FASB Emerging Issues Task Force

Issue No. 13-D

Title: Determining Whether a Performance Target That Can Be Achieved after the Requisite Service Period Is a Performance Condition or a Condition That Affects the Grant-Date Fair Value of the Awards

Document: Issue Summary No. 1, Supplement No. 1*

Date prepared: August 30, 2013

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Date previously discussed: June 11, 2013

Previously distributed EITF materials: Issue Summary No. 1, dated May 30, 2013

Background

1. At the June 11, 2013 EITF meeting, the Task Force considered the issue of whether a performance target that can be achieved after the requisite service period is a performance condition or a condition that affects the grant-date fair value of the awards ("nonvesting condition"). The Master Glossary defines a *performance condition* as "a condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that relates to both of the following:

a. An employee's rendering service for a specified (either explicitly or implicitly) period of time
b. Achieving a specified performance target that is defined solely by reference to the employer's own operations (or activities).

*** The alternative views presented in this Issue Summary Supplement are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

2. The definition of a performance condition does not specify that the employee must be rendering service when the performance target is achieved. Accordingly, when a performance target can be achieved after the requisite service period ends and there is no forfeiture of the award, stakeholders indicate that there is diversity in practice about whether the performance target should be treated as (a) a performance condition that affects the vesting of an award, (b) a non-vesting condition that affects the grant-date fair value of the award, or (c) a factor that would result in the award being classified as a liability in accordance with paragraph 718-10-25-13.

3. At the June 2013 EITF meeting, the Task Force discussed and acknowledged the merits of the performance condition approach (View A) and the non-vesting condition approach (View B). The Task Force observed that the non-vesting condition approach (View B) would be more consistent with recent tentative decisions reached under International Financial Reporting Standards (IFRS), however, the Task Force also observed that this approach may add additional measurement uncertainty into the grant-date fair value of the awards because the measurement would have to incorporate a prediction about the likelihood of the performance target being achieved, adding complexity to the measurement of the awards.

4. The Task Force directed the FASB staff to perform additional analysis on this Issue in respect of View A and View B. The purpose of this Issue Summary Supplement is to report back with the results of the staff's additional analysis to assist the Task Force in making a decision about its preferred view.

Alternative Views

5. Below is a summary of the Views that are outlined in this paper. Task Force members should also refer to Issue Summary No. 1 for the proponents' and opponents' arguments under View A and View B. The proponents' and opponents' arguments under View C are discussed later in this paper, commencing at paragraph 49.

View A – Performance Condition Approach

Under View A, the performance target for awards within the scope of this Issue is treated as a performance condition that affects vesting. Performance conditions that affect vesting are not reflected in estimating the grant date fair value of the award. Compensation cost is recognized when the achievement of the performance condition is considered "probable," which may be some years after the requisite service period when the recipient is no longer in service or, possibly, never. Any previously recognized compensation cost is reversed if the performance target is not achieved or the requisite service is not rendered.

View B – Non-vesting Condition Approach

Under View B, the performance target for awards within the scope of this Issue is treated as a non-vesting condition and is reflected in estimating the grant date fair value of the award. Compensation cost is recognized over the requisite service period, irrespective of when, if ever, the performance target is satisfied. Any previously recognized compensation cost is reversed only if the requisite service is not rendered.

New View C – "Substantial Coincidence" Approach – <u>New Alternative</u>

Rather than providing determinative guidance such as in View A and View B, View C would provide interpretive guidance on when a performance target that is allowed to be achieved after the requisite service period should be treated as a performance condition. The performance target would qualify as a performance condition when the requisite service period "substantially coincides" with the measurement period of the performance target. Judgment would be required to assess whether the two time periods substantially coincide with one another.

6. The Task Force largely dismissed the liability approach (the old View C in Issue Summary 1) for awards within the scope of this Issue (unless they would otherwise qualify for the liability classification under Topic 718) because that treatment is rarely observed in practice and is conceptually weaker than the other approaches. Accordingly, the staff decided not to carry over the liability approach into this Supplement. Instead, in response to user feedback, the staff replaced the old View C alternative with another approach that will be referred to as the new View C approach.

7. Some Task Force members discussed a modified approach in which a performance target for awards within the scope of this Issue should be treated as a performance condition that affects both the grant-date fair value <u>and</u> the vesting of the award. In other words, the performance target is treated similarly to a market condition but retains certain attributes of the current definition of a performance condition, such as probability-based recognition and reversal treatment. The staff believes that this alternative would require a reconsideration of the accounting treatment for vesting conditions and, therefore, does not fall within the scope of this Issue.

Staff Analysis and Outreach

8. The Task Force directed the FASB staff to perform additional analysis on this Issue in respect of View A and View B to assist the Task Force in making its decision. The Task Force requested that this analysis include the following:

- ***User Feedback:*** Obtain and report on feedback from users as to their preferred approach
- ***Retirement-Eligible Employees:*** Analyze how the approaches would affect awards issued to retirement-eligible employees and other employees
- ***Measurement Complexities:*** Analyze the measurement complexities under the approaches
- ***Comparison to IFRS:*** Comparison of the performance condition approach and the non-vesting condition approach to IFRS 2, *Share-based Payments*
- ***Variations of Performance Targets:*** Consideration of other types of performance targets that may be relevant to awards in the scope of this Issue.

User Feedback

9. The staff sought feedback from the 13 members of the FASB's Investors Advisory Committee and sent 28 unsolicited requests for feedback to company stock analysts. A further five requests were sent to individual contacts of the FASB's investor liaison staff. The staff was

aware at the outset that it is often difficult to obtain feedback from investors on a narrow scope accounting topic, such as this Issue.

10. There were 10 responses received to all requests. The staff would, however, like to draw the Task Force's attention to the fact that the quality of those responses was particularly high and, therefore, believes that they may provide the Task Force with adequate user input to enable it to reach a decision. While respondents were asked to give an answer of either View A or View B, many respondents indicated an ultimate preference for variations of those two views.

Comments received in support of View A

11. Given a choice between View A and View B, some respondents prefer View A for two primary reasons. The first reason cited by these users is that the "quality" of the expense under View B is lower. That is, ratably allocating amounts under View B that may never result in either a cash flow or a share issuance would not reflect the underlying economics. This is not to say that all non-cash expenses are of poor quality. Depreciation, for example, occurs to a physical asset and is reflective of its natural state. Impairment charges for tangible or intangible assets also reflect a diminution in the value of an acquired asset. Respondents commented that View B would create a share-based payment expense that would not reverse or be "trued-up" to reflect the actual awards that are settled. In other words, it is an expense that either over- or under-states the income statement for the actual number of awards that vest to the recipient. Accordingly, some respondents believe that View B results in a lower quality expense and would prefer the accounting under View A for those reasons.

