ALERT

May 12, 2017

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

The Financial Accounting Standards Board (FASB) on May 10, 2017 issued Accounting Standards Update (ASU) 2017-09 that narrows the scope of modification accounting under FASB Accounting Standards Codification (ASC) Topic 718 (Topic 718)[1] [2]. 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.

ASU 2017-09 amends 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.

The amended definition of modification should be applied to all changes to award terms, including in connection with equity restructurings, business combinations, and cancellation and replacement transactions. If the modification does not affect any of the inputs to the valuation model used to estimate fair value, companies are not required to calculate fair value immediately before and after the modification.

[1] Refer to our most recent alert letter on this topic dated December 6, 2016 on our website at http://www.fwcook.com/content/documents/publications/12-6-16__FASB_Proposes_Accounting_Standards_Update_On_The_Scope_Of_Modification_Accounting_Under_Topic_718.pdf
[2] Refer to our 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

ASU 2017-09 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
  - For example, changing the permissible stock-for-tax withholding provision from minimum required to maximum marginal tax rates

WOULD require modification accounting

- Modifications that effect a re-pricing of stock options that results in a change in fair value
- 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 an involuntary termination provision in anticipation of sale of business unit that accelerates vesting of the award

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

For all public and nonpublic companies, ASU 2017-09 is effective for annual reporting periods beginning after December 15, 2017, and interim periods within those annual periods (that is, 2018 financial statements for calendar year companies). Early adoption is permitted, including adoption in any interim period. ASU 2017-09 should be applied prospectively to award modifications occurring on or after the date of adoption.

****

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. A complete summary of Topic 718 can be found on our website at http://www.fwcook.com/content/documents/publications/05-12-17__ORIGINALLY_4-29-05__-_Accounting_for_Stock_Compensation_Under_FASB_ASC_Topic_718.pdf