

Appendix A

AMENDMENTS TO STATEMENT 123

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Appendix A

AMENDMENTS TO STATEMENT 123

INTRODUCTION

A1. This appendix consists of a copy of paragraphs 1–50 of Statement 123 marked to indicate the amendments made by this Statement. Appendix F provides a clean copy of Statement 123 as amended by this Statement. As noted in paragraph 2, this Statement does not substantively change Statement 123’s original requirements for transactions with nonemployees. The Board expects to reconsider accounting for share-based payment arrangements with nonemployees in a later phase of its project on equity-based compensation. However, some paragraphs of Statement 123 that deal with transactions with nonemployees are included both for completeness and because of the need to revise certain terminology and to make other conforming changes.*

A2. The term *this Statement* throughout the following marked copy refers to Statement 123 as amended by this Statement.

MARKED COPY OF STATEMENT 123

Statement of Financial Accounting Standards No. 123

Share-Based Payment

~~Accounting for Stock-Based Compensation~~

October 1995

INTRODUCTION

1. This Statement requires that the cost resulting from all **share-based payment transactions**¹ be recognized in the financial statements. This Statement establishes a fair-

*Refer to footnote 1 of this Statement.

¹Terms defined in Appendix E, the glossary, are set in **boldface type** the first time they appear.

value-based method of accounting for ~~stock-based compensation plans, share-based payment arrangements~~ and requires **public entities** to apply that method in accounting for share-based payment transactions with **employees** (except for **employee stock ownership plans**). This Statement also establishes the fair-value-based method of accounting as preferable for **nonpublic entities**, but it permits those entities to account for their **share options** and similar instruments at **intrinsic value** remeasured at each reporting date until exercise or other manner of **settlement**. ~~It encourages entities to adopt that method in place of the provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, for all arrangements under which employees receive shares of stock or other equity instruments of the employer or the employer incurs liabilities to employees in amounts based on the price of its stock.~~

2. This Statement also establishes **fair value** as the measurement basis for transactions in which an entity acquires goods or services from nonemployees in ~~share-based payment transactions—exchange for equity instruments~~. This Statement uses the terms *compensation* and *payment* in ~~their~~ *its* broadest senses to refer to the consideration paid for goods or services, regardless of whether the supplier is an employee or not. ~~For example, employee compensation includes both cash salaries or wages and other consideration that may be thought of more as means of attracting, retaining, and motivating employees than as direct payment for services rendered.~~

3. APB Opinion No. 25, *Accounting for Stock Issued to Employees*, issued in 1972, requireds compensation cost² for ~~stock-share-based employee compensation arrangements plans~~ to be recognized based on the difference, if any, between the quoted market price of the stock and the amount an employee must pay to acquire the stock. Opinion 25 specifieds different dates for the pertinent quoted market price of the stock used in measuring compensation cost, depending on whether the terms of an award³ ~~were~~ are fixed or variable, as those terms ~~were~~ are defined in Opinion 25.

4. Since 1972, ~~stock-share~~ options and other forms of ~~stock-share-based payment arrangements with employees~~ employee compensation plans have become increasingly common. Also, option-pricing models have become widely used for measuring the value of ~~stock-share~~ options and similar ~~equity instruments other than those issued to employees as compensation~~. Opinion 25 ~~has been~~ was criticized for producing anomalous results and for providing little general guidance to use in deciding how to account for new forms of ~~stock-share-based payment arrangements with employees~~ employee compensation plans. Several FASB Interpretations and Technical Bulletins have dealt with specific kinds of ~~plans arrangements and other issues~~, and the Emerging Issues Task Force (EITF) has considered numerous related issues.

²This Statement refers to recognizing *compensation cost* rather than *compensation expense* because part of the amount recognized in a period may be capitalized as part of the cost to acquire an asset, such as inventory.

³This Statement uses the term *award* as the collective noun for multiple instruments with the same terms and conditions granted at the same time either to a single employee or to a group of employees. An award may specify multiple vesting dates, referred to as graded vesting, and different parts of an award may have different expected terms-lives.

5. Because of the ~~perceived~~ deficiencies in Opinion 25, early in the 1980s the AICPA's Accounting Standards Executive Committee (AcSEC), the staff of the Securities and Exchange Commission (SEC), most of the larger accounting firms, industry representatives, and others asked the Board to reconsider the accounting specified in Opinion 25. ~~This Statement 123, as originally issued, which is the result of from that reconsideration and established~~ an accounting method based on the fair value of equity instruments awarded to employees as compensation that mitigates ~~many of the~~ deficiencies in Opinion 25. This Statement results from the Board's further reconsideration of those issues. ~~The Board encourages entities to adopt the new method. However, this Statement permits an entity in determining its net income to continue to apply the accounting provisions of Opinion 25 to its stock-based employee compensation arrangements. An entity that continues to apply Opinion 25 must comply with the disclosure requirements of this Statement, which supersede the disclosure requirements of paragraph 19 of Opinion 25. This Statement also supersedes or amends other accounting pronouncements listed in Appendix D. Appendix A explains the reasons the Board decided not to require recognition of compensation cost for stock based employee compensation arrangements measured in accordance with the fair value based method described in this Statement.~~

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

6. This Statement applies to all share-based payment transactions in which an entity acquires goods or services by issuing⁴ its shares equity instruments or by incurring liabilities to the supplier in amounts based on the price of the entity's common stock or other equity instruments (except for equity instruments held by an employee stock ownership plan)⁵ or by incurring liabilities to the supplier (a) in amounts based, at least in part, on the price of the entity's shares or other equity instruments or (b) that require or may require settlement by issuing the entity's equity shares or other equity instruments. Therefore, it applies to all transactions in which an entity grants shares of its common stock, share options, or other equity instruments to its employees, except for equity instruments held by an employee stock ownership plan.

⁴An entity may conditionally transfer an equity instrument to another party under an arrangement that permits that party to choose at a later date or for a specified time whether to deliver the consideration for it or to forfeit the right to the conditionally transferred instrument with no further obligation. In that situation, the equity instrument is not *issued* until the issuing entity has received the consideration, such as cash, an enforceable right to receive cash, other financial instruments, goods, or services, agreed to by the parties to the transaction. For that reason, this Statement does not use the term *issued* for the grant of ~~stock equity share options or other equity instruments subject to service or performance various conditions (or both) for vesting.~~

⁵AICPA Statement of Position 93-6, *Employers' Accounting for Employee Stock Ownership Plans*, specifies the accounting by employers for employee stock ownership plans. The Board expects to reconsider accounting for employee stock ownership plans in a later phase of its project on equity-based compensation.

7. The accounting for all ~~stock~~ share-based payment compensation arrangements with employees or others shall reflect the ~~inherent rights conveyed to the holder and the obligations imposed on the issuer~~, regardless of how those arrangements are ~~described structured~~. For example, the rights and obligations embodied in a transfer of ~~stock equity shares~~ to an employee for consideration of a ~~nonrecourse note that provides no recourse to other assets of the employee (that is, other than the shares)~~ are substantially the same as those embodied in a grant of equity share options ~~if the transaction were structured as the grant of a stock option, and the transaction shall be accounted for as such~~. Thus, that transaction shall be accounted for as a grant of equity share options. The ~~terms of the a~~ share-based payment arrangement may affect the fair value of the stock options liability or other equity instruments granted and shall be appropriately reflected in determining that value. For example, whether an employee who is granted an implicit option structured as the exchange of equity shares of stock for a nonrecourse note is required to pay nonrefundable interest on the note affects the fair value of the implicit option. Assessment of both the rights and obligations in a share-based payment arrangement and how the arrangement's terms affect the fair value of the related awards will require the exercise of judgment based on consideration of the relevant facts and circumstances.