12. The second reason for supporting View A is the greater uncertainty in the measurement of the awards under View B. That is, the item that is measured is much more uncertain under View B than under View A, which reduces the overall quality of the information. Three key attributes of measurement uncertainty were brought up by users. The first is the "nature" of the performance target. One respondent commented that a financial-based performance target, such as EBITDA, is easier to predict the likelihood than a regulatory approval target. This may be because financial-based performance targets give rise to binary outcomes; that is, the target is either achieved or not. Whereas a regulatory approval target could be conditionally approved,

subject-to-final-approval, in-advance stage of approval, and so forth. The second attribute that respondents emphasized is the difficulty predicting the "timing" of when the performance target will be achieved. In general, the longer the measurement period of the performance target, the greater the measurement uncertainty at grant-date. The third attribute that respondents commented on was the entity's ability to "control" the outcome of the target. Some respondents believe that financial-based performance targets are more within the entity's control than, say, the regulatory approval target, which is subject to third-party approval. View B, in effect requires entities to make a once-only prediction about these attributes and uses that prediction in the grant-date fair value of the awards. Accordingly, some respondents prefer the probability-based recognition under View A, which is required each reporting period.

13. When queried that the core principle of stock compensation is that an entity should recognize employee services when they are received, some users explained that it is not helpful to their analysis to have a pattern of expense under View B that is based on a conceptual principle and would prefer the pattern of expense to reflect subsequent changes in the estimated and actual number of awards that vest. One respondent explained that View A would bring greater volatility to the income statement; however, that volatility reflects the actual outcome of achieving the performance target. In other words, it is more closely aligned with the economics of the transaction itself and the awards that are transferred to the employee. Further, that user explained that analysts are able to handle volatility in their models provided there is adequate disclosure.

Comments received in support of View B

14. Given a choice between View A and View B, some users prefer View B because they believe that the grant date fair value should reflect how an efficient market would price this type of transaction and the perceived value on the grant date. One respondent explained that in reaching that view, they thought of stock-based compensation as effectively two cash transactions collapsed into one non-cash transaction. That is, rather than grant stock directly to the employee, the company could have issued stock in the market and used the money from the market sale to pay the employee in cash. If the company offered stock options with performance targets in the market and required that those options could only be exercised if the company hit

the performance target, the market price of the option with the performance target would be lower in comparison to an option without the performance target. Some users believe that the instrument is inherently less valuable because of the existence of the performance target. In an efficient market, price-discovery would mean that the issue price would assume some probability of the performance target being met.

15. Other users also prefer View B because they believe that it reflects the "economic interest" that is transferred to the recipient once the requisite service period is completed. Those with this view believe that View A is the lower quality outcome by treating the performance target as a vesting condition when the employee does not have to remain in service to receive the compensation. In other words, the economic interest in the award "vests" to the employee once the service condition is completed. The grant-date measurement of the award should reflect the probability of achieving the performance target. Some respondents believe that View B better reflects when an employee becomes entitled to the economic interest in an award.

16. Some respondents believe that View B is the preferred outcome because management's discretion in applying probability-based recognition under View A can lead to earnings manipulation. In both the IPO and regulatory approval examples, no expense occurs under View A during the service period, which makes the operating profit appear better than it otherwise would. View B would result in the share-based payment expense being attributed to the period in which the service was rendered. The staff recognizes that the probability-based recognition under View A exists in normal stock compensation awards and, therefore, the concern raised by respondents about the potential for earnings manipulation exists outside of this Issue.

Comments received for a modified approach

17. Many respondents commented on the limitations of both approaches. For example, no share-based payment expense is recognized under View A for the IPO or regulatory approval examples during the service period, whereas too much expense is recognized under View B if the performance target is not achieved. The staff received several comments that a better approach is a modified View B approach that recognizes the expense over the requisite service period. After the service period is completed, the grant-date fair value of the awards is not re-measured;

however, adjustments occur to recognize changes in the estimated and actual likelihood of achieving the performance target and the number of awards that vest to the employee. Respondents indicated that the advantages of a modified approach are that it reflects the economic value that the entity receives in employee services and that it will also reflect whether the cash flow or share issuance actually occurs.

18. The staff appreciates that a modified approach appears to have the advantages of both View A and View B. This Issue concerns whether an award that has a performance target that can be achieved after the requisite service period should be treated as a *performance condition* or as a non-vesting condition. A modified approach does not resolve the diversity in practice as to whether these awards meet the technical definitions of performance, market, and service conditions. Further, the staff is not aware of a conceptual basis for why only awards within the scope of this Issue should be permitted to apply a modified approach and has concern that such an exception would add complexity to stock compensation accounting. Accordingly, the staff has not introduced the modified approach as an alternative for this Issue and does not recommend the Task Force consider a modified approach as a viable option.

The staff's response to user feedback

19. The staff interprets the diversity in users' views to reflect an uneasiness in the binary outcome that occurs between View A and View B. That is, the performance target is treated as either a performance condition that affects vesting or is treated as a non-vesting condition. That reflects the tension between when the economic interest in the award vests and when the actual vesting of the award occurs. The staff believes that interpretive guidance could be provided to respond to this tension and, therefore, has presented a third option for Task Force consideration (View C). This guidance is based on a principle that a performance target should be treated as a performance condition when the requisite service period "substantially coincides" with the measurement period of the performance target. When the two time periods substantially coincide, the difference between when the economic interest in the award vests and when the vesting occurs would not be economically significant. The staff believes that this guidance would partially address the uneasiness in the binary outcomes that occur between View A and View B.

Retirement-Eligible Employees

20. The Task Force requested that the staff analyze how View A and View B would affect awards issued to retirement-eligible employees and to employees who become retirement-eligible during the measurement period of the performance target. It was noted by some Task Force members that this Issue was first raised in respect of retirement-eligible employees in 2005 by the Resource Group on FASB Statement No. 123 (revised 2004), *Share-Based Payment*, and no conclusion was reached at that time. The staff has reviewed the working papers and memorandums from the Resource Group as part of this analysis.

21. It is common in share-based payment plans that an employee can retire after the grant date and is entitled to receive the same awards as if they had remained in service. In those cases, when an entity grants an award to a retirement-eligible employee that contains a performance target, the recipient does not need to be rendering service when the performance target is achieved in order for that individual to earn the award. That issue also arises when an employee becomes retirement-eligible during the period. In those cases, the employee is required to complete a period of service until that individual becomes retirement-eligible, say on their 65th birthday, and will not be required to provide service thereafter.

22. The example in paragraph 718-10-55-88 titled "Example 1: Estimating the Requisite Service Period," states that if an employee is eligible to retire at the grant date, the award's explicit service condition is nonsubstantive. Consequently, the example concludes that the entity has granted "*an award that does not contain a performance condition* or service condition *for vesting*, that is, the award is effectively vested, and thus, the award's entire fair value should be recognized as compensation cost on the grant date" (emphasis added).

