

# FINANCIAL ACCOUNTING SERIES



## ACCOUNTING STANDARDS UPDATE

No. 2010-05  
January 2010

### Compensation – Stock Compensation (Topic 718)

Escrowed Share Arrangements and the  
Presumption of Compensation

An Amendment of the *FASB Accounting Standards Codification*<sup>™</sup>

Financial Accounting Standards Board  
of the Financial Accounting Foundation

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# Securities and Exchange Commission (SEC) Content

## Compensation – Stock Compensation (Topic 718)

### Escrowed Share Arrangements and the Presumption of Compensation

*This Accounting Standards Update codifies EITF Topic D-110, Escrowed Share Arrangements and the Presumption of Compensation.*

1. Add paragraph 718-10-S99-2, with no link to a transition paragraph, as follows:

#### **>> Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings**

#### **>>> SEC Staff Announcement: Escrowed Share Arrangements and the Presumption of Compensation**

**718-10-S99-2** This SEC staff announcement provides the SEC staff's views regarding Escrowed Share Arrangements and the Presumption of Compensation.

The SEC Observer made the following announcement of the SEC staff's position on escrowed share arrangements. The SEC Observer has been asked to clarify SEC staff views on overcoming the presumption that for certain shareholders these arrangements represent compensation. [EITF D-110, sequence 1]

Historically, the SEC staff has expressed the view that an escrowed share arrangement involving the release of shares to certain shareholders based on performance-related criteria is presumed to be compensatory, equivalent to a reverse stock split followed by the grant of a restricted stock award under a performance-based plan. FN 1 [EITF D-110, sequence 2.1]

When evaluating whether the presumption of compensation has been overcome, registrants should consider the substance of the arrangement, including whether the arrangement was entered into for purposes unrelated to, and not contingent upon, continued employment. For example, as a condition of a financing transaction, investors may request that specific significant shareholders, who also may be officers or directors, participate in an escrowed share arrangement. If the escrowed shares will be released or canceled without regard to continued employment, specific facts and circumstances may indicate that the arrangement

is in substance an inducement made to facilitate the transaction on behalf of the company, rather than as compensatory. In such cases, the SEC staff generally believes that the arrangement should be recognized and measured according to its nature and reflected as a reduction of the proceeds allocated to the newly-issued securities. FN 2, 3 [EITF D-110, sequence 3.1]

The SEC staff believes that an escrowed share arrangement in which the shares are automatically forfeited if employment terminates is compensation, consistent with the principle articulated in paragraph 805-10-55-25(a). [EITF D-110, sequence 4]

FN 1 Under these arrangements, which can be between shareholders and a company or directly between the shareholders and new investors, shareholders agree to place a portion of their shares in escrow in connection with an initial public offering or other capital-raising transaction. Shares placed in escrow are released back to the shareholders only if specified performance-related criteria are met. [EITF D-110, sequence 2.1.1]

FN 2 The SEC staff notes that discounts on debt instruments are amortized using the effective interest method as discussed in Section 835-30-35, while discounts on common equity are not generally amortized. [EITF D-110, sequence 3.1.1]

FN 3 Consistent with the views in paragraph 225-10-S99-4, SAB Topic 5.T., Accounting for Expenses or Liabilities Paid by Principal Stockholder(s), and paragraph 225-10-S99-3, SAB Topic 1.B., Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity, the SEC staff believes that the benefit created by the shareholder's escrow arrangement should be reflected in the company's financial statements even when the company is not party to the arrangement. [EITF D-110, sequence 3.1.2]

2. Based on the amendments made in paragraph 718-10-S99-2 above, add paragraph 718-10-S25-1, with no link to a transition paragraph, as follows:

**> Escrowed Share Arrangements and the Presumption of Compensation**

**718-10-S25-1** See paragraph 718-10-S99-2: SEC Staff Announcement: Escrowed Share Arrangements and the Presumption of Compensation, for SEC Staff views on the accounting for escrowed share arrangements. [EITF D-110, sequence 1]

3. Based on the amendments made in paragraph 718-10-S99-2 above, add paragraph 505-50-S25-3, with no link to a transition paragraph, as follows:

**> Escrowed Share Arrangements and the Presumption of Compensation**

**505-50-S25-3** See paragraph 718-10-S99-2: SEC Staff Announcement: Escrowed Share Arrangements and the Presumption of Compensation, for SEC Staff views on the accounting for escrowed share arrangements. [EITF D-110, sequence 1]

4. Amend paragraph 505-50-S00-1, by adding the following items to the table, as follows:

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
505-50-S25-3	Added	2010-05	01/15/2010

5. Amend paragraph 718-10-S00-1, by adding the following items to the table, as follows:

<b>Paragraph Number</b>	<b>Action</b>	<b>Accounting Standards Update</b>	<b>Date</b>
718-10-S25-1	Added	2010-05	01/15/2010
718-10-S99-2	Added	2010-05	01/15/2010