Accounting for Share-Based Payment Transactions with Other Than Employees

8. Except for transactions with employees as defined in this Statement,^{5a} ~~that are within the scope of Opinion 25~~, all transactions in which goods or services are the consideration received for the issuance of equity instruments shall be accounted for based on the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. The fair value of goods or services received from suppliers other than employees frequently is reliably measurable and therefore indicates the fair value of the equity instruments issued. The fair value of the equity instruments issued shall be used to measure the transaction if that value is more reliably measurable than the fair value of the consideration received.⁶ ~~A common example of the latter situation is the use of the fair value of tradable equity instruments issued in a business combination to measure the transaction because the value of the equity instruments issued is more reliably measurable than the value of the business acquired.~~

9. This Statement uses the term ~~fair value for assets and financial instruments, including both liability and equity instruments, to refer to~~ with the same meaning as in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. That definition refers explicitly only to assets and liabilities.

^{5a}For purposes of this Statement, nonemployee directors acting in their role as members of a board of directors are treated as employees if those directors were (a) elected by the employer's shareholders or (b) appointed to a board position that will be filled by shareholder election when the existing term expires. (Refer to Illustration 1, paragraphs B50 and B51, of Appendix B.)

⁶The consideration received for issuing equity instruments, like the consideration involved in a repurchase of treasury shares, may include intangible rights. FASB Technical Bulletin No. 85-6, *Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares and the Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt*, provides pertinent guidance.

but the concept of *value in a current exchange* embodied in it applies equally to the equity instruments subject to this Statement.

~~the amount at which the asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances. The estimate of fair value shall consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option pricing models, matrix pricing, option adjusted spread models, and fundamental analysis.~~

10. If the fair value of the goods or services received is not reliably measurable, paragraph 8 of this Statement requires that the measure of the cost of goods or services acquired in a transaction with other than an employee be based on the fair value of the equity shares or other equity instruments issued. However, this Statement does not prescribe the **measurement date**, that is, the date of the ~~stock-share~~ price on which the fair value of ~~the equity shares or other equity instruments~~ is based, for a transaction with a nonemployee ~~(paragraphs 70-73).~~^{6a}

Accounting for Share-Based Payment Transactions with Employees

10A. The objective of accounting for transactions under share-based payment arrangements with employees is to recognize as an expense in the income statement the cost to the entity of services received (and consumed) in exchange for equity instruments issued, or liabilities incurred.

11. Except as indicated in paragraphs 20, 22, and 25B, an entity shall measure and recognize compensation cost from share-based payment transactions with employees based on the fair value of the shares or other equity instruments issued, or the liabilities incurred, in accordance with the fair-value-based method set forth in paragraphs 16-44 of this Statement. That is, the cost of services received from employees in exchange for awards of share-based compensation shall be measured based on the fair value of the equity instruments issued (based on the share price and other pertinent factors at the grant date) or the liabilities incurred (remeasured at the end of each reporting period until settlement). This Statement provides a choice of accounting methods for transactions with employees that are within the scope of Opinion 25. Paragraphs 16-44 of this Statement describe a method of accounting based on the fair value, rather than the

^{6a}EITF Issue No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services,” establishes criteria for determining the measurement date for equity shares or other equity instruments issued in share-based payment transactions with other than employees.

~~intrinsic value, of an employee stock option or a similar equity instrument. The Board encourages entities to adopt the fair value based method of accounting, which is preferable to the Opinion 25 method for purposes of justifying a change in accounting principle under APB Opinion No. 20, *Accounting Changes*.⁷ However, an entity may continue to apply Opinion 25 in accounting for its stock-based employee compensation arrangements. An entity that does so shall disclose pro forma net income and, if presented, earnings per share, determined as if the fair value based method had been applied in measuring compensation cost (paragraph 45).~~

~~12. The fair value based method described in paragraphs 16-44 of this Statement applies for (a) measuring stock-based employee compensation cost by an entity that adopts that method for accounting purposes and (b) determining the pro forma disclosures required of an entity that measures stock-based employee compensation cost in accordance with the intrinsic value based method in Opinion 25. Neither those paragraphs (16-44) nor subsequent paragraphs (45-54) of this Statement affect application of the *accounting* provisions of Opinion 25 by an entity that continues to apply it in determining reported net income.~~

~~13. For convenience, in describing the fair value based method, paragraphs 16-44 of this Statement refer only to *recognition or accounting* requirements. However, those provisions apply equally in determining the pro forma amounts that must be disclosed if an entity continues to apply Opinion 25.~~

~~14. An entity shall apply the same accounting method either the fair value based method described in this Statement or the intrinsic value based method in Opinion 25 in accounting for all of its stock-based employee compensation arrangements. Once an entity adopts the fair value based method for those arrangements, that election shall not be reversed.⁸~~

Certain Transactions with Related Parties and Other Economic Interest Holders

~~15. Equity ~~instruments~~ shares or other equity instruments of the reporting entity granted or otherwise transferred directly to an employee by a related party or other holder of an economic interest in that entity ~~principal stockholder~~ are stock-share-based employee compensation to be accounted for by the that entity under either Opinion 25 or this Statement, whichever method the entity is applying, unless the transfer clearly is for a purpose other than compensation.⁹ The substance of a transaction in which a related party or other economic interest holder ~~principal stockholder~~ directly transfers equity~~

⁷Opinion 20, paragraph 8, provides that initial adoption of an accounting principle for a transaction that the entity has not previously had to account for is not a change in accounting principle.

⁸APB Opinion No. 22, *Disclosure of Accounting Policies*, requires an entity to include a description of all significant accounting policies as an integral part of the financial statements. The method used to account for stock-based employee compensation arrangements is an accounting policy to be included in that description.

⁹That accounting has been required since 1973 in accordance with AICPA Accounting Interpretation 1, "Stock Plans Established by a Principal Stockholder," of Opinion 25.

instruments to an employee as compensation is that the economic interest holder ~~principal stockholder~~ makes a capital contribution to the entity and the entity awards equity instruments to its employee. An example of a situation in which a direct transfer of equity instruments from an economic interest holder to an employee ~~from a principal stockholder~~ is not compensation ~~cost~~ is a transfer to settle an obligation of the economic interest holder ~~principal stockholder~~ that is unrelated to employment by the ~~reporting~~ entity.

Valuation of Equity Instruments Issued for Employee Services

Measurement Basis

16. ~~Frequently,~~ ~~p~~Part or all of the consideration received for liabilities incurred or equity instruments issued to employees under a share-based payment arrangement is past or future employee services. ~~Equity instruments issued to employees and~~ ~~t~~The cost of the services received by the entity as consideration for those liability or equity instruments shall be measured and recognized based on the fair value of the liability settled or equity instruments issued. The portion of the fair value of an ~~equity~~ instrument attributed to employee services is net of the amount of cash or other assets, if any, that employees pay (or become obligated to pay) for the instrument when it is granted. Paragraphs 17–25B of this Statement provide guidance on how to measure the fair value of instruments issued under share-based payment arrangements with employees ~~stock-based employee compensation~~. Paragraphs 25E–33 provide guidance on how to attribute compensation cost to the periods in which employees render the related services. Appendix B, which is an integral part of this Statement, provides additional related implementation guidance ~~on both measurement and attribution of employee compensation cost~~.