23. Some believe that this guidance determines the treatment of the performance target as a non-vesting condition consistent with View B. The staff notes, however, that this example illustrates how to estimate the requisite service period, as indicated in the title, rather than how to determine whether the performance target is a performance or non-vesting condition. Further, the example does not illustrate how entities should treat the performance target when the employee becomes

retirement-eligible during the period. In that latter case, the service condition could be substantive.

24. This guidance illustrates that the requisite service period typically will be either (a) immediately on the grant-date for retirement-eligible employees or (b) the period of time from the grant-date to the date that the employee is eligible to retire.

Analysis of approaches to retirement-eligible employees

25. Assume the following example occurs under all approaches. An EPS growth target is measured over 3 calendar years from January 20X1 to December 20X3, and the employee's 65th birthday occurs on February 1, 20X1, which is when the recipient becomes retirement-eligible and becomes entitled to receive the same awards as if they remain in service.

26. Under View A, the terms of the award (a) contain a specified period of service and (b) require the achievement of a specified performance target that is defined solely by reference to the employer's own operations. There is no requirement under View A that the requisite service period be at least as long as the measurement period of the performance target. In the above example, the performance target would be treated as a performance condition.

27. Under View B, both elements (a) and (b) from the definition of a performance condition exist. When the terms allow for the performance target to be achieved after the requisite service period, the performance target, under View B, would be treated as a condition that affects the grant date fair value of the awards. In the above example, the performance target would be treated as a non-vesting condition.

28. Under View C, both elements (a) and (b) from the definition of a performance condition exist. The measurement period of the performance target would need to be evaluated to assess whether it substantially coincides with the requisite service period. In the above example, the employee becomes retirement-eligible shortly after the grant date (February 20X1) but well before the end of the measurement date (December 20X3). The two time periods do not substantially coincide and, therefore, the performance target would be treated as a nonvesting

condition consistent with View B. If the above example were modified such that the employee becomes retirement-eligible in November 20X3, one month before the end of the measurement date, the entity could conclude that the performance target is a performance condition.

29. The staff recognizes that the current wording in paragraph 718-10-55-88 conflicts with the accounting outcomes under View A and View C and is also unnecessary and redundant in the accounting outcome under View B. Therefore, the staff recommends that the paragraph is amended as follows regardless of the view selected (deletions are ~~struck through~~):

> **718-10-55-88** Because the employee is eligible to retire at the grant date, the award's explicit service condition is nonsubstantive. Consequently, Entity A has granted an award that does not contain a ~~performance condition or~~ service condition for vesting, that is, the award is effectively vested, and thus, the award's entire fair value should be recognized as compensation cost on the grant date. All of the terms of a share-based payment award and other relevant facts and circumstances must be analyzed when determining the requisite service period

30. The staff does not believe that any other amendments would be needed to U.S GAAP in respect of View A, View B, or View C for retirement-eligible employees.

Measurement Complexities

31. The Task Force asked the staff to provide an analysis of the measurement complexities that arise under both View A and View B. Some Task Force members believe that View B would result in greater complexity to the measurement of awards and therefore expressed initial support for View A for that reason.

Measurement complexity – View A

32. As part of the due diligence process leading up to the issuance of Statement 123(R), respondents to the Invitation to Comment as well as members of the Option Valuation Group indicated that calculating a grant-date fair value for awards with performance targets would be considerably more difficult to measure than awards with market conditions, should performance targets be required to be incorporated into the grant-date fair value.

33. The Board's basis for conclusions in paragraph B176 of Statement 123(R) indicate that the effects of performance targets in calculating the grant-date fair value were generally not considered measureable with sufficient reliability for financial reporting purposes. Developing probability distributions that reflect the likelihood of achieving the performance target was, in most cases, not considered reliable due to the limited data on which to base that information. That conclusion supports the rationale for the measurement approach under View A for awards in the scope of this Issue.

34. Vesting conditions, which includes most performance conditions, are ignored when calculating the grant-date fair value. Instead, the outcome of vesting conditions reflects the ultimate amount of the compensation cost that is recognized. That is, the expense reflects the number of awards that are settled or transferred to the employee. That simpler measurement approach may explain why some preparers and investors are more comfortable with View A.

Measurement complexity – View B

35. Under View B, the performance target is reflected in the calculation of the grant-date fair value. Topic 718 does not specify a preference for one particular valuation technique or model for calculating grant-date fair values, however, certain valuation models, such as lattice models, have been developed to value path-dependent options and awards with complex terms, for example, market conditions. The staff understands that those types of models are currently used in practice to value awards that are within the scope of this Issue and are able to accommodate dynamic assumptions that would be required under View B. Therefore, the Board's conclusion in paragraph B176 may not necessarily support how practice has developed over time. The staff is not suggesting that all awards with performance targets should reflect that target in the grant-date fair value; rather, the staff understands that awards within the scope of this Issue could be measured with sufficient reliability for financial reporting purposes and understands that some awards are currently measured this way in practice.

36. The staff believes that the measurement complexity that was discussed and identified by Task Force members under View B may, in fact, reflect the uneasiness they may have about preparers developing a once-only prediction of those attributes that are inherent in a performance

target. The staff notes that this concern was also raised by some outreach respondents. Some respondents noted that certain attributes of a performance target are inherently difficult to predict, such as its "nature," its potential "timing," and the entity's ability to "control" the outcome and contribute to the uncertainty in calculating the grant-date fair value. Those attributes form the basis of the inputs that are used in, say, a lattice model to make a one-time prediction at the grant-date of the likelihood of achieving the performance target.

37. The staff also notes that a further aspect of measurement complexity that arises under View B results from the reporting system changes and internal processes that are needed. That is, entities would need to develop internal processes to assess at the grant date whether the recipient is retirement-eligible or will become retirement-eligible. Multiple valuations may be required because some employees may be retirement-eligible, whereas others are not. Reporting system changes may be necessary to "ring fence" the compensation cost for employee groups that apply View B from the compensation cost for conventional employee groups. That is because, unlike View A, there are no subsequent adjustments under View B to reflect changes in the estimated or actual likelihood of achieving the performance target.

Measurement complexity – View C

38. The same measurement complexity aspects discussed above in respect of both View A and View B are relevant under View C. One further aspect of complexity that arises under View C is the need to develop an additional internal process to assess whether there is substantial coincidence between the measurement period of the performance target and the requisite service period for each grant.

Comparison to IFRS

39. As part of the 2010-2012 IFRS Annual Improvements Cycle, the IASB's Exposure Draft clarified the definition of vesting conditions by separately defining performance condition within Appendix A of IFRS 2. The proposed definition states that "the period of the performance target(s) shall not extend beyond the end of the service period but it may start before the service period on the condition that the period of the performance target substantially coincides with the service period."

