellation of an award that is not accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a repurchase for no consideration. Accordingly, any previously unrecognized compensation cost shall be recognized at the cancellation date.

5. Amend paragraphs 718-20-55-2 through 55-3, 718-20-55-104 through 55-105, 718-20-55-122 and its related heading, 718-20-55-134, and 718-20-55-144, with a link to transition paragraph 718-20-65-1, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Equity Restructuring

718-20-55-2 In accordance with paragraph 718-20-35-6, an entity shall apply the guidance in paragraph 718-20-35-2A to exchanges of share options or other equity instruments or changes to their terms in conjunction with an equity restructuring to determine whether it shall account for the effects of those modifications as described in paragraphs 718-20-35-3 through 35-9. ~~accounting for a modification in conjunction with an equity restructuring requires a comparison of the fair value of the modified award with the fair value of the original award immediately before the modification, except as follows. If an award is modified to add an antidilution provision (that is, a provision designed to equalize an award's value before and after an equity restructuring) and that modification is not made in contemplation of an equity restructuring, a comparison of the fair value of the modified award and the fair value of the original award immediately before the modification is not required.~~ Example 13 (see paragraph 718-20-55-103) provides additional guidance on accounting for modifications of **{add glossary link}awards{add glossary link}** in the context of equity restructurings.

> Illustrations

718-20-55-3 The following Examples are included in this Subtopic because they assume equity classification. However, these Examples would also apply to awards classified as liabilities except that the amounts in the Examples would likely change due to the requirement under Subtopic 718-30 to remeasure share-based liability awards at **{add glossary link}fair value{add glossary link}** each reporting period until **settlement**.

> > Example 13: Modifications Due to an Equity Restructuring

> > > Case A: Original Award Contains Antidilution Provisions

718-20-55-104 In this Case, assume an award contains antidilution provisions. On May 1 there is an announcement of a future equity restructuring. On October 12 the equity restructuring occurs and the terms of the award are modified in accordance with the antidilution provisions. In this Case, the modification occurs on October 12 when the terms of the award are changed. The fair value of the award is compared pre- and postmodification on October 12. The calculation of fair value is necessary to determine whether there is any incremental value transferred as a result of the modification, and if so, that incremental value would be recognized as additional compensation cost. If there is no change in incremental fair value, vesting conditions, or the classification of the award, the entity would not account for the effect of the modification (see paragraph 718-20-35-2A). ~~no additional compensation cost would be recognized.~~

>>> Case B: Original Award Does Not Contain Antidilution Provisions

718-20-55-105 In this Case, the original award does not contain antidilution provisions. On May 1 there is an announcement of a future equity restructuring. On July 26 the terms of an award are modified to add antidilution provisions in contemplation of an equity restructuring. On September 30 the equity restructuring occurs. In this Case, there are two modifications to account for. The first modification occurs on July 26, when the terms of the award are changed to add antidilution provisions. ~~Because the modification to add antidilution provisions on July 26 is done in contemplation of an equity restructuring, there~~ There must be a comparison of the fair value of the award pre- and postmodification on July 26 in accordance with paragraph 718-20-35-2A to determine whether the entity should account for the effects of the modifications as described in paragraphs 718-20-35-3 through 35-9. The premodification fair value on July 26 is based on the award without antidilution provisions taking into account the effect of the contemplated restructuring on its value. The postmodification fair value is based on an award with antidilution provisions, taking into account the effect of the contemplated restructuring on its value. Any incremental value transferred would be recognized as additional compensation cost. Once the equity restructuring occurs, there is a second modification event on September 30 when the terms of the award are changed in accordance with the antidilution provisions. A second comparison of pre- and postmodification fair values is then required to determine whether the fair value of the award has changed ~~any incremental value is transferred~~ as a result of the modification. If there is no change in fair value, vesting conditions, or the classification of the award, the entity would not account for the effect of the modification on September 30 (see paragraph 718-20-35-2A). Changes to the terms of an award in accordance with its antidilution provisions ~~typically~~ generally would not result in additional compensation cost if the antidilution provisions were properly structured. If there is a change in fair value, vesting conditions, or the classification of the award, the ~~The~~ incremental value transferred, if any, would be recognized as additional compensation cost.