Measurement Objective and Measurement Date for Equity Instruments

17. The objective of the measurement process for equity instruments awarded to employees is to estimate the fair value of the equity instruments ~~based on the stock price at the grant date~~, of ~~stock options or other equity instruments~~ to which employees become entitled when they have rendered the **requisite service** and satisfied any other conditions necessary to earn the right to benefit from the instruments (for example, to exercise stock-share options or to sell shares of stock). That estimate is based on the share price (and other pertinent factors, such as expected volatility) at the grant date. **Restrictions** that continue in effect after employees have earned the rights to benefit from their instruments, such as the inability to transfer **vested** employee stock-share options to third parties or the inability to sell vested shares for a period of time, affect the value of the instruments ~~actually~~ issued at the vesting date and therefore are reflected in estimating ~~their~~ the fair value of the instruments at the grant date. However, restrictions that stem directly from the forfeitability of instruments to which employees have not yet earned the right, such as the inability either to exercise a nonvested option or to sell **nonvested shares**, ~~stock~~ do not affect the fair value of the instruments issued at the vesting date and therefore are not reflected in estimating their fair value at the grant date; ~~and their effect therefore is not included in that value~~. The effect of those restrictions is taken into account by recognizing compensation cost only for instruments for which the requisite service has been rendered. That is, no compensation cost is recognized for

instruments that employees forfeit because a **service condition** or a **performance condition** is not satisfied (paragraph 26D). Illustrations 4 (paragraphs B59–B75), 5 (paragraphs B76–B81), and 11 (paragraphs B108–B114) of Appendix B provide examples of how compensation cost is recognized for awards with service and performance conditions. ~~Instead, no value is attributed to instruments that employees forfeit because they fail to satisfy specified service or performance related conditions.~~

Measurement Methods

Awards Classified as That Call for Settlement by Issuing Equity Instruments

18. ~~A nonvested equity share or nonvested equity **share unit**~~ The fair value of a share of nonvested stock awarded to an employee shall be measured at its fair value—the market price (or estimated market price, if the stock is not publicly traded) of a share of the same stock as if it were vested and issued on the grant date. Nonvested-stock shares granted to employees usually—is are referred to as **restricted shares**—stock, but this Statement reserves that term for shares whose sale is contractually or governmentally prohibited ~~restricted—after the shares are vested and fully outstanding. The fair value of a share of restricted stock~~ A restricted share awarded to an employee, that is, a share that will be restricted after the employee has a vested right to it, shall be measured at its fair value, which is the same amount for which a as a share of similarly restricted stock issued—share is issued to nonemployees. Illustration 10(a) (paragraphs B99–B101) of Appendix B provides an example of accounting for an award of nonvested shares.

19. ~~The fair value of a stock-share option (or its equivalent) granted by a public entity shall be measured based on the observable market price of an option with the same or similar terms and conditions, if one is available (paragraphs B4 and B5). Otherwise, the fair value of an employee share option or similar instrument shall be estimated using an option-pricing model (for example, the Black-Scholes or a binomial model) that takes into account as of the grant date the following factors, at a minimum (paragraph B13): exercise price and expected life of the option, the current price of the underlying stock and its expected volatility, expected dividends on the stock (except as provided in paragraphs 32 and 33), and the risk-free interest rate for the expected term of the option. For options that a U.S. entity grants on its own stock, the risk-free interest rate used shall be the rate currently available on zero-coupon U.S. government issues with a remaining term equal to the expected life of the options. Guidance on selecting other assumptions is provided in Appendix B.~~

- a. The exercise price of the option
- b. The expected term of the option, taking into account both the contractual term of the option and the effects of employees' expected exercise and expected post-vesting employment termination behavior
- c. The current price of the underlying share
- d. The expected **volatility** of the price of the underlying share
- e. The expected dividends on the underlying share (except as provided in paragraphs 32 and 33)
- f. The risk-free interest rate(s) for the expected term of the option.

The fair value of ~~an~~ a share option or similar instrument estimated at the grant date shall not be subsequently remeasured ~~adjusted~~ for changes in the price of the underlying share ~~stock~~ or other pertinent factors incorporated in the estimated fair value of the option at the grant date ~~its volatility, the life of the option, dividends on the stock, or the risk-free interest rate~~. Paragraphs B2–B30 provide additional guidance on estimating the fair value of share options and other equity instruments.

Equity Share Options Granted by a Nonpublic Entity

20. A nonpublic entity shall choose whether to account for its equity share options and similar instruments based on (a) their fair value at the date they are granted as determined in accordance with this Statement or (b) their intrinsic value, remeasured at each reporting date through the date they are exercised or otherwise **settled**.^{9a} For this purpose, a *similar instrument* is one whose fair value differs from its intrinsic value, that is, an instrument that has **time value**. For example, a share appreciation right (SAR) that requires net settlement in equity shares has time value;^{9b} an equity share does not.^{9c} Changes in the intrinsic value of a share option or similar instrument accounted for by the intrinsic value method shall be recognized in the same manner as required by paragraph 25B for changes in the fair value (or intrinsic value) of a liability. Illustration 10 (paragraphs B98–B107) of Appendix B further explains and illustrates the measurement requirements for equity instruments granted to employees by a nonpublic entity that elects to use the intrinsic value method of accounting. ~~A nonpublic entity shall estimate the value of its options based on the factors described in the preceding paragraph, except that a nonpublic entity need not consider the expected volatility of its stock over the expected life of the option.~~

^{9a}APB Opinion No. 22, *Disclosure of Accounting Policies*, requires an entity to include a description of all significant accounting policies as an integral part of the financial statements. This Statement requires an entity to disclose the policy adopted pursuant to this paragraph (paragraph B191(a)).

^{9b}This assumes that the SAR is not structured to be the equivalent of an equity share.

^{9c}In certain circumstances, the time value of a share option may be such an insignificant portion of its fair value that the risks and rewards to the holder of the option are essentially the same at the grant date as the risks and rewards to the holder of a share, for example, a share option with an exercise price of \$0.20 on a share with a grant-date fair value of \$20. In that situation, the share option shall be accounted for the same as the underlying share for purposes of applying paragraph 20 of this Statement. On the other hand, if a share option with an exercise price of \$0.03 on a share with a fair value of \$0.05 is granted by an entity, the share option shall be accounted for as a share option, not as a share.

The result of excluding volatility in estimating an option's value is an amount commonly termed **minimum value**.

20A. The fair-value-based method is preferable for purposes of justifying a change in accounting principle under APB Opinion No. 20, *Accounting Changes*,^{9d} and a nonpublic entity's election to use that method shall not be reversed. A nonpublic entity that changes to the fair-value-based method—either voluntarily or because it becomes a public entity—shall continue to account for awards outstanding at that date under the intrinsic value method until those awards are settled. Illustration 21 (paragraph B183) of Appendix B provides further guidance with respect to such a change. A nonpublic entity's election to use the fair-value-based or intrinsic value method shall be consistent for equity share options (and similar instruments) and liability instruments (paragraph 25B).