40. It is noted that View A and the IFRS 2 proposals are not consistent in any of the aspects analyzed. Accordingly, the staff does not consider it necessary to bring any single aspect of this comparative analysis to the Task Force's attention for further discussion. The View A approach would diverge from IFRS.

41. It is observed that, on the whole, View B and View C are more consistent with the IFRS 2 proposals; however, there could be different outcomes between those views and IFRS 2 if the measurement period of the performance target commences before the service inception or if the measurement period of the performance target is longer than the requisite service period.

42. In some cases, the measurement period of the performance target will commence before the service inception date. For example, an EPS growth target may be measured over three calendar years from January 20X1 to December 20X3, and an employee may be granted awards and commence service in March of 20X1. The staff was aware of practice concerns relating to this aspect of a share-based payment arrangement; however, it was not the area in which guidance was being sought from the Task Force and, therefore, was not discussed in detail in Supplement. It is noted, however, that the proposed amendments to IFRS 2 provide that "the measurement period of the performance target can start before the service period on the condition that the period of the performance target substantially coincides with the service period."

43. Unlike the proposed amendments to IFRS 2, View B is silent on situations in which the measurement period of the performance target covers a period of time before the employee commences service. View B determines that in all cases in which the performance target is longer than the requisite service period, the performance target should be treated as a non-vesting condition. Therefore, it is the end of the performance target that determines the accounting treatment, rather than its beginning.

44. Unlike IFRS 2, View C does not preclude the measurement period extending beyond the requisite service period, but rather provides a principle about whether the entire measurement period, from beginning to end, substantially coincides with the service period. The staff

recognizes a difference between View C and IFRS 2. In some cases under View C, the measurement period of the performance target could be longer than the requisite service period and the performance target could be treated as a performance condition. However, the two time periods must substantially coincide for this treatment to apply. Conversely, View C is comparable to the IFRS 2 proposals with respect to the beginning of the performance target for which IFRS 2 also require that the dates substantially coincide.

45. In summary, while View B and View C would be more converged with the recent proposals to IFRS 2 than View A, there are still important differences.

Variations of Performance Targets

46. The Task Force asked the staff to consider other types of performance targets that may be in the scope of this Issue. Some Task Force members indicated that the Agenda Request and Issue Summary No. 1 focused predominately on one type of performance target, that being the completion of an initial public offering. The Task Force asked the staff to consider other examples that illustrate different types of performance targets because that would enable the Task Force to consider the wider relevance of this Issue.

47. In Appendix 13-DC, the staff has prepared two additional illustrations and has reformatted the examples from Issue Summary No 1. The first additional illustration assumes a regulatory approval performance target with no future service period and the second illustration is a comprehensive example that assumes an EBITDA performance target.

Proponents and opponents arguments for the Substantial Coincidence Approach

48. This Supplement introduces for the first time the new View C for which the proponent and opponent arguments are explored below. Under View C, the measurement period of the performance target must substantially coincide with the requisite service period in order for the performance target to be treated as a performance condition that affects vesting.

49. Proponents of View C observe that this approach would help entities interpret the definition of a performance condition, rather than developing a "bright-line" as to how to account for

awards within the scope of this Issue. Preparers would use judgment to form their own conclusions based on the relevant facts and circumstances.

50. Proponents believe that the principle of substantial coincidence would provide interpretive guidance that would address the primary area in which guidance is being sought and that View C is a better reflection of the service condition that often arises when an employee becomes eligible to retire during the measurement period. For example, an EPS growth target may be measured over 3 calendar years from January 20X1 to December 20X3 and the employee's 65th birthday occurs on November 30, 20X3 (1 month before the performance-target end date), which is when the recipient becomes retirement-eligible. In such cases, preparers may conclude that the employee's requisite service period of January 20X1 to November 20X3 would substantially coincide with the measurement period of the performance target and, therefore, would treat the performance target as a performance condition.

51. Opponents of View C believe that without greater clarity of the meaning of "substantial coincidence" and when the length of the requisite service period covers "substantially all" of the measurement period of the performance target, the diversity in practice for awards that are in the scope of this Issue will not be eliminated. That is, judgment will be entity-specific and may not be comparable across reporting entities. Those with this view believe that View A and View B would provide greater certainty, which would reduce diversity.

52. Opponents of View C note that this approach is not converged with the proposed changes in IFRS for awards within the scope of this Issue. That is, in some circumstances under View C, the performance target can be achieved after the requisite service period and be treated as a performance condition.

53. Opponents of View C also observe that this approach would necessitate that entities evaluate at each grant date whether there is substantial coincidence based on the terms of the award and whether the recipient would become retirement-eligible during the service period. Similar to View B, this would require additional administration and valuations when accounting for share-based payments.

Question 1 for the Task Force: Based on the additional analysis provided and the arguments outlined in Issue Summary No. 1, which alternative does the Task Force prefer: View A, View B, or View C?

Question 2 for the Task Force: Depending on the view selected, does the Task Force agree with the staff's proposed amendments to the Codification in Appendix 13-DA?

Recurring Disclosures

54. During the staff's outreach, several respondents suggested that additional disclosures are required. One user commented that the primary limitation with View A is the lack of transparency in the disclosures and recommended that the Task Force consider requiring enhanced disclosures to enable users to understand the impact of the accounting. Examples cited by that respondent include probabilities of achievement, cash flow implications, timing of the performance target and the maximum exposure to the entity.

55. A second respondent also commented that, regardless of whether View A or View B is chosen by the Task Force, full disclosure of all assumptions should be provided. Examples cited by that respondent included disclosure of the range of probabilities of achievement and a reconciliation between the beginning and ending balance of the unrecognized compensation cost.

56. The staff appreciates the respondents' views calling for enhanced disclosures for awards that contain performance targets. The staff observes, however, that there are already extensive disclosures required in Topic 718 on stock compensation. For example, paragraph 718-10-50-1 requires information on the nature of the share-based payment arrangements and the potential effects of those arrangements on shareholders. Accordingly, the staff does not recommend that additional amendments are made to require enhanced disclosures. That said, the staff acknowledges that the current disclosures on unrecognized compensation cost could be further disaggregated such that the information is separately disclosed for the types of awards within the scope of this Issue. However, since such disaggregation is not required for certain other

variations of awards with performance or market conditions, the staff does not believe there is a compelling reason to require any additional disclosures under any of the alternative views.

Question 3 for the Task Force: Does the Task Force agree with the staff's recommendation not to require additional disclosures for awards that fall within the scope of this Issue?