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

718-20-55-122 A modification may affect the classification of an award (for example, change the award from an equity instrument to a liability instrument). If an entity modifies an award in that manner, the Compensation—Stock Compensation Topic requires that the entity account for that modification in accordance with paragraph 718-20-35-3. The following Cases illustrate modifications regarding an award's that change the classification of the award:

- a. Equity to liability modification (share-settled share options to cash-settled share options) (Case A)
- b. Equity to equity modification (share options to shares) (Case B)

- c. Liability to equity modification (cash-settled to share-settled stock appreciation rights) (Case C)
- d. Liability to liability modification (cash-settled to cash-settled stock appreciation rights) (Case D)
- e. Equity to liability modification (share options to fixed cash payment) (Case E).

>>> Case B: Equity to Equity Modification (Share Options to Shares)

718-20-55-134 Equity to equity modifications also are addressed in Examples 12 (see paragraph 718-20-55-93) and 14 (see paragraph 718-20-55-107). This Case is based on Example 1, Case A (see paragraph 718-20-55-10), in which Entity T granted its employees 900,000 options with an exercise price of \$30 on January 1, 20X5. At January 1, 20X9, after 747,526 share options have vested, the market price of Entity T stock has declined to \$8 per share, and Entity T offers to exchange 4 options with an assumed per-share-option fair value of \$2 at the date of exchange for 1 share of nonvested stock, with a market price of \$8 per share. The nonvested stock will cliff vest after two years of service. All option holders elect to participate, and at the date of exchange, Entity T grants 186,881 ($747,526 \div 4$) nonvested shares of stock. Entity T considers the guidance in paragraph 718-20-35-2A. Because the change in the terms or conditions of the award changes the vesting conditions of the award, Entity T applies modification accounting. However, because~~Because~~ the fair value of the nonvested stock is equal to the fair value of the options, there is no incremental compensation cost. Entity T will not make any additional accounting entries for the shares regardless of whether they vest, other than possibly reclassifying amounts in equity; however, Entity T will need to account for the ultimate income tax effects related to the share-based compensation arrangement.

>>> 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. Entity T considers the guidance in paragraph 718-20-35-2A. Because the change in the terms or conditions of the award changes the classification of the award from equity to liability, Entity T applies modification accounting. This transaction is considered a modification instead of a settlement 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. Compensation cost of \$4,022,151 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 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).

6. Add paragraph 718-20-65-1 and its related headings as follows:

Transition and Open Effective Date Information

General

> Transition Related to Accounting Standards Update No. 2017-09, Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting

718-20-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-09, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*:

- a. The pending content that links to this paragraph shall be effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017.
- b. Early adoption is permitted, including adoption in any interim period, 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.

- c. An entity shall apply the pending content that links to this paragraph prospectively to a **modification** that occurs on or after the effective date.

Amendments to Status Sections

7. 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
Modification	Amended	2017-09	05/10/2017
718-10-50-2	Amended	2017-09	05/10/2017

8. Amend paragraph 718-20-00-1, by adding the following items to the table, as follows:

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

Paragraph	Action	Accounting Standards Update	Date
Modification	Amended	2017-09	05/10/2017
Public Business Entity	Added	2017-09	05/10/2017
718-20-35-2A	Added	2017-09	05/10/2017
718-20-35-3	Amended	2017-09	05/10/2017
718-20-35-5	Amended	2017-09	05/10/2017
718-20-35-6	Amended	2017-09	05/10/2017
718-20-35-8	Amended	2017-09	05/10/2017
718-20-55-2	Amended	2017-09	05/10/2017
718-20-55-3	Amended	2017-09	05/10/2017
718-20-55-104	Amended	2017-09	05/10/2017
718-20-55-105	Amended	2017-09	05/10/2017
718-20-55-122	Amended	2017-09	05/10/2017
718-20-55-134	Amended	2017-09	05/10/2017
718-20-55-144	Amended	2017-09	05/10/2017
718-20-65-1	Added	2017-09	05/10/2017

9. Amend paragraph 718-30-00-1, by adding the following item to the table, as follows:

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

Paragraph	Action	Accounting Standards Update	Date
Modification	Amended	2017-09	05/10/2017

10. Amend paragraph 718-50-00-1, by adding the following item to the table, as follows:

718-50-00-1 The following table identifies the changes made to this Subtopic.

Paragraph	Action	Accounting Standards Update	Date
Modification	Amended	2017-09	05/10/2017

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*
- Christine A. Botosan
- Harold L. Monk, Jr.
- R. Harold Schroeder
- Marc A. Siegel
- Lawrence W. Smith

Background Information and Basis for Conclusions

Background Information

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

BC2. An entity may change the terms or conditions of a share-based payment award for many different reasons, and the nature and effect of the change can vary significantly. The Master Glossary of the Codification currently defines the term *modification* as "a change in any of the terms or conditions of a share-based payment award."

BC3. Stakeholders observed that the definition of the term *modification* is broad and that its interpretation results in diversity in practice. Some entities evaluate whether a change to the terms or conditions of an award is substantive. When those entities conclude that a change is substantive, they apply modification accounting in Topic 718. When those entities conclude that a change is not substantive, they do not apply modification accounting. Topic 718 does not contain guidance about which changes are substantive.

BC4. Other entities apply modification accounting for any change to an award, except for a change they deem to be purely administrative in nature. However, Topic 718 does not provide guidance about what changes are considered purely administrative. Still, other entities apply modification accounting when a change to an award changes the fair value, the vesting, or the classification of the award. In those cases, it appears that an evaluation of the change in fair value, vesting, or classification may be used in practice to evaluate whether the change is substantive.

BC5. The issue that is addressed by the amendments in this Update was raised as part of a technical inquiry to the FASB staff about Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. One of the areas addressed by the amendments in Update 2016-09 relates to statutory tax withholding requirements. Before the amendments in Update 2016-09 became effective, for an award to qualify for equity classification, an entity could not partially settle the award in cash in excess of an employer's minimum statutory withholding requirements. The amendments in Update 2016-09 change the threshold to permit withholding *up to the maximum* statutory tax rate in the applicable jurisdictions. After the Board issued the amendments in Update 2016-09, stakeholders questioned whether an amendment to an award that already includes a net settlement feature to permit

withholding up to an employer's maximum statutory withholding amount requires an entity to apply modification accounting under Topic 718. The question emerged because the definition of the term *modification* is broad.

BC6. An entity that modifies an award under Topic 718 is generally required to calculate and recognize the incremental fair value of the modified award as compensation cost on the date of modification (for a vested award) or over the remaining service period (for an unvested award). The accounting for some modifications is more complex (for example, the modification might result in a new measurement date for some awards that are not considered probable of vesting at the time of modification). Paragraph 718-20-35-3 currently states, in part:

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.

BC7. At its August 31, 2016 meeting, the Board added to its agenda a project to (a) provide clarity and (b) reduce both diversity in practice and cost and complexity when applying the guidance in Topic 718 about a change to the terms or conditions of a share-based payment award.

BC8. On November 17, 2016, the Board issued proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting*, for public comment. The Board received 15 comment letters on the proposed Update. Most respondents supported the amendments in the proposed Update and said that the proposed amendments would clarify the scope of modification accounting and reduce diversity in practice while maintaining or improving the usefulness of information provided to financial statement users. Some respondents made suggestions to clarify specific aspects of the proposed amendments, which are described below.

Basis for Conclusions

Scope of Modification Accounting

BC9. The amendments in this Update do not fundamentally change the notion of a modification. Instead, they provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity should account for the effects of a modification as described in paragraphs 718-20-35-3 through 35-9, unless all the following are met:

- a. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the modified award is the same as the fair value (or calculated value or intrinsic value, if such an alternative

measurement method is used) of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique the entity uses to value the award, the entity is not required to estimate the value immediately before and after the modification.

- b. The vesting conditions of the modified award are the same as the vesting conditions of the original award immediately before the original award is modified.
- c. The classification of the modified award as an equity instrument or a liability instrument is the same as the classification of the original award immediately before the original award is modified.

BC10. Paragraphs BC11 and BC12 include examples of changes to the terms or conditions of an award and whether those changes require an entity to apply modification accounting. The examples in paragraphs BC11 and BC12 are educational in nature, are not all-inclusive, and should not be used to override the guidance in paragraph 718-20-35-2A. Therefore, an entity should evaluate a change to an award on the basis of the guidance in paragraph 718-20-35-2A.

BC11. Examples of changes to an award that generally do not require modification accounting include the following:

- a. Changes that are administrative in nature, such as a change to the company name, company address, or plan name
- b. Changes in an award's net settlement provisions related to tax withholdings that do not affect the classification of the award.

BC12. Examples of changes to an award that generally require modification accounting include the following:

- a. Repricing of share options that results in a change in value of those share options
- b. Changes in a service condition
- c. Changes in a performance condition or a market condition
- d. Changes in an award that result in a reclassification of the award (equity to liability or vice versa)
- e. Adding an involuntary termination provision in anticipation of a sale of a business unit that accelerates vesting of the award.

BC13. For the purpose of assessing the criterion in paragraph 718-20-35-2A(a), an entity should evaluate whether the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the award changes immediately before and after the modification and not whether the compensation cost recognized changes. For example, consider a circumstance in which an entity changes the terms or conditions of an award. If the entity concludes that the change results in a Type IV modification (improbable to improbable), the entity might have no change in compensation cost recognized on the modification date. However, the fair value (or calculated value or intrinsic value, if such an alternative

measurement method is used) might change as a result of the change in terms or conditions of the award. Consequently, the entity should apply modification accounting on the basis of paragraph 718-20-35-2A.

BC14. Under the amendments in this Update, one of the considerations in evaluating whether modification accounting is required is to determine whether a change to the terms or conditions of an award changes the value of the award. The Board is aware that if there is no change in value, then sometimes there is no difference in financial reporting outcomes, regardless of whether the entity applies modification accounting. However, the Board concluded that the amendments are an improvement to generally accepted accounting principles (GAAP) because they clarify when an entity is required to even consider whether the application of modification accounting will have a financial reporting effect.

BC15. In some circumstances, the financial reporting outcome (share-based payment disclosure or recognition of compensation cost) changes depending on whether modification accounting is applied. Under modification accounting in Topic 718, changes to terms or conditions for some awards result in a new measurement date on the modification date, which typically results in a different value for the award. For example, consider a circumstance in which an entity changes the terms or conditions of an award. As required by the modification accounting guidance in Topic 718, the entity assesses whether it is probable that the award will vest before and after the modification. If the entity concludes that the change results in a Type III modification (improbable to probable) or a Type IV modification (improbable to improbable), the entity has a new measurement date for the award. The new measurement date for that award affects disclosures about the share-based payment award and, in some circumstances, affects recognition of compensation cost.

BC16. Paragraph 718-20-35-2A(a) addresses whether there is a change in fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) immediately before and after the modification of the award. The Board does not expect that an entity will need to estimate the value immediately before and after the modification in all cases. Rather, the entity might be able to determine whether the modification affects any of the inputs to the value estimation technique for the award. If the modification does not affect any of the inputs to the valuation technique for the award, then the entity is not required to estimate the value immediately before and after the modification.

BC17. Some respondents to the amendments in the proposed Update questioned whether the Board intends an entity to apply the criterion in paragraph 718-20-35-2A(a) as a binary assessment (that is, the value is either *exactly* the same immediately before and after the modification or it is not) or whether the Board intends an entity to use judgment to decide whether a change in the value of an award is insignificant. The Board decided not to include guidance about the use of judgment specifically for paragraph 718-20-35-2A(a). The Board noted that practitioners use judgment to apply other areas of Topic 718 without specific

guidance about the use of judgment, and the Board expects that practitioners will be able to use judgment to apply paragraph 718-20-35-2A(a) without specific guidance. In addition, the Board was concerned about the risk of unintended consequences of including guidance about the use of judgment to apply paragraph 718-20-35-2A(a) (for example, the risk that a practitioner might conclude that the guidance intended for paragraph 718-20-35-2A(a) changes practice in another area of Topic 718 for which judgment is necessary). The Board did not want to inadvertently change practice beyond the narrow amendments made to Topic 718 in this Update.