Equity Instruments for Which It Is Not Possible to Reasonably Estimate Fair Value at the Grant Date

21. It should be possible to reasonably estimate the fair value of most ~~stock~~ equity share options and other equity instruments at the date they are granted. Appendix B illustrates techniques for estimating the fair values of several ~~instruments~~ options with complicated features. However, in ~~unusual~~ certain circumstances, the terms of a ~~stock~~ an equity share option or other equity instrument may make it virtually impossible to reasonably estimate the instrument's fair value at the date it is granted. ~~For example, it may be extremely difficult, if not impossible, to reasonably estimate the fair value of a stock option whose exercise price decreases (or increases) by a specified amount with specified changes in the price of the underlying stock. Similarly, it may not be possible to reasonably estimate the value of a convertible instrument if the conversion ratio depends on the outcome of future events.~~

22. If it is not possible to reasonably estimate the fair value of ~~an a~~ share option or other equity instrument at the grant date, the final measure of compensation cost shall be the ~~fair~~ intrinsic value of the instrument at the date it is settled ~~based on the stock price and other pertinent factors at the first date at which it is possible to reasonably estimate that value.~~ Compensation cost for each period until settlement shall be based on the change (or pro rata change, depending on the percentage of the requisite service that has been rendered at the reporting date) in intrinsic value of the instrument for each reporting period, based on the current share price and other pertinent factors at the reporting date. The entity shall continue to use that accounting method for those awards even if it subsequently concludes that it is possible to reasonably estimate their fair value—for example, if the terms of the award are modified or a new valuation technique is developed. Generally, that is likely to be the date at which the number of shares to which an employee is entitled and the exercise price are determinable. Estimates of compensation cost for periods during which it is not possible to determine fair value shall

^{9d}Opinion 20, paragraph 8, provides that initial adoption of an accounting principle for a transaction that the entity has not previously had to account for is not a change in accounting principle. The December 15, 2003, FASB Exposure Draft, *Accounting Changes and Error Corrections*, would retain that provision of Opinion 20.

be based on the current intrinsic value of the award, determined in accordance with the terms that would apply if the option or similar instrument had been currently exercised.

Employee ~~Share-Stock~~ Purchase Plans

23. ~~If the terms of an employee share purchase plan are no more favorable than those available to all holders of the same class of shares and substantially all eligible employees that meet limited employment qualifications may participate on an equitable basis, the plan is not compensatory.^{9c} Illustration 19 (paragraphs B177–B179) of Appendix B provides guidance on how to determine whether the terms of an employee share purchase plan are no more favorable than those available to all holders of the same class of shares and gives examples of limited employment qualifications. If an employee stock purchase plan satisfies all of the following criteria, the plan is not compensatory. Therefore, the discount from market price merely reduces the proceeds from issuing the related shares of stock.~~

- a. ~~The plan incorporates no option features other than the following, which may be incorporated:-
 - (1) ~~Employees are permitted a short period of time not exceeding 31 days after the purchase price has been fixed to enroll in the plan.~~
 - (2) ~~The purchase price is based solely on the stock's market price at date of purchase, and employees are permitted to cancel participation before the purchase date and obtain a refund of amounts previously paid (such as those paid by payroll withholdings).~~~~
- b. ~~The discount from the market price does not exceed the greater of (1) a per share discount that would be reasonable in a recurring offer of stock to stockholders or others or (2) the per share amount of stock issuance costs avoided by not having to raise a significant amount of capital by a public offering. A discount of 5 percent or less from the market price shall be considered to comply with this criterion without further justification.~~
- c. ~~Substantially all full-time employees that meet limited employment qualifications may participate on an equitable basis.~~

24. ~~A plan provision that establishes the purchase price as an amount based on the lesser of the stock's market price at date of grant or its market price at date of purchase is, for example, an option feature that causes the plan to be compensatory. Similarly, a plan in which the purchase price is based on the stock's market price at date of grant and that permits a participating employee to cancel participation before the purchase date and obtain a refund of amounts previously paid is a compensatory plan.~~

^{9c}~~A transaction subject to an employee share purchase plan involving a class of equity shares designed exclusively for and held only by current or former employees (or their beneficiaries) may be compensatory depending on the terms of the arrangement. Illustration 20 (paragraphs B180–B182) of Appendix B provides guidance on making that determination.~~

Awards Classified as Liabilities That Call for Settlement in Cash

25. Some awards of ~~stock share~~-based compensation result in the entity's incurring a liability either because employees can compel the entity to settle the award by transferring its-in cash or other assets or because criteria in FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, under which an equity-settled instrument is a liability, are satisfied-to employees rather than by issuing equity instruments. For example, an entity may incur a liability to pay an employee either on demand or at a specified date an amount of cash or other assets to be determined by the increase in the entity's stock share price from a specified level. Such a liability is generally referred to as a cash share appreciation right (cash SAR). The amount of the liability for such an award shall be measured each period based on the current stock price. The effects of changes in the stock price during the ~~service period~~ are recognized as compensation cost over the service period in accordance with the method illustrated in FASB Interpretation No. 28, *Accounting for Stock Appreciation Rights and Other Variable Stock Option or Award Plans*. Changes in the amount of the liability due to stock price changes after the service period are compensation cost of the period in which the changes occur.

Liability Awards of Public Entities

25A. A public entity shall measure a liability incurred under a share-based payment arrangement with employees at its fair value. The liability shall be remeasured at the end of each reporting period until settlement based on the current share price and other pertinent factors at the reporting or settlement date. Illustration 11 (paragraphs B108–B114) of Appendix B provides an example of accounting for an instrument classified as a liability.

Liability Awards of Nonpublic Entities

25B. A nonpublic entity shall make a policy decision of whether to measure its liabilities incurred under share-based payment arrangements with employees at fair value or at intrinsic value, remeasured at the end of each reporting period until settlement based on the current share price and other pertinent factors at the reporting date or settlement date. A nonpublic entity's election to use the fair-value-based or intrinsic value method shall be consistent for liability instruments and equity share options (and similar instruments) (paragraphs 20 and 20A). Illustrations 11 (paragraphs B108–B114) and 10(b) (paragraphs B102–B107) of Appendix B provide examples of accounting for an instrument classified as a liability using the fair-value-based method and an equity share option using the intrinsic value method (which results in similar accounting for an instrument classified as a liability and accounted for using the intrinsic value method).

Cashless Exercises and Minimum Statutory Withholding Requirements

25C. A provision for employees to effect a **cashless exercise** of their share options through a broker that is not a related party of the entity does not result in liability classification for instruments that otherwise would be classified as equity as long as (a)

the cashless exercise requires a valid exercise of the share options and (b) the entity concludes that the employee is the legal owner of all the shares subject to the option (even though the employee has not paid the exercise price to the entity prior to the sale of the shares subject to the option).^{9f} Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options to meet the employer's minimum statutory withholding requirements^{9g} (related to the exercise) does not, by itself, result in liability classification of instruments that otherwise would be classified as equity.

Evaluating the Terms of a Share-Based Payment Arrangement in Determining Whether It Qualifies as a Liability

25D. As indicated in paragraph 7, the accounting shall reflect the terms of a share-based payment arrangement—that is, the substantive terms as they are mutually understood by the employer and the employees who receive awards under the arrangement. Generally, the written arrangement provides the best evidence of its terms. However, an entity's past practice may indicate that the substantive terms of an arrangement differ from its written terms. For example, an entity that grants a **tandem award** consisting of either a stock option or a cash SAR is obligated to pay cash on demand if the choice is the employee's, and the entity thus incurs a liability to the employee. In contrast, if the choice is the entity's, it can avoid transferring its assets by choosing to settle in stock, and the award qualifies as an equity instrument. However, if an entity that nominally has the choice of settling awards by issuing stock predominantly settles in cash, or if the entity ordinarily settles in cash whenever an employee asks for cash settlement, the entity is settling a substantive liability rather than repurchasing an equity instrument. The substantive terms of the share-based payment arrangement shall be the basis for the accounting.