Transition

57. The FASB staff recommends a prospective transition approach. The guidance would be applied only to awards that are granted or modified on or after the effective date with early adoption permitted. The FASB staff does not recommend a retrospective transition approach for the following reasons:

a. The costs and complexity of applying the guidance on a retrospective basis may be significant for entities that are required to change their accounting policies. Those entities would be required to estimate a new grant-date fair value of their awards (and they may have many different awards with different grant dates). The costs may include external consultants.
b. If the Task Force were to select a retrospective transition approach, it may be necessary to provide entities with various reliefs to make the transition approach operational. Reliefs necessary to make the transition approach operational may reduce the benefits of such information.

58. The guidance on other presentation matters in Subtopic 250-10, Accounting Changes and Error Corrections—Overall, is applicable for any voluntary change in accounting principle, including a change in the method of applying an accounting principle. The FASB staff recommends that the Task Force should require companies to apply the disclosure requirements in Section 250-10-50 for an accounting change required by this Issue. Additionally, the FASB staff recommends that the Task Force not require any additional transition disclosures other than the requirements in paragraphs 250-10-50-1 through 50-3.

Question 4 for the Task Force: Does the Task Force agree with a prospective transition approach that would apply only to awards that are granted or modified on or after the effective date, with early adoption permitted?

Question 5 for the Task Force: Does the Task Force agree with the staff's recommendation not to require transition disclosures other than those required in paragraphs 250-10-50-1 through 50-3?

APPENDIX 13-D(A) - Potential Amendments

The potential amendments under View A, View B, and View C are presented below (additions are <u>underlined</u> and deletions are ~~struck through~~):

<u>View A – Performance Condition Approach</u>

718-10-30 Initial Measurement

> Market, Performance, and Service Conditions

718-10-30-28 <u>The terms of a share-based payment arrangement that allow a performance target to be achieved after the requisite service period, shall be treated as a performance condition that affects vesting</u>

<u>View B – Non Vesting Condition Approach</u>

718-10-30 Initial Measurement

> > Market, Performance, and Service Conditions that Affect Factors Other than Vesting or Exercisability

30-16 <u>The terms of a share-based payment arrangement that allow a performance target to be achieved after the requisite service period, shall be treated as a condition that affects the grant date fair value of the awards</u>.

<u>View C – Substantial Coincidence Approach</u>

718-10-30 Initial Measurement

> Market, Performance, and Service Conditions

<u>**718-10-30-28** The measurement period of the performance target may not be coterminous with the requisite service period. In such cases, the measurement period of a performance target must substantially coincide with the requisite service period in order for the performance target to be treated as a performance condition that affects vesting. That is, the length of the requisite service period must cover substantially all of the measurement period of the performance target.</u>

<u>All Views (A, B and C)</u>

718-10-55 Implementation Guidance and Illustrations

718-10-55-88 Because the employee is eligible to retire at the grant date, the award's explicit service condition is nonsubstantive. Consequently, Entity A has granted an award that does not contain a ~~performance condition or~~ service condition for vesting, that is, the award is effectively vested, and thus, the award's entire fair value should be recognized as compensation cost on the grant date. All of the terms of a share-based payment award and other relevant facts and circumstances must be analyzed when determining the requisite service period.

APPENDIX 13-D(B) - Comparison of Views A, B and C and IFRS 2

This table compares the different accounting outcomes that arise under each approach.

	View A – Performance condition approach	View B – Non-vesting condition approach	View C – Substantial coincidence approach	IFRS 2
Required accounting treatment when a performance target can be achieved after the requisite service period (Assuming the service period is satisfied)	Under the proposed View A amendments, when the measurement period of the performance target is longer than the requisite service period, the performance target should be treated as a performance condition that affects vesting. Performance conditions that affect vesting are ignored when calculating the grant-date fair value of the award.	Under the proposed View B amendments, when the measurement period of the performance target is longer than the requisite service period, the performance target is treated as a non-vesting condition and is reflected within the grant-date fair value of the award.	Under the proposed View C amendments, when the measurement period of the performance target substantially coincides with the requisite service period, the performance target should be treated as a performance condition. That is, the length of the requisite service period must cover substantially all of the measurement period of the performance target in order to be treated as a performance condition. If the two time periods do not substantially coincide, the performance target should be treated as a non-vesting condition.	Under IFRS 2, when the measurement period of the performance target is longer than the requisite service period, the performance target is treated as a non-vesting condition and is reflected within the grant-date fair value of the award.

	View A – Performance condition approach	View B – Non-vesting condition approach	View C – Substantial coincidence approach	IFRS 2
Attribution period of the compensation cost When the compensation cost is recognized in the profit or loss for awards that are in the scope of this Issue.	Under View A, the performance target is treated as a performance condition that affects vesting. Compensation cost is recognized over the vesting period when the achievement of the performance condition is considered "probable," which may be some years after the requisite service period when the recipient is no longer in service or, possibly, never.	Under View B, the performance target is treated as a non-vesting condition that is reflected within the grant-date fair value. Therefore, the target is not a vesting condition. The compensation cost is recognized over the requisite service period, being the period that the entity receives the employee services.	Under View C, depending on whether the measurement period of the performance target substantially coincides with the requisite service period, the performance target may be treated as a performance condition that affects vesting or it may be treated as a non-vesting condition. Under the performance condition approach, the compensation cost will be recognized over the vesting period when the achievement of the performance condition is considered "probable," which may be some years after the requisite service period. Alternatively, under the non-vesting condition approach, the compensation cost will be recognized over the requisite service period.	Under the IFRS 2 proposals, the performance target is treated as a non-vesting condition that is reflected within the grant-date fair value. Therefore, the target is not a vesting condition. The compensation cost is recognized over the requisite service period, being the period that the entity receives the employee services.

	View A – Performance condition approach	View B – Non-vesting condition approach	View C – Substantial coincidence approach	IFRS 2
Reversal treatment of the compensation cost When the compensation cost can be reversed, if ever, for awards that are in the scope of this Issue.	Under View A, the performance target is treated as a performance condition that affects vesting. The final measure of compensation cost recognized in the profit or loss is based on the actual outcome that is satisfied and the number of awards that vest. Any previously recognized compensation cost is reversed if the performance condition is not achieved.	Under View B, the performance target is treated as a non-vesting condition. No previously recognized compensation cost should be reversed once the requisite service is completed irrespective of the actual outcome of the performance target.	Under View C, depending on whether the measurement period of the performance target substantially coincides with the requisite service period, the performance target may be treated as a performance condition that affects vesting or it may be treated as a non-vesting condition. Under the performance condition approach, any previously recognized compensation cost will be reversed if the performance condition is not achieved. Alternatively, under the non-vesting condition approach, any previously recognized compensation cost will not be reversed once the requisite service is completed, irrespective of the actual outcome of the performance target.	Under the IFRS 2 proposals, the performance target is treated as a non vesting condition. No previously recognized compensation cost should be reversed once the requisite service is completed irrespective of the actual outcome of the performance target.