BC18. Some stakeholders commented that if an entity changes an award and appropriately concludes, on the basis of the guidance in paragraph 718-20-35-2A, that it should not account for the effects of the modification as described in paragraphs 718-20-35-3 through 35-9, then the entity might inappropriately conclude that it should not consider those changes it made to the award when applying other guidance in Topic 718 or guidance in other Topics (for example, accounting for financial instruments following a modification when the holder is no longer an employee as described in paragraph 718-10-35-10 or calculation of earnings per share under Topic 260, Earnings Per Share). Consider a situation in which an entity modifies an award by reducing both the strike price and the number of share options. The entity applies the guidance in paragraph 718-20-35-2A to determine whether it would account for the effects of the modification. If the value, the vesting conditions, and the classification of the award are the same immediately before and after the change to the award, then the entity would not account for the effects of the modification. While the entity would not account for the effects of the modification as described in paragraphs 718-20-35-3 through 35-9, it should not ignore the changes it made to the award when it applies other guidance in Topic 718 or guidance in other Topics. The Board does not expect that the amendments in this Update will change the application of other guidance in practice. The amendments only explain which modifications require an entity to account for the effects of a modification, as described in paragraphs 718-20-35-3 through 35-9.

BC19. The Board learned from outreach with respondents to the proposed Update that the unit of account to apply the criterion in paragraph 718-20-35-2A(a) could be further specified. In some circumstances, the unit of account affects whether a modification changes the value of an award. Those stakeholders questioned whether an entity should compare the value of an award immediately before and after a modification on the basis of (a) the total instruments in an award to an employee that are modified or (b) each individual instrument awarded to an employee that is modified. For example, consider a circumstance in which an entity grants an employee an award for 10,000 share options. After the grant date, the share options become significantly out of the money and the entity modifies the award. The modification of the award both reduces the exercise price of the share options and reduces the number of share options to 5,000. The entity's goal with the modification is for the value of the original award to be the same as the value

of the modified award. Some stakeholders questioned whether the criterion in paragraph 718-20-35-2A(a) would require that an entity compare the aggregate value of the original 10,000 share options with the aggregate value of the modified 5,000 share options or whether the paragraph would require that an entity compare the value of one share option in the original award with the value of one share option in the modified award.

BC20. The Board decided to further specify that the unit of account to apply the criterion in paragraph 718-20-35-2A(a) is the same unit of account to apply other areas of Topic 718. The guidance in paragraph 718-20-35-2A(a) applies to an *award* to an employee that is modified. The term *award* is defined in the Master Glossary of the Codification and is used throughout Topic 718. The Board decided to link the term *award* in paragraph 718-20-35-2A(a) to the Master Glossary definition to emphasize that the term should be applied in the same manner that it is applied elsewhere in Topic 718.

BC21. In some instances, entities make changes to an award solely to preserve the value of the award after an equity restructuring. An example is the addition of an antidilution provision in contemplation of an equity restructuring event. Under current GAAP, an antidilution provision added in contemplation of an equity restructuring event constitutes a modification and generally results in incremental compensation cost. That is because the fair-value-based measure of the award is higher after the change because it assumes that the equity restructuring event occurs with the antidilution provision, whereas the fair-value-based measure before the change does not include the antidilution provision even though it assumes that the equity restructuring event does occur. The Board considered but rejected an alternative that modification accounting under Topic 718 should not be applied in circumstances in which the change is made solely to preserve the value of an award after an equity restructuring.

BC22. The Board rejected that alternative because there is incremental value for an award (a) when an antidilution provision is added in contemplation of an equity restructuring or (b) when adjustments are made to preserve the value of the award in an equity restructuring when there is no antidilution provision in place. Therefore, the change should be accounted for as a modification. A few Board members did not agree with the assessment that those modifications increase the value of the award; they noted that it seems to preserve the original value of the award. However, the Board agreed that equity restructurings are beyond the scope of the narrow issue being addressed by the amendments in this Update. That also is why the Board did not undertake a broader reconsideration of the definition of the term *modification* in Topic 718.

BC23. The Board also considered but rejected a view that modification accounting should not be applied to changes to an award made as a result of newly effective amendments to the Codification or newly effective laws or regulations if those changes do not result in a change in the fair value (or calculated value or intrinsic

value, if such an alternative measurement method is used), the vesting conditions, or the classification of the award.

BC24. The Board rejected that alternative, noting that stakeholders indicated that entities will have difficulty determining, and auditors will have difficulty verifying, that the change is made solely as a result of a new accounting standard, law, or regulation. Therefore, the Board agreed that entities should apply the guidance in paragraph 718-20-35-2A to changes to an award made as a result of adopting a new standard, law, or regulation to determine whether modification accounting is required.

Recurring Disclosures

BC25. Paragraph 718-10-50-2(h)(2) requires an entity to disclose a description of significant modifications for each year in which an income statement is presented, including:

- a. The terms of the modifications
- b. The number of employees affected
- c. The total incremental compensation cost resulting from the modifications.

A stakeholder noted that a significant modification may not result in incremental compensation cost. Accordingly, the Board amended paragraph 718-10-50-2(h)(2)(iii) in this Update.

BC26. Those disclosure requirements apply to a modification (that is, a change to an award) regardless of whether an entity is required to apply modification accounting under the amendments in this Update. In the Board's view, the disclosures about a modification provide useful information (for example, changes in the economic characteristics of an award, changes in the risk of dilution, and changes to management's future plans for share-based payments) to users of financial statements regardless of whether a change is required to undergo modification accounting. The Board noted that in some circumstances an entity will not apply modification accounting under the amendments even though the change substantively alters the economic characteristics of the award. For example, an entity might reprice share options and reduce the number of share options or it might change the form of an award from share options to restricted stock. If the value, the vesting conditions, and the classification of the award are the same immediately before and after the modification, then the entity would not apply modification accounting on the basis of the amendments. However, those types of changes might substantively alter the economic characteristics of the award and generally should be disclosed in accordance with paragraph 718-10-50-2(h)(2).

BC27. The Board does not anticipate that disclosure practices for modifications will change significantly as a result of the amendments in this Update. For example, many entities do not disclose changes to an award that are administrative in nature because, in their view, the administrative changes do not convey useful information. In addition, many entities disclose repricing of share options even when the modification does not result in incremental compensation. The Board does not expect those practices to change as a result of the amendments.

Effective Date and Transition

BC28. The amendments in this Update are effective for all entities for annual periods, including interim periods within those annual periods, beginning after December 15, 2017. Early adoption is permitted, including adoption in any interim period, for (a) public business entities for reporting periods for which financial statements have not yet been issued and (b) all other entities for reporting periods for which financial statements have not yet been made available for issuance. The Board decided that the amendments should be applied prospectively to modifications that occur on or after the adoption date.

BC29. Respondents to the amendments in the proposed Update indicated that significant time would not be necessary to implement those amendments, especially if they would be adopted prospectively. The Board considered whether additional time would be necessary for entities other than public business entities and concluded that additional time would not be necessary because the amendments in this Update are narrow, are expected to reduce cost and complexity, and involve transactions that are not recurring for most entities.

BC30. The Board decided not to permit or require retrospective application of the amendments in this Update. While the Board acknowledged that retrospective application potentially could improve comparability of financial information across entities, the Board was concerned about the cost of a retrospective approach. In the Board's view, the benefits of requiring or permitting a retrospective approach do not justify the costs (including costs borne by financial statement users). The quality of information provided to users should not change significantly under the amendments.

BC31. The Board considered transition disclosures in Topic 250, Accounting Changes and Error Corrections, but concluded that they are not necessary for the amendments in this Update because modifications are not a recurring event for most entities. An entity might not have any modifications in the year of adoption but may have one several years after adoption. Also, Topic 718 already requires disclosure about a modification when it occurs.

Benefits and Costs

BC32. 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.

BC33. The objectives of the amendments in this Update are to provide clarity and reduce both diversity in practice and cost and complexity when applying the guidance in Topic 718 about a change to the terms or conditions of a share-based payment award. Based on stakeholder feedback, the Board does not anticipate that transition costs will be significant.

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 2018 Taxonomy, are available for public comment through [ASU Taxonomy Changes](#) provided at www.fasb.org, and finalized as part of the annual release process.