Recognition of Compensation Cost for an Award Accounted for as an Equity Instrument

Recognition of Compensation Cost over the Requisite Service Period

25E. The compensation cost for an award of share-based compensation accounted for as an equity instrument shall be recognized over the requisite employee service period by a charge to compensation cost and a corresponding credit to equity (paid-in capital). The **requisite service period** is the period of time over which employee service is rendered in exchange for the award, often the vesting period. That period is estimated based on an analysis of the terms of the share-based payment arrangement. The requisite service period may be explicitly stated or it may be implicit, being inferred from an analysis of other terms in the arrangement, including other explicit service or performance conditions. Further, the requisite service period for an award that contains a **market condition** may be derived from certain valuation techniques used to estimate that award's grant-date fair value (paragraphs B47–B49). An award may have one or more explicit, implicit, or

^{9f}A broker that is a related party of the entity must sell the shares on the open market within three days for the award to qualify as equity.

^{9g}Based on minimum statutory withholding rates for federal and state tax purposes, including payroll taxes, that are applicable to such supplemental taxable income.

derived service periods; however, an award may have only one requisite service period for accounting purposes.^{9h} Paragraphs B37–B49 provide guidance on estimating the requisite service period and provide examples of how that period should be estimated if an award’s terms include more than one explicit, implicit, or derived service period. The **service inception date** is the beginning of the requisite service period.⁹ⁱ Illustration 2 (paragraphs B52–B56) of Appendix B provides guidance on the concept of *service inception date* and how it should be applied. The service completion date is the end of the requisite service period.

25F. Compensation cost for each part of an award with a graded vesting schedule shall be measured separately and recognized over the requisite service period for that part of the award. Illustration 4 (paragraphs B59–B75) of Appendix B provides an example of the accounting for an award with a graded vesting schedule.

Recognition Amount of Compensation Cost to Be Recognized over the Requisite Service Period

~~26. The total amount of compensation cost recognized for an award of stock share-based employee compensation shall be based on the number of instruments for which the requisite service is rendered (that is, for which the requisite service period is completed) that eventually vest. 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 and shall revise that estimate if subsequent information indicates that the actual number of instruments for which the requisite service is expected to be rendered is likely to differ from initial estimates. The effect of a change in the estimated number of instruments for which the requisite service is expected to be rendered is a change in an estimate, and the cumulative effect of the change on current and prior periods shall be recognized in the period of the change. No compensation cost is recognized for awards that employees forfeit either because they fail to satisfy a service requirement for vesting, such as for a **fixed award**, or because the entity does not achieve a **performance condition**, unless the condition is a target stock price or specified amount of intrinsic value on which vesting or exercisability is conditioned. For awards with the latter condition, compensation cost shall be recognized for awards to employees who remain in service for the requisite period regardless of whether the target stock price or amount of intrinsic value is reached.¹⁰ Previously recognized compensation cost shall not be reversed if a vested employee stock option expires unexercised.~~

^{9h}Certain awards, including an award with a graded vesting schedule, may have more than one requisite service period because the award’s terms represent, in substance, multiple awards (paragraph 25F).

⁹ⁱIf both the service inception date and a reporting date occur before the grant date, for example, if the necessary approvals have not yet been obtained, accrual of compensation cost for periods before the grant date shall be based on the fair value of the award at the reporting date. In the period in which the grant date occurs, cumulative compensation cost shall be adjusted to reflect the cumulative effect of measuring compensation cost based on fair value at the grant date.

¹⁰The existence of a target stock price that must be achieved to make an option exercisable generally affects the value of the option. Option pricing models have been adapted to value many of those *path-dependent* options.

26A. Accruals of compensation cost for an award with a performance condition shall be based on the probable^{10a} outcome of that performance condition. If an award has multiple performance conditions (for example, the number of options or shares an employee earns varies depending on which condition is satisfied), accruals of compensation cost shall be based on which, if any, of the conditions is the most likely outcome. Illustration 5 (paragraphs B76–B81) of Appendix B provides an example of how to account for awards with multiple performance conditions.

26B. Previously recognized compensation cost shall not be reversed if an employee share option (or share unit) expires unexercised (or unconverted) if the entity has already received and consumed the services for which the option (or unit) was exchanged; that is, the requisite employee service has been rendered.

Adjusting the Initial Estimate of Requisite Service Period

26C. Awards with multiple market, performance, or service conditions may have multiple service periods because of each particular condition. An entity shall make its best estimate of the requisite service period at the grant date (or at the service inception date if that date precedes the grant date) and shall, if appropriate, consider that period in measuring the fair value of the instrument granted and shall base accruals of compensation cost on that period. If that initial best estimate is based on a performance or service condition, an entity shall revise that estimate if subsequent information indicates that additional service or performance is required to achieve the condition or another performance or service condition is the probable outcome. If that initial best estimate is based on a market condition, the requisite service period shall not be revised unless the market condition is satisfied prior to the end of that initially estimated period or another performance or service condition becomes probable of achievement prior to the end of that initially estimated period.

Effect of Market, Performance, and Service Conditions on Recognition and Measurement of Compensation Cost

Market, performance, and service conditions that affect vesting or exercisability

26D. If an award requires satisfaction of one or more market, performance, or service conditions (or any combination thereof), compensation cost is recognized if the requisite service is rendered, and no compensation cost is recognized if the requisite service is not rendered. Paragraphs B31–B33 of Appendix B provide specific guidance on applying this provision to awards with market, performance, or service conditions (or any combination thereof).

26E. Service and performance conditions that affect whether vesting occurs are not reflected in estimating the fair value of instruments at the grant date because they are restrictions that stem directly from the forfeitability of instruments to which employees

^{10a}Probable is used in the same sense as in FASB Statement No. 5, *Accounting for Contingencies*: “the future event or events are likely to occur” (paragraph 3).

have not yet earned the right (paragraph 17). However, for purposes of this Statement, an award is not deemed forfeited solely because a market condition is not satisfied. For an award with a market condition, reversal of previously recognized compensation cost is not permitted, provided the requisite service has been rendered, regardless of when, if ever, the market condition is satisfied. Rather, the effect of a market condition shall be reflected in estimating the fair value of an award at the grant date.

Market, performance, and service conditions that affect factors other than vesting or exercisability

26F. Market, performance, and service conditions (or any combination thereof) may affect an award's exercise price, contractual term, quantity, conversion ratio, or other pertinent factors (excluding vesting) that are relevant in measuring an award's fair value. All such conditions are reflected in estimating a grant-date fair value of instruments for each possible outcome. An award shall be classified and accounted for as a liability, if it includes conditions that are not market, performance, or service conditions that affect vesting, exercisability, or other pertinent factors that are relevant in measuring an award's fair value. Paragraphs B34 and B35 provide guidance on the effect of market, performance, and service conditions that affect factors other than vesting and exercisability. Illustrations 5 (paragraphs B76–B81), 6 (paragraphs B82–B84), and 8 (paragraphs B92–B95) of Appendix B provide examples of accounting for awards with such conditions.