APPENDIX 13-D(C): Illustrative examples

Example 1 – IPO condition

- Performance target = IPO completing
- Measurement period of the performance target = 10 years
- Requisite service period = 3 years

Fact Pattern

The Company grants Restricted Stock Units (RSUs) to employees that include a three-year service condition. In addition, the RSUs will be settled only in shares if the Company completes an IPO within 10 years of the grant date. If there is no IPO by that date, then the RSUs will expire worthless. However, once the 3-year service condition has been met, employees may terminate service and will receive the underlying shares if the IPO occurs within the 10-year period. There are no expected or actual forfeitures during the service period and the IPO occurs in Year 8. The grant-date fair value of the awards is $100 million under View A and $70 million under View B.

		Income Statement Recognition					
	Measure-ment date	Service Period				Outcome of the performance target	Total amount recognized in the P&L
Different Views[1]	Grant- date fair value of awards issued	Year 1	Year 2	Year 3	Years 4-7	Year 8 Incremental/ (Reversal)	Cumulative stock comp expense
View A – Performance condition	$100m[2]	0[3]	0	0	0	$100m[4]	$100m
View B – Non vesting condition	$70m	$23.3m[5]	$23.3m	$23.3m	0	0[6]	$70m

[1] View C is intentionally not illustrated in this Example.

[2] The Grant-date fair value of the awards is $30million lower under View B, because the performance target has been treated as a post-vesting restriction and is reflected within the calculation of the $70m. Under View A, the effect of the performance target has been ignored when calculating the $100m.

[3]Under View A, no compensation cost is recognized during the 3-year service period because the IPO is not deemed probable.

[4] In Year 8, the period that includes the IPO, the Company would recognize compensation cost equal to the entire amount of the grant-date fair value of $100 million. If the IPO does not occur by Year 10, then no compensation cost would be recognized under View A.

[5] The $70m grant-date fair value is recognized ratably over the 3-year service period.

[6] In Year 8 when the IPO occurs, no incremental compensation cost is recognized. If the IPO does not occur by Year 10, then the compensation cost in Years 1 to 3 would not be reversed or adjusted.

Example 2 – Regulatory approval of an experimental drug therapy that is not achieved

- Performance target = Regulatory approval of a drug therapy
- Measurement period of the performance target = 10 years
- Requisite service period = No future service required

Fact Pattern

The Company grants RSUs to certain senior management executives. The RSUs have no future service condition and will only be settled in shares if the Company receives regulatory approval for a specific experimental drug therapy within 10 years of the grant date. The requirements to obtain regulatory approval include various work programs including successful phase-one and phase-two clinical trials during the 10 years. The employees may terminate service at any time and would receive the underlying RSUs if the regulatory approval occurs within the 10-year period.

Each reporting period, the company considers the probability of achieving the regulatory approval. The regulatory approval does not occur and the RSUs expire worthless. Similar to Example 1, the grant-date fair value of the awards is $100 million under View A and $70 million under View B.

		Income Statement Recognition				
	Measure-ment date	**No future service required**			**End of the performance target**	**Total amount recognized in the P&L**
Different Views[7]	**Grant- date fair value of awards issued**	**Grant date**	**Year 1**	**Years 2 -9**	**Year 10 Incremental/ (Reversal)**	**Cumulative stock comp expense**
View A – Performance condition	$100m[8]	0	0[9]	0	0[10]	$0m
View B – Non vesting condition	$70m	$70m[11]	0	0	0[12]	$70m

[7] View C is intentionally not illustrated in this Example.

[8] The Grant-date fair value of the awards is $30million lower under View B, because the performance target has been treated as a post-vesting restriction and is reflected within the calculation of the $70m. Under View A, the effect of the performance target has been ignored when calculating the $100m.

[9] No compensation cost is recognized under View A because the regulatory approval is not deemed probable.

[10] In Year 10, the awards expire worthless and no compensation cost is recognized because the company never receives regulatory approval for its drug therapy.

[11] The award's entire fair value should be recognized as compensation cost on the grant date because there is no future service required.

[12] In Year 10 when the RSUs expire, no reversal of the compensation cost is recognized under View B.

<u>Example 3 – Awards granted to retirement-eligible employees</u>

- Performance target = EBITDA target
- Measurement period of the performance target = 3 years
- Requisite service period = Different service periods depending on employee type:
  - No future service required from employees eligible to retire on the grant date;
  - Two years of service required from employees that become retirement eligible in two years;

<u>Fact pattern</u>
The Company grants 100,000 RSUs each to four employees that include a 3-year service condition and a performance target about the Company's EBITDA at the end of Year 3. If the EBITDA target is not achieved, then the RSUs will expire worthless. However, if a maximum EBITDA threshold is achieved, each employee will receive 150,000 RSUs. Under View A, the grant-date fair value of an RSU is $10 per RSU (View B: $7 per RSU). The grant-date fair value is $3 lower per RSU under View B because the performance target has been treated as a post-vesting restriction and is reflected within the calculation of the $7.

Under the terms of the plan, employees who become eligible to retire during the three-year service period are entitled to receive the same awards they would have earned as if they had remained employed throughout the three-year period. Two of the four employees who received awards are retirement-eligible at the grant date ("immediately retirement-eligible"), therefore forfeitures are not possible and there is no future service condition. The remaining two employees will become retirement eligible two years after the grant date; accordingly, those two employees must provide two years of service. There are no expected or actual forfeitures during their two year service period.

Each reporting period, the company considers the probability of achieving the EBITDA target. The best estimate is that EBITDA target will be achieved. The actual outcome in Year 3 is that the EBITDA levels exceed the maximum threshold; therefore, all four employees receive 150,000 awards each.

The accounting impact of both View A and View B is illustrated in the table below. View C is intentionally not illustrated in this Example.

		Income Statement Recognition				
	Measure-ment date	Service Period			End of the performance target	Total amount recognized in the P&L
Employee Group	Estimated Grant-date fair value of the awards	Grant date	Year 1	Year 2	Year 3 Incremental/ (Reversal)	Cumulative stock comp expense
View A – Performance Condition						
Immediately retirement-eligible	$2m[13]	$2m[14]	0	0	$1m[15]	$3m
Retirement eligible in 2 years	$2m	0	$1m[16]	$1m	$1m	$3m
Total		**$2m**	**$1m**	**$1m**	**$2m**	**$6m**
View B – Non vesting Condition						
Immediately retirement-eligible	$1.4m[17]	$1.4m[18]	0	0	0[19]	$1.4m
Retirement eligible in 2 years	$1.4m	0	$0.7m[20]	$0.7m	0	$1.4m
Total		**$1.4m**	**$0.7m**	**$0.7m**		**$2.8m**

[13] For both the immediately retirement-eligible employees and those who are retirement eligible in Year 2, the Company estimates a grant-date fair value for the compensation cost of $2 million (100,000 awards × 2 employees × $10) for each group under View A.

