

FINANCIAL ACCOUNTING SERIES



ACCOUNTING STANDARDS UPDATE

No. 2010-13

April 2010

Compensation—Stock Compensation (Topic 718)

Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades

a consensus of the FASB Emerging Issues Task Force

An Amendment of the *FASB Accounting Standards Codification*[™]

Financial Accounting Standards Board
of the Financial Accounting Foundation

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FINANCIAL ACCOUNTING SERIES (ISSN 0885-9051) is published quarterly by the Financial Accounting Foundation. Periodicals postage paid at Norwalk, CT and at additional mailing offices. The full subscription rate is \$230 per year. POSTMASTER: Send address changes to Financial Accounting Standards Board, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116. | **No. 342**

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CONTENTS

	Page Numbers
Summary.....	1–2
Amendments to the <i>FASB Accounting Standards Codification</i> ™.....	3–5
Background Information and Basis for Conclusions.....	6–8
Amendments to the XBRL Taxonomy.....	9

Summary

Why Is the FASB Issuing This Accounting Standards Update (Update)?

The objective of this Update is to address the classification of an employee share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades. *FASB Accounting Standards Codification*TM Topic 718, Compensation—Stock Compensation, provides guidance on the classification of a share-based payment award as either equity or a liability. A share-based payment award that contains a condition that is not a market, performance, or service condition is required to be classified as a liability.

Under Topic 718, awards of equity share options granted to an employee of an entity's foreign operation that provide a fixed exercise price denominated in (1) the foreign operation's functional currency or (2) the currency in which the employee's pay is denominated should not be considered to contain a condition that is not a market, performance, or service condition. However, U.S. generally accepted accounting principles (GAAP) do not specify whether a share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades has a market, performance, or service condition. Diversity in practice has developed on the interpretation of whether such an award should be classified as a liability when the exercise price is not denominated in either the foreign operation's functional currency or the currency in which the employee's pay is denominated.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect entities that issue employee share-based payment awards with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades that differs from the functional currency of the employer entity or payroll currency of the employee. The amendments affect entities that have previously considered such awards to be liabilities because of their exercise price.

What Are the Main Provisions?

Accounting Guidance

This Update provides amendments to Topic 718 to clarify that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades

should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity.

Disclosures

The amendments in this Update do not expand the recurring disclosures required by Topic 718. Disclosures currently required under Topic 718 are applicable to a share-based payment award, including the nature and terms of share-based payment arrangements.

How Do the Main Provisions Differ from Current U.S. Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

The amendments clarify that a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, such an award should not be classified as a liability if it otherwise qualifies as equity.

The amendments improve GAAP because they improve consistency in financial reporting by eliminating diversity in practice.

When Will the Amendments Be Effective?

The amendments in this Update are effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The amendments in this Update should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings. The cumulative-effect adjustment should be calculated for all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied, as if the amendments had been applied consistently since the inception of the award. The cumulative-effect adjustment should be presented separately. Earlier application is permitted.

How Do the Provisions Compare with International Financial Reporting Standards (IFRS)?

IFRS does not provide specific guidance for these types of employee share-based payment awards. However, the amendments in this Update are consistent with IFRS because entities that apply IFRS generally classify such awards in equity if they otherwise qualify as equity.

Amendments to the *FASB Accounting Standards Codification*TM

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–5. In some cases, not only are the amended paragraphs shown but also the preceding and following paragraphs are shown to put the change in context. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 718-10

2. Add paragraph 718-10-25-14A, with a link to transition paragraph 718-10-65-2, as follows:

Compensation—Stock Compensation—Overall

Recognition

718-10-25-14A For purposes of applying paragraph 718-10-25-13, a share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, in accordance with that paragraph, such an award shall not be classified as a liability if it otherwise qualifies for equity classification. For example, a parent entity whose functional currency is the Canadian dollar grants equity share options with an exercise price denominated in U.S. dollars to employees of a Canadian entity with the functional and payroll currency of the Canadian dollar. If a substantial portion of the parent entity's equity securities trades on a U.S. dollar denominated exchange, the options are not precluded from equity classification.

3. Amend paragraph 718-10-55-65, with a link to transition paragraph 718-10-65-2, as follows:

Implementation Guidance and Illustrations

718-10-55-65 An award may be indexed to a factor in addition to the entity's share price. If that factor is not a market, performance, or service condition, that award shall be classified as a liability for purposes of this Topic (see paragraphs

718-10-25-13 through ~~25-14~~25-14A). An example would be an award of options whose exercise price is indexed to the market price of a commodity, such as gold. Another example would be a share award that will vest based on the appreciation in the price of a ~~commodity, commodity~~ such as gold; that award is indexed to both the value of that commodity and the issuing entity's shares. If an award is so indexed, the relevant factors shall be included in the fair value estimate of the award. Such an award would be classified as a liability even if the entity granting the share-based payment instrument is a producer of the commodity whose price changes are part or all of the conditions that affect an award's vesting conditions or fair value.