~~27. For purposes of this Statement, a stock based employee compensation award becomes vested when an employee's right to receive or retain shares of stock or cash under the award is not contingent on the performance of additional services. Typically, an employee stock option that is vested also is immediately exercisable. However, if performance conditions affect either the exercise price or the exercisability date, the service period used for attribution purposes shall be consistent with the assumptions used in estimating the fair value of the award. Paragraphs 309 and 310 in Appendix B illustrate how to account for an option whose exercise price depends on a performance condition.~~

~~28. An entity may choose at the grant date to base accruals of compensation cost on the best available estimate of the number of options or other equity instruments that are expected to vest and to revise that estimate, if necessary, if subsequent information indicates that actual forfeitures are likely to differ from initial estimates. Alternatively, an entity may begin accruing compensation cost as if all instruments granted that are subject only to a service requirement are expected to vest. The effect of actual forfeitures would then be recognized as they occur. Initial accruals of compensation cost for an award with a performance condition that will determine the number of options or shares to which all employees receiving the award will be entitled shall be based on the best estimate of the outcome of the performance condition, although forfeitures by individual employees may either be estimated at the grant date or recognized only as they occur.¹¹~~

¹¹For convenience, the remainder of this document refers to options or shares *expected to vest* because referring specifically to both acceptable methods of accounting for forfeitures by individual employees each time the point is mentioned would be too unwieldy.

~~29. Compensation cost estimated at the grant date for the number of instruments that are expected to vest based on performance related conditions, as well as those in which vesting is contingent only on future service for which the entity chooses to estimate forfeitures at the grant date pursuant to paragraph 28, shall be adjusted for subsequent changes in the expected or actual outcome of service and performance related conditions until the vesting date. The effect of a change in the estimated number of shares or options expected to vest is a change in an estimate, and the cumulative effect of the change on current and prior periods shall be recognized in the period of the change.~~

~~30. The compensation cost for an award of equity instruments to employees shall be recognized over the period(s) in which the related employee services are rendered by a charge to compensation cost and a corresponding credit to equity (paid in capital) if the award is for future service. If the service period is not defined as an earlier or shorter period, the service period shall be presumed to be the period from the grant date to the date that the award is vested and its exercisability does not depend on continued employee service (paragraph 27). If an award is for past services, the related compensation cost shall be recognized in the period in which it is granted.~~

~~31. Compensation cost for an award with a graded vesting schedule shall be recognized in accordance with the method described in Interpretation 28 if the fair value of the award is determined based on different expected lives for the options that vest each year, as it would be if the award is viewed as several separate awards, each with a different vesting date. If the expected life or lives of the award is determined in another manner, the related compensation cost may be recognized on a straight line basis. However, the amount of compensation cost recognized at any date must at least equal the value of the vested portion of the award at that date. Appendix B illustrates application of both attribution methods to an award accounted for by the fair value based method.~~

Effect of Dividends or Dividend Equivalents on Recognition and Measurement of Equity Awards

~~32. Dividends or dividend equivalents paid to employees on the portion of an award of stock equity shares or other equity instruments that vests shall be charged to retained earnings. ~~Nonforfeitable d~~Dividends or dividend equivalents paid on shares of stock instruments that do not vest shall be recognized as additional compensation cost if employees are not required to return those dividends or dividend equivalents when they forfeit the rights to the related instruments.^{11a} ~~The choice of whether to estimate forfeitures at the grant date or to recognize the effect of forfeitures as they occur described in paragraph 28 also applies to recognition of nonforfeitable dividends paid on shares that do not vest.~~~~

~~33. If employees receive only the dividends declared on the class of shares stock granted to them after the stock shares become vested, the value of the award at the grant date shall be reduced by the present value of dividends expected to be paid on the shares stock~~

^{11a}The estimate of compensation cost for dividend equivalents paid on instruments that are not expected to vest shall be consistent with an entity's estimates of forfeitures (paragraph 26).

during the vesting period, discounted at the appropriate risk-free interest rate(s). The fair value of an award of ~~share-stock~~ options on which dividend equivalents are paid to employees or are applied to reduce the exercise price pursuant to antidilution provisions shall be estimated based on a dividend payment of zero (paragraph 19).

Recognition of Changes in the Fair Value or Intrinsic Value of Liabilities

33A. The effects of changes in the fair value (or intrinsic value for a nonpublic entity that elects that method) of a liability during the requisite service period shall be recognized as compensation cost over that period. The percentage of the fair value (or intrinsic value) that is accrued as compensation cost at the end of each period shall equal the percentage of the requisite service that has been rendered at that date. Changes in the fair value (intrinsic value) of a liability after the requisite service period are compensation cost of the period in which the changes occur. Any difference between the amount for which a liability award is settled and the fair value of the award at that date estimated in accordance with the provisions of this Statement is an adjustment of compensation cost in the period of settlement. Illustration 11 (paragraphs B108–B114) of Appendix B provides an example of accounting for a liability award from the grant date through its settlement.

Additional Awards and Modifications of Outstanding Awards

Reload Options

34. The fair value of each award of equity instruments, including an award of **reload options**, shall be measured separately based on its terms and the current ~~stock-share~~ price and ~~related~~ other pertinent factors at the date it the award is granted. That is, the effect of a reload provision in the terms of an award when it is granted shall not be included in estimating the fair value. A subsequent grant of reload options pursuant to that provision shall be accounted for as a separate award when the reload options are granted.

Modifications of Outstanding Awards

35. A **modification** of the terms or conditions of an award that increases its fair value makes it more valuable 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 greater fair value, incurring additional compensation cost for that incremental value. ~~The incremental value shall be measured by the difference between (a) the fair value of the modified option determined in accordance with the provisions of this Statement and (b) the value of the old option immediately before its terms are modified, determined based on the shorter of (1) its remaining expected life or (2) the expected life of the modified option. Appendix B provides further guidance on and illustrates the accounting for modifications of both vested and nonvested options. The effects of a modification shall be measured as follows:~~

- a. Incremental compensation shall be measured as the excess, if any, of the fair value of the modified award determined in accordance with the provisions of this Statement over the fair value of the original award immediately before its terms are modified. The effect of the modification on the number of instruments expected to vest also shall be reflected. 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 26 of this Statement.
- b. Total recognized compensation cost for an award rarely will be less than 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 (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 plus (2) the incremental cost resulting from the modification. Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 26 of this Statement.
- c. A change in compensation cost from the modification of an award measured at intrinsic value in accordance with either paragraph 20A or paragraph 22 of this Statement shall be measured by comparing the intrinsic value of the modified award, if any, and the intrinsic value of the original award, if any, immediately before the modification.

Illustrations 12 (paragraphs B115–B121), 13 (paragraphs B122–B131), and 14 (paragraphs B132–B153) of Appendix B provide 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.

Inducements

35A. 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 inducements are modifications of the terms of all awards subject to them and shall be accounted for as such.

Cancellations and Replacements of Awards

35B. Cancellation of an award accompanied by the concurrent grant of a **replacement award** or other valuable consideration shall be accounted for as a modification of the terms of the cancelled award. Therefore, incremental compensation cost for a cancellation and replacement 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 date the cancellation and replacement occur.