[14] The Company recognizes the full compensation cost of $2 million on the grant date for the immediately retirement-eligible employees because there is no future service required and the achievement of the target is deemed probable.

[15] In Year 3, the final outcome is that the maximum level of EBITDA is achieved, and the Company recognizes incremental compensation cost for the 150,000 RSUs that actually vest under View A of $1 million in Year 3 (150,000 awards × 2 employees × $10, less the $2 million recognized previously).

[16] For the two employees who become retirement-eligible, the $2m grant-date fair value is recognized ratably over the 2-year service period. The Company recognizes compensation cost in Year 1 of $1million and $1million in Year 2.

[17] For both the immediately retirement-eligible employees and those who are retirement eligible in Year 2, the Company estimates a grant-date fair value for the compensation cost of $1.4million (100,000 awards x 2 employees x $7) for each group under View B.

[18] For the two immediately retirement-eligible employees, the Company recognizes the full compensation cost of $1.4m the grant date because there is no future service required.

[19] In Year 3 the final outcome of the performance target is that the maximum level of EBITDA is achieved. However, under View B there would be no adjustment to the amount of compensation cost for differences between the expected (100,000) and actual (150,000) payout of the awards.

[20] For the two employees who become retirement eligible, the $1.4m grant-date fair value is recognized ratably over the 2-year service period.

<u>Example 4 – Comprehensive Example</u>

- Performance target = EBITDA growth rate
- Measurement period of the performance target = 3 years
- Requisite service period = Different service periods depending on employee type

<u>Fact pattern</u>
The Company grants RSUs to ten employees that include a 3-year service condition and a performance target about the Company's EBITDA growth rate. The performance target is measured over a period from January 1, 20X1 to December 31, 20X3. The awards are equity classified. The terms of the plan provide for a "minimum" EBITDA growth rate to receive 70 percent of the awards, a "targeted" EBITDA growth rate to receive 100 percent of the awards, and a "maximum" EBITDA growth rate to receive 150 percent of the awards. Under the terms of the plan, employees who become eligible to retire by reaching the normal retirement age of 65 during the 3-year service period are entitled to receive the same awards they would have earned as if they had remained employed throughout the 3-year period.

The profile of the 10 employees is as follows:

- Two employees granted awards on January 1, 20X1, are retirement-eligible ("immediately retirement-eligible"). Therefore, forfeitures are not possible for these employees and there is no future service condition.
- One employee granted awards on January 1, 20X1, will become retirement eligible in two years. That employee must provide two years of service. The awards will forfeit if the employee does not complete the service.
- One employee granted awards on January 1, 20X1, will become retirement eligible on November 30, 20X3. That employee must provide two years and 11 months of service.
- Six employees were granted awards on January 1, 20X1, and must complete the full service period ("conventional employees"). The awards will forfeit if the employee ceases to be employed during the 3-year service period.

There are no expected or actual forfeitures during the relevant service periods.

Grant-date fair value per RSU
Under View A, the grant-date fair value of an RSU on January 1, 20X1, is $10 (View B: $7). The grant-date fair value is $3 lower per RSU under View B because the performance target has been treated as a post-vesting restriction and is reflected within the calculation of the $7.

Estimated awards granted
On the grant date, the Company estimates the expected number of awards it will issue under the terms of the plan and the probability of achieving the EBITDA growth rates as follows:

EBITDA Growth Rate Achievement level	Probability	Awards to be issued under the terms of the Plan	Expected Payout Probability Weighted
Less than the minimum growth rate	20%	0	0
Minimum growth rate achieved but less than the targeted growth rate	25%	70,000	17,500
Targeted growth rate achieved but less than the maximum	40%	100,000	40,000
Maximum growth rate is achieved	15%	150,000	22,500
Total	100%		80,000

Under View A, the accrual of compensation cost is based on the outcome that is considered probable of occurring. The Company believes that it is probable that compensation will be earned (80 percent likelihood in the aggregate) and its best estimate within the range of possible outcomes (at 40 percent) is that the "targeted" EBITDA growth rate is achieved. This results in an initial estimate of 100,000 RSUs at the grant date for each of the ten employees.

Under View B, the accrual of compensation cost is based on the number of awards which are expected to be paid out. This results in a probability weighted estimate of 80,000 RSUs at the grant date for those employees that treat the performance target as a non vesting condition, see the relevant employee groups in the table below.

Under View C, the accrual of compensation cost is based on whether the performance target is treated as a performance condition or as a non vesting condition, depending upon whether the requisite service period substantially coincides with the measurement period of the performance target. An initial estimate of 100,000 RSUs is assumed, when the performance target is treated as a performance condition and a probability weighted estimate of 80,000 RSUs is assumed when it is treated as a non-vesting condition.

The Company's estimates did not change until Year 3. The actual outcome in Year 3 is that the maximum EBITDA growth rate is achieved; therefore, all 10 employees received 150,000 awards each.

					Income Statement Recognition					
	Measurement date				Service Period				Outcome of the performance target	Total amount recognized in the P&L
Employee Group	**No of employees**	**Grant date fair value per award**	**Estimated awards granted**	**Grant date fair value of the awards**	**Grant date**	**Year 1**	**Year 2**	**Year 3**	**Year 3 Incremental/ (Reversal)**	**Cumulative stock comp expense**
View A – Performance Condition Approach										
Immediately Retirement eligible	2	$10	100,000	$2m	$2m[i]	0	0	0	$1m[ii]	$3m
Retirement eligible in 2 years	1	$10	100,000	$1m	0	$0.5m[iii]	$0.5m	0	$0.5m	$1.5m
Retirement eligible in 2 year and 11 months	1	$10	100,000	$1m	0	$0.34m[iv]	$0.34m	$0.31m	$0.5m	$1.5m
Sub total				**$4m**	**$2m**	**$0.84m**	**$0.84m**	**$0.31m**	**$2.0m**	**$6.0**
Conventional employees	6	$10	100,000	$6m[v]	0	$2m	$2m	$2m	$3m[vi]	$9m
Grand Total	**10**			**$10m**	**$2m**	**$2.84m**	**$2.84m**	**$2.31m**	**$5.0m**	**$15.0m**
View B – Non Vesting Condition Approach										
Immediately Retirement eligible	2	$7	80,000[vii]	$1.12m	$1.12m [viii]	0	0	0	0[ix]	$1.12m
Retirement eligible in 2 years	1	$7	80,000	$0.56m	0	$0.28m[x]	$0.28m	0	0	$0.56m
Retirement eligible in 2 year and 11 months	1	$7	80,000	$0.56m	0	$0.19m	$0.19m	$0.17m	0	$0.56m
Sub total				**$2.24m**	**$1.12m**	**$0.47m**	**$0.47m**	**$0.17m**	**0**	**$2.24m**
Conventional employees	6	$10	100,000	$6m	0	$2m[xi]	$2m	$2m	$3m	$9m
Grand Total	**10**			**$8.24m**	**$1.12m**	**$2.47m**	**$2.47m**	**$2.17m**	**$3m**	**$11.24m**

