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FASB Commences Project to Improve and Simplify Accounting for Stock Compensation under FASB ASC Topic 718

On October 8, 2014 the Financial Accounting Standards Board (FASB) added to its agenda a narrow-scope project to improve and simplify accounting for stock compensation under FASB Accounting Standards Codification (ASC) Topic 718. The project is intended to focus on the following six areas:

1. Minimum statutory withholding requirements
2. Presentation of stock-for-tax withholding transactions on the statement of cash flows
3. Accounting for forfeitures
4. Accounting for excess tax benefits and deficiencies
5. Presentation of excess tax benefits on the statement of cash flows
6. Simplifications and practical expedients for nonpublic companies

These areas were identified based on recently completed outreach efforts by the FASB staff as well as the Financial Accounting Foundation's (FAF) post-implementation review of the overall effectiveness of ASC Topic 718. This project is part of a series of narrow-scope projects intended to improve and simplify Generally Accepted Accounting Principles (GAAP) in a relatively short period of time. Thus, an Exposure Draft for this project could be issued for public comment sometime in 2015.

At the October 8 meeting, the FASB made the following tentative decisions, which are intended to reduce complexity and cost and should be favorably received by most public and nonpublic companies:

Minimum Statutory Withholding Requirements and Presentation on Statement of Cash Flows - Under current accounting rules for equity awards, companies must limit stock-for-tax withholding transactions to minimum statutory withholding rates or face liability accounting for the entire award. Further, there exists diversity in practice related to the classification of the cash paid to meet withholding requirements on the statement of cash flows.

> The FASB tentatively decided to relax the minimum required rate limitation by permitting stock-for-tax withholding up to the highest applicable marginal tax rate for each jurisdiction. The FASB further tentatively decided that companies should report stock-for-tax withholding transactions as a financing activity on the statement of cash flows because the substance of the transaction is a repurchase of shares from employees.
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> In light of this tentative decision, companies should review their stock plan documents to determine if a plan amendment is necessary and, if so, whether shareholder approval of the amendment is required.

Accounting for Forfeitures - Under current accounting rules, companies are required to estimate forfeitures for awards with service and/or performance vesting conditions when recognizing compensation cost over the requisite service (i.e., vesting) period, with true-ups in event actual forfeitures differ from prior period estimates.

> The FASB tentatively decided to allow companies to make an entity-level accounting policy election for awards with service vesting conditions to either estimate forfeitures and true-up, or to recognize forfeitures as they occur. This election would not apply to awards with performance vesting conditions.

Accounting for Excess Tax Benefits and Deficiencies and Presentation on Statement of Cash Flows - Under current accounting rules for equity awards, if the tax deduction reported on a company's tax return is more than the amount of compensation cost recognized in its financial statements (such as when the option profit at exercise exceeds fair value at grant), the effect of the "excess tax benefit" is reported as an increase to additional paid-in capital (referred to as the APIC pool) on the balance sheet and as both a financing cash receipt and operating cash payment on the statement of cash flows. Conversely, if the tax deduction reported on the company's tax return is less than the amount of compensation cost recognized in its financial statements (such as when the option profit at exercise is less than fair value at grant), the effect of the "tax deficiency" is first offset against the APIC pool, and the remainder (if any) is recognized as an increase to income tax expense on the income statement.

> The FASB tentatively decided to simplify this approach by requiring all excess tax benefits and deficiencies to be recognized on the income statement, regardless of whether the tax benefit is realized. The FASB further tentatively decided to eliminate the presentation of excess tax benefits on the statement of cash flows.

Simplifications and Practical Expedients for Nonpublic Companies - The FASB made no tentative decisions in this area, but intends to consider at a future date whether nonpublic companies should be permitted to elect to (1) switch from fair value to intrinsic value for liability awards, (2) use the SEC staff prescribed "simplified method" to determine the expected option term, and (3) measure the fair value of awards in formula value plans on the basis of that formula. The FASB also intends to further research simplification of nonpublic company equity/liability award classification for awards with share repurchase features.

Finally, at the October 8 meeting the FASB decided to add a separate project to its agenda to further research potential improvements to the accounting for stock compensation granted to nonemployees, other than nonemployee directors who are included within the scope of ASC Topic 718.

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General questions about this summary can be addressed to Thomas M. Haines in our Chicago office at 312-332-0910 or by email at tmhaines@fwcook.com. Specific questions should be referred to the company's professional accountants. Copies of this summary and other published materials are available on our website at www.fwcook.com.