Equity Restructurings

36. Exchanges of share options or other equity instruments or changes to their terms in conjunction with ~~business combinations, spinoffs, or other~~ an equity restructurings, or a business combination are modifications for purposes of this Statement.^{11b} ~~However, a change to the terms of an award in accordance with antidilution provisions that are designed, for example, to equalize an option's value before and after a stock split or a stock dividend is not a modification of an award for purposes of this Statement.~~

Settlements of Awards

Repurchases or Cancellations of Awards of Equity Instruments

37. An entity ~~occasionally~~ may repurchase equity shares or other equity instruments issued to employees after the employees have rendered the requisite service for them vested rights to them. An entity that settles an award for which the requisite service has not been rendered for cash or other assets has, in effect, vested the award (or made it exercisable), and the amount of compensation cost measured at the grant date but not yet recognized shall be recognized at the date of settlement. The amount of cash or other assets paid (or liabilities incurred) to repurchase an equity instrument shall be charged to equity, provided that the amount paid does not exceed the fair value of the instruments at the repurchase date repurchased. Any excess of the repurchase price over the fair value of the instruments shall be recognized as additional compensation cost. ~~For example, an entity that repurchases for \$10 a share of stock on the date it becomes vested does not incur additional compensation cost if the market price of the stock is \$10 at that date. However, if the market price of the stock is only \$8 at that date, the entity incurs an additional \$2 (\$10 - \$8) of cost. An entity that settles a nonvested award for cash has, in effect, vested the award, and the amount of compensation cost measured at the grant date but not yet recognized shall be recognized at the date of repurchase.~~

37A. A cancellation of an award that is not accompanied by the concurrent grant of 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 date of the cancellation.

~~38. For employee stock options, the incremental amount, if any, to be recognized as additional compensation cost upon cash settlement shall be determined based on a comparison of the amount paid with the value of the option repurchased, determined based on the remainder of its original expected life at that date. As indicated in paragraph 37, if stock options are repurchased before they become vested, the amount of unrecognized compensation cost shall be recognized at the date of the repurchase.~~

^{11b}Other aspects of accounting for share-based payment arrangements in a business combination are expected to be addressed as part of the current project on business combinations.

39. The accounting shall reflect the terms of a stock based compensation plan as those terms are mutually understood by the employer and the employees who receive awards under the plan. Generally, the written plan provides the best evidence of its terms. However, an entity's past practice may indicate that the **substantive terms** of a plan differ from its written terms. For example, an entity that grants a **tandem award** consisting of either a stock option or a cash stock appreciation right (SAR) is obligated to pay cash on demand if the choice is the employee's, and the entity thus incurs a liability to the employee. In contrast, if the choice is the entity's, it can avoid transferring its assets by choosing to settle in stock, and the award qualifies as an equity instrument. However, if an entity that nominally has the choice of settling awards by issuing stock generally settles in cash, or if the entity generally settles in cash whenever an employee asks for cash settlement, the entity probably is settling a substantive liability rather than repurchasing an equity instrument. The substantive terms shall be the basis for the accounting.

Interaction of This Statement and Statement 150

39A. Statement 150 establishes standards for determining whether certain **freestanding financial instruments** are classified as liabilities (or in some cases, assets). Statement 150 excludes from its scope instruments that are accounted for under this Statement. Nevertheless, an entity shall apply the classification criteria in paragraphs 8–14 of Statement 150 as they are effective at the reporting date in determining whether to classify as a liability a freestanding financial instrument granted to an employee in a share-based payment transaction.^{11c} On November 7, 2003, the Board directed its staff to issue FASB Staff Position (FSP) FAS 150-3, “Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*.” In determining the classification of an instrument, an entity shall also take into account the deferrals contained in that FSP; furthermore, call options^{11d} written on instruments that are classified as equity due to the deferrals in that FSP also shall be classified as equity while the deferral is in effect. Once the classification of an instrument is determined, the recognition and measurement provisions of this Statement shall be applied until the instrument ceases to be subject to this Statement in accordance with paragraph 40A.

^{11c}The payoff to the employee from an award with a vesting condition is based on both the vesting condition and variations in the fair value of the entity's shares. For example, a vesting condition that awards equity share options equal to .05 times the number of units sold in excess of 1,000 units would create a payoff that is based on both units sold and the fair value of the equity share options. That arrangement or an arrangement that conveys a fixed number of equity share options to an employee that vests (or becomes exercisable) based on the satisfaction of a market, performance, or service condition (or any combination thereof) is generally not a liability under Statement 150 (paragraph 12(b)) because, in most cases, the effect of the vesting condition on the monetary value of the conditional obligation to issue the equity share options is not predominant over the effect of variations in the fair value of the entity's shares.

^{11d}Refer to the definition of *share option* in Appendix E.

~~40. To restrict control to a limited group, for example, the members of a particular family, a nonpublic entity may obligate itself to repurchase its equity instruments for their fair value at the date of repurchase. In practice, such an obligation is not deemed to convert the stock to a liability. This Statement is not intended to change that view of the effect of a fair value repurchase agreement for a nonpublic entity. Thus, a nonpublic entity may grant or otherwise issue to employees equity instruments subject to such a repurchase agreement. The repurchase agreement does not convert those equity instruments to liabilities, provided that the repurchase price is the fair value of the stock at the date of repurchase.~~

Subsequent Accounting for Certain Freestanding Financial Instruments

40A. A freestanding financial instrument ceases to be subject to this Statement and becomes subject to the recognition and measurement requirements of Statement 150 when an employee could terminate service and receive or retain the fair value of the instrument for the remaining contractual term of that instrument. In general, a share option or similar instrument remains subject to this Statement until it is exercised, forfeited, allowed to lapse at the end of its contractual term, or otherwise settled. In contrast, a vested share, as well as a vested share option whose contractual term is not affected by an employee's termination, generally is subject to Statement 150. Illustration 22 (paragraph B184) of Appendix B provides guidance on when specific types of financial instruments cease to be subject to this Statement and become subject to Statement 150.

40B. An entity may modify (including cancel and replace) or settle a fully vested, freestanding financial instrument after it becomes subject to Statement 150. Such a modification or settlement shall be accounted for under the provisions of this Statement unless it applies equally to all financial instruments of the same class regardless of whether the holder is (or was) an employee (or an employee's beneficiary).^{11e} Subsequently, the modified instrument shall continue to be accounted for under Statement 150.

Accounting for Tax Consequences of Equity Instruments Awarded to Employees

41. Income tax regulations specify allowable tax deductions for instruments awarded to employees under stock share-based payment-employee compensation arrangements in determining an entity's income tax liability. Compensation cost recognized under this Statement ~~is~~ may be measured based on the fair value of an award ~~to an employee~~. Under existing U.S. tax law, allowable tax deductions are generally measured as the intrinsic value of an instrument on at a specified date ~~as the excess of the market price of the related stock over the amount the employee is required to pay for the stock (that is, at intrinsic value)~~. The time value component, if any, of the fair value of an ~~option instrument generally~~ is not tax deductible. Therefore, tax deductions generally will arise

^{11e}A modification or settlement of a class of financial instrument that is designed exclusively for and held only by current or former employees (or their beneficiaries) may stem from the employment relationship depending on the terms of the modification or settlement. Thus, such a modification or settlement may be subject to the requirements of this Statement.

in different amounts and in different periods from compensation cost recognized in financial statements.

42. ~~The cumulative amount of compensation cost recognized for a stock-based instruments award~~ classified as equity that ordinarily would results in a future tax deduction under existing tax law shall be considered to be a deductible temporary difference in applying FASB Statement No. 109, *Accounting for Income Taxes*. The deductible temporary difference shall be based on the fair value of the instruments recognized as compensation cost for financial reporting purposes. The deferred tax benefit (or expense) that results from increases (or decreases) in that temporary difference, for example, as additional service is rendered and the related cost is recognized, shall be recognized in the income statement. Recognition of compensation cost for instruments that ordinarily do not result in tax deductions under existing tax law shall not be considered to result in a deductible temporary difference in applying Statement 109. A future event, such as an employee's disqualifying disposition of stock under existing U.S. tax law, can give rise to a tax deduction for instruments that ordinarily do not result in a tax deduction. The tax effects of such an event shall be recognized only when it occurs.