					Income Statement Recognition					
	Measurement date				**Service Period**				**Outcome of the perfor-mance target**	**Total amount recognized in the P&L**
Employee Group	**No of employees**	**Grant date fair value per award**	**Esti-mated awards granted**	**Grant date fair value of the awards**	**Grant date**	**Year 1**	**Year 2**	**Year 3**	**Year 3 Incre-mental/ (Reversal)**	**Cumula-tive stock comp expense**
View C – Substantial coincidence Approach										
Immediately Retirement eligible	2	$7	80,000[xii]	$1.12m	$1.12m	0	0	0	0[xiii]	$1.12m
Retirement eligible in 2 years	1	$7	80,000[xiv]	$0.56m	0	$0.28m[xv]	$0.28m	0	0	$0.56m
Sub total				**$1.68m**	**$1.12m**	**$0.28m**	**$0.28m**	**0**	**0**	**$1.68m**
Retirement eligible in 2 year and 11 months	1	$10	100,000	$1m[xvi]	0	$0.34m[xvii]	$0.34m	$0.31m	$0.5m	$1.5m
Conventional employees	6	$10	100,000	$6m	0	$2m	$2m	$2m	$3m	$9m
Grand Total	**10**			**$8.68m**	**$1.12m**	**$2.62m**	**$2.62m**	**$2.31m**	**$3.5m**	**$12.18m**

Immediately retirement eligible – View A

[i] For the two immediately retirement-eligible employees, the Company recognizes compensation cost of $2 million (100,000 awards × 2 employees × $10) on the grant date because there is no future service required.

[ii] In Year 3, the final outcome is that the maximum EBITDA growth rate is achieved, and the Company recognizes incremental compensation cost of $1 million in Year 3 (150,000 awards × 2 employees × $10, less the $2 million recognized previously)

Employee who becomes retirement eligible in two years – View A

[iii] For the one employee who becomes retirement-eligible in two years' time, the $1m grant-date fair value is recognized ratably over the 2-year service period. The Company recognizes compensation cost in Year 1 of $0.5 million and $0.5 million in Year 2. In Year 3, the Company recognizes incremental compensation cost of $0.5 million in Year 3 to reflect the final outcome of issuing 150,000 RSUs (150,000 RSUs × 1 employee × $10, less the $1million recognized previously.)

Employee who becomes retirement eligible in 2 years and 11 months – View A

[iv] For the 1 employee who becomes retirement-eligible in 2 years and 11 months' time, the $1m grant-date fair value is recognized ratably over the 2-year and 11-month service period. The Company recognizes compensation cost in Year 1 of $0.34 million, $0.34 million in Year 2, and $0.31 million in Year 3. In Year 3, the Company also recognizes incremental compensation cost of $0.5 million in Year 3 to reflect the final outcome of issuing 150,000 RSUs.

Conventional employees – View A

[v] For conventional employees, they must complete three years of service and achieve the performance target. For these employees, the performance condition approach is the only approach that will apply. They are illustrated in this example to demonstrate the administrative complexities that arise for different types of employees.

[vi] For conventional employees, the Company recognizes incremental compensation cost of $3 million in Year 3 to reflect the final outcome of issuing 150,000 RSUs (150,000 RSUs × 6 employees × $10, less the $6million recognized previously).

All employee groups that apply View B

[vii] Under View B, the accrual of compensation cost would be based on the number of awards which are expected to be paid out; being 80,000 awards to each of the employee groups that apply View B.

Immediately retirement eligible – View B

[viii] For the two immediately retirement-eligible employees, the Company recognizes the full compensation cost of $1.12 million the grant date because there is no future service required.

[ix] In Year 3 the final outcome of the performance target is that the maximum level of EBITDA growth rate is achieved. However, there would be no adjustment to the compensation cost for differences between the expected (80,000) and actual (150,000) payout of the awards.

Employee who becomes retirement eligible in two years – View B

[x] For the one employee who becomes retirement eligible in 2 years' time, the $0.56 million grant date fair value is recognized ratably over the 2-year service period. In Year 3, there would be no adjustment to the compensation cost for differences between the expected (80,000) and actual (150,000) payout of the awards.

Conventional employees

[xi] For conventional employees, they must complete three years of service and achieve the performance target. For these employees, View A is the only approach that will apply. They are illustrated in this example to demonstrate the administrative complexities that arise for different types of employees.

Immediately retirement eligible – View C

[xii] Under View C, the requisite service period for the two immediately retirement-eligible employees does not substantially coincide with the measurement period of the performance target of three years. The performance target should be treated as a non vesting condition that is reflected in the grant-date fair value of the awards. The accrual of

compensation cost would be based on the number of awards which are expected to be paid out; being 80,000 awards to each employee. The Company recognizes the full compensation cost of $1.12 million (80,000 RSUs × 2 employees × $7) at the grant date because there is no future service required.

[xiii] In Year 3 the final outcome of the performance target is that the maximum level of EBITDA growth rate is achieved. However, there would be no adjustment to the compensation cost for differences between the expected (80,000) and actual (150,000) payout of the awards.

Employee who becomes retirement-eligible in two years – View C

[xiv] Under View C, the entity would need to assess whether the requisite service period of two years substantially coincides with the measurement period of the performance target of three years. The FASB Staff does not believe that the length of the requisite service period, in this instance, covers substantially all of the measurement period of the performance target. Therefore, the performance target should be treated as a non vesting condition that is reflected in the grant-date fair value of the awards. The accrual of compensation cost would be based on the number of awards which are expected to be paid out; being 80,000 awards to each employee.

[xv] The $0.56m grant-date fair value is recognized ratably over the 2-year service period. In Year 3 the final outcome of the performance target is that the maximum level of EBITDA growth rate is achieved, however, there would be no adjustment to the compensation cost for differences between the expected (80,000) and actual (150,000) payout of the awards

Employee who becomes retirement eligible in two years and 11 months – View C

[xvi] Under View C, the entity would need to assess whether the requisite service period of two years and 11 months substantially coincides with the measurement period of the performance target of three years. The FASB Staff believes that, in this instance, there is substantial coincidence between the two time periods. Accordingly, the performance target should be treated as a performance condition. The accrual of compensation cost would be based on the best estimate within a range of possible outcomes; being 100,000 awards.

[xvii]The $1m grant-date fair value is recognized ratably over the 2-year and 11month service period. The Company recognizes compensation cