

December 6, 2016

# FASB PROPOSES ACCOUNTING STANDARDS UPDATE ON THE SCOPE OF MODIFICATION ACCOUNTING UNDER TOPIC 718

The Financial Accounting Standards Board (FASB) on November 17, 2016 released a proposed Accounting Standards Update (ASU) that narrows the scope of modification accounting under FASB Accounting Standards Codification (ASC) Topic 718 (Topic 718)<sup>1</sup>. Topic 718 currently defines a modification as “a change to *any of* the terms or conditions of a share-based payment award.” Modification accounting requires companies to recognize additional compensation cost for any incremental fair value resulting from the modification unless the award is considered not probable of vesting at the time of the modification, in which case companies are required to recognize a new measurement date. The rationale for this treatment is that the company in substance is repurchasing the original award by issuing a new award of equal or greater value, incurring additional compensation cost for the incremental value.

The proposed ASU would amend the definition of modification by deleting “any of” in the definition above and qualifying that modification accounting does not apply to changes to outstanding share-based payment awards that do not affect the total fair value, vesting requirements, or equity/liability classification of the awards. Nonpublic companies are permitted to substitute calculated value or intrinsic value for fair value in the preceding sentence if such an alternative measurement method is used.

When assessing whether the fair value of a share-based payment award changes as a result of a modification, companies are permitted to assess whether any of the inputs to the valuation model are affected. If no inputs are affected, companies may conclude the modification does not affect the fair value of the share-based payment award.

<sup>1</sup> Refer to our most recent alert letter on this topic dated October 14, 2016 on our website at [http://www.fwcook.com/content/documents/publications/10-14-16\\_FASB\\_to\\_Issue\\_an\\_Accounting\\_Standards\\_Update\\_Topic\\_718.pdf](http://www.fwcook.com/content/documents/publications/10-14-16_FASB_to_Issue_an_Accounting_Standards_Update_Topic_718.pdf)

The proposed ASU provides the following non-exhaustive list of illustrative examples of changes to outstanding share-based payment awards that would and would not trigger modification accounting.

**WOULD NOT require modification accounting**

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

**WOULD require modification accounting**

- Modifications that effect a re-pricing of underwater stock options
- Modifications that affect a service, performance, or market vesting condition
- Modifications that result in a reclassification of an award from equity to liability or vice versa
- Modifications to add single-trigger acceleration of vesting in event of change in control

Regardless of whether modification accounting is required for the change, companies must continue to disclose in notes to financial statements a description of significant modifications for each year in which an income statement is provided, including the terms of the modifications, the number of employees affected, and the total incremental compensation cost resulting from the modifications.

The revised definition of modification would be applied prospectively to changes to outstanding share-based payment awards beginning in the period of adoption of the final ASU. The proposed ASU is subject to a comment period that ends on January 6, 2017.

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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](mailto: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](http://www.fwcook.com). A complete summary of Topic 718 can be found on our website at [http://www.fwcook.com/content/documents/publications/04-06-16\\_\(ORIGINALLY\\_4-29-05\)\\_-\\_Accounting\\_for\\_Stock\\_Compensation\\_Under\\_FASB\\_ASC\\_Topic\\_718.pdf](http://www.fwcook.com/content/documents/publications/04-06-16_(ORIGINALLY_4-29-05)_-_Accounting_for_Stock_Compensation_Under_FASB_ASC_Topic_718.pdf)