42A. The cumulative amount of compensation cost recognized for instruments classified as liabilities that ordinarily would result in a future tax deduction under existing tax law also shall be considered to be a deductible temporary difference. The deductible temporary difference shall be based on the fair value of the instruments recognized as compensation cost for financial reporting purposes.

43. Statement 109 requires a deferred tax asset to be evaluated for future realization and to be reduced by a valuation allowance if, based on the weight of the available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. Differences between (a) the deductible temporary difference computed pursuant to paragraph 42 and (b) the tax deduction inherent in the current fair value of the entity's stock shall not be considered in measuring either the gross deferred tax asset or the need for a valuation allowance for a deferred tax asset recognized under this Statement.

44. ~~If a deduction changes in the fair value of an entity's shares after the grant date result in deductible compensation cost reported on the employer's tax return for a stock-based award~~ an individual employee's equity instruments (received in exchange for the requisite service) that exceeds the cumulative compensation cost for those instruments that award recognized for financial reporting, the any resulting realized tax benefit that exceeds the previously recognized deferred tax asset for those instruments (that is, the excess tax benefit) for that excess deduction shall be recognized as additional paid-in capital (paragraph 42). An excess of a tax benefit for an individual employee's equity instruments over the deferred tax asset for those instruments 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. If the amount deductible for an individual employee's equity instruments ~~deduction reported~~ on the employer's tax return is less than the cumulative compensation cost recognized for those instruments for financial

reporting purposes, the write-off of the portion of the a-related-deferred tax asset related to that deficiency in excess of the benefits of the tax deduction, net of the related valuation allowance, if any, shall be recognized in the income statement—except to the extent that there is remaining additional paid-in capital from excess tax deductions from previous stock-based employee compensation awards accounted for in accordance with the fair value based method in this Statement. In that situation, the amount of the write-off shall be charged against that additional paid-in capital. Illustrations 4 (paragraphs B67–B69), 10 (paragraphs B100 and B101), 11 (paragraphs B113 and B114), and 14 (paragraphs B139–B141) of Appendix B provide examples of accounting for the income tax effects of various awards.

Disclosures

45. Regardless of the method used to account for stock-based employee compensation arrangements, the financial statements of an entity shall include the disclosures specified in paragraphs 46–48. In addition, an entity that continues to apply Opinion 25 shall disclose for each year for which an income statement is provided the pro forma net income and, if earnings per share is presented, pro forma earnings per share, as if the fair value based accounting method in this Statement had been used to account for stock-based compensation cost. Those pro forma amounts shall reflect the difference between compensation cost, if any, included in net income in accordance with Opinion 25 and the related cost measured by the fair value based method, as well as additional tax effects, if any, that would have been recognized in the income statement if the fair value based method had been used. The required pro forma amounts shall reflect no other adjustments to reported net income or earnings per share.

46. An entity with one or more share-based payment arrangements with employees shall disclose information that enables users of the financial statements to understand:

- a. The nature and general terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders (for example, the transfer of value from existing shareholders to option holders upon option exercise)
- b. The effect of compensation cost arising from share-based employee 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, during the period
- d. The cash flow effects resulting from share-based payment arrangements.

Paragraphs B191–B193 indicate the minimum information needed to achieve those objectives and illustrate how the disclosure requirements might be satisfied.

An entity with one or more stock-based compensation plans shall provide a description of the plan(s), including the general terms of awards under the plan(s), such as vesting requirements, the maximum term of options granted, and the number of shares authorized for grants of options or other equity instruments. An entity that uses equity instruments to acquire goods or services other than employee services shall provide disclosures similar to those required by this paragraph and paragraphs 47 and 48 to the extent that those

~~disclosures are important in understanding the effects of those transactions on the financial statements.~~

47. An entity that acquires goods or services other than employee services in share-based payment transactions shall provide disclosures similar to those required by paragraph 46 to the extent that those disclosures are important in understanding the effects of those transactions on the financial statements. 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. Paragraph B191 provides additional guidance on satisfying the requirements for multiple arrangements.

~~The following information shall be disclosed for each year for which an income statement is provided:~~

- ~~a. The number and weighted average exercise prices of options for each of the following groups of options: (1) those outstanding at the beginning of the year, (2) those outstanding at the end of the year, (3) those exercisable at the end of the year, and those (4) granted, (5) exercised, (6) forfeited, or (7) expired during the year.~~
- ~~b. The weighted average grant date fair value of options granted during the year. If the exercise prices of some options differ from the market price of the stock on the grant date, weighted average exercise prices and weighted average fair values of options shall be disclosed separately for options whose exercise price (1) equals, (2) exceeds, or (3) is less than the market price of the stock on the grant date.~~
- ~~c. The number and weighted average grant date fair value of equity instruments other than options, for example, shares of nonvested stock, granted during the year.~~
- ~~d. A description of the method and significant assumptions used during the year to estimate the fair values of options, including the following weighted average information: (1) risk free interest rate, (2) expected life, (3) expected volatility, and (4) expected dividends.~~
- ~~e. Total compensation cost recognized in income for stock based employee compensation awards.~~
- ~~f. The terms of significant modifications of outstanding awards.~~

~~An entity that grants options under multiple stock based employee compensation plans shall provide the foregoing information 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 stock based compensation. For example, separate disclosure of weighted average exercise prices at the end of the year for options with a fixed exercise price and those with an indexed exercise price is likely to be important, as would segregating the number of options not yet exercisable into those that will become exercisable based solely on employees' rendering additional service and those for which an additional condition must be met for the options to become exercisable.~~

~~48. For options outstanding at the date of the latest statement of financial position presented, the range of exercise prices (as well as the weighted average exercise price) and the weighted average remaining contractual life shall be disclosed. If the range of exercise prices is wide (for example, the highest exercise price exceeds approximately 150 percent of the lowest exercise price), the exercise prices shall be segregated into ranges that are meaningful for assessing the number and timing of additional shares that may be issued and the cash that may be received as a result of option exercises. The following information shall be disclosed for each range:~~

- ~~a. The number, weighted average exercise price, and weighted average remaining contractual life of options outstanding~~
- ~~b. The number and weighted average exercise price of options currently exercisable.~~

Earnings per Share Implications

49. FASB Statement No. 128, *Earnings per Share*, requires that employee ~~stock~~share options, nonvested stock and similar equity instruments granted to employees be treated as potential common shares in computing diluted earnings per share. Diluted earnings per share shall be based on the actual number of options or shares granted and not yet forfeited, unless doing so would be antidilutive. If vesting is contingent upon factors other than continued service, such as the level of future earnings, the shares or share options shall be treated as contingently issuable shares in accordance with paragraphs 30–35 of Statement 128. If ~~stock~~share options or other equity instruments are granted or forfeited during a period, the shares issuable shall be weighted to reflect the portion of the period during which the equity instruments were outstanding.

50. In applying the treasury stock method of Statement 128, the assumed proceeds shall be the sum of (a) the amount, if any, the employee must pay, (b) the amount of compensation cost attributed to future services and not yet recognized, and (c) the amount of excess tax benefits, if any, that would be credited to additional paid-in capital. ~~Statement 128 provides detailed examples of the treatment of stock compensation plans accounted for under Statement 128 in earnings per share computations.~~