4. Add paragraph 718-10-65-2 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2010-13, Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades

718-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2010-13, *Compensation—Stock Compensation (Topic 718): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades*:

- a. An entity shall apply the pending content that links to this paragraph by recording a cumulative-effect adjustment to the opening balance of retained earnings for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010.
- b. An entity shall calculate the cumulative-effect adjustment by applying the pending content that links to this paragraph to all awards outstanding as of the beginning of the fiscal year in which the amendments are initially applied, as if the amendments had been applied consistently since the inception of the award.
- c. An entity shall present the cumulative-effect adjustment separately.
- d. Earlier application is permitted. An entity shall apply the pending content that links to this paragraph retrospectively from the beginning of the entity's fiscal year, if both of the following conditions are met:
 1. The entity elects early application.
 2. The period of adoption is not the first reporting period of the entity's fiscal year.
- e. An entity shall provide the disclosures in paragraphs 250-10-50-1 through 50-3 in the period the entity adopts the pending content that links to this paragraph.

5. Amend paragraph 718-10-00-1 as follows:

718-10-00-1 ~~No updates have been made to this subtopic.~~ The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
718-10-25-14A	Added	2010-13	04/16/2010
718-10-55-65	Amended	2010-13	04/16/2010
718-10-65-2	Added	2010-13	04/16/2010

The amendments in this Update were adopted by the unanimous vote of the five members of the Financial Accounting Standards Board:

Robert H. Herz, *Chairman*
Thomas J. Linsmeier
Leslie F. Seidman
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

BC1. The following summarizes the Task Force's conclusions in reaching the conclusions in this Update. It includes the Board's basis for ratifying the Task Force consensus when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information and Conclusions

BC2. The Task Force considered the classification of an employee share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades. Topic 718 provides guidance on the classification of a share-based payment award as either equity or a liability. A share-based payment award that contains a condition that is not a market, performance, or service condition is required to be classified as a liability.

BC3. Under Topic 718, awards of equity share options granted to an employee of an entity's foreign operation that provide a fixed exercise price denominated in (a) the foreign operation's functional currency or (b) the currency in which the employee's pay is denominated should not be considered to contain a condition that is not a market, performance, or service condition. However, GAAP does not specify whether a share-based payment award with an exercise price denominated in the currency of a market in which the underlying equity security trades has a market, performance, or service condition. Diversity in practice has developed regarding the interpretation of whether such an award should be classified as a liability when the exercise price is neither the foreign operation's functional currency nor the currency in which the employee's pay is denominated.

BC4. At the November 19, 2009 EITF meeting, the Task Force reached a consensus-for-exposure on EITF Issue No. 09-J, "Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades." A proposed Accounting Standards Update was issued on December 17, 2009, with a comment period that ended on February 12, 2010. No comments were received from constituents on the proposed Update.

BC5. The Task Force reached a consensus that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should be

considered an equity award assuming all other criteria for equity classification are met. In reaching that conclusion, the Task Force observed that a share-based payment award with an exercise price denominated in the currency of the market in which the underlying security trades is not precluded from equity classification because, in the Task Force's opinion, that condition is similar to the specified acceptable exercise price currencies for awards to employees of an employer's foreign operations provided in paragraph 718-10-25-14. Under paragraph 718-10-25-14, an award of equity share options granted to an employee of an entity's foreign operation that provides for a fixed exercise price denominated either in the foreign operation's functional currency or in the currency in which the employee's pay is denominated should not be considered to contain a condition that is not a market, performance, or service condition.

BC6. The Task Force decided to use the term *substantial portion of* to describe the level of an entity's equity in a market that would meet the qualifications to apply the amendments in this Update. The Task Force believes that this threshold allows an entity to appropriately apply the principle of the amendments in this Update, while limiting potential abuse.

BC7. The Task Force acknowledged that such a provision would result in liability classification if the guidance on indexation for equity-linked financial instruments in Subtopic 815-40, Derivatives and Hedging—Contracts in Entity's Own Equity, was applied. However, the Task Force noted that share-based awards are clearly excluded from the scope of Subtopic 815-40 and that the guidance on accounting for share-based payment awards under Topic 718 is also different in other respects from the accounting for similar financial instruments under other GAAP guidance.

Effective Date and Transition

BC8. The Task Force concluded that the amendments in this Update should be effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2010. The guidance should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings for all outstanding awards as of the beginning of the fiscal year in which the amendments are initially applied. The Task Force believes that this effective date provides an entity with sufficient time to consider whether it wants to make any changes to its compensation programs as a result of the clarification provided in the amendments in this Update.

Benefits and Costs

BC9. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation

decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or quantify the value of improved information in financial statements.

BC10. The Task Force believes that the amendments in this Update will require minimal effort and cost for most entities to gather the necessary data for implementation. The Task Force reached this conclusion because the transition provisions do not require retrospective application. The Task Force also noted that the amendments in this Update improve financial reporting by reducing diversity in practice.

Amendments to the XBRL Taxonomy

There are no proposed amendments to the XBRL taxonomy as a result of the amendments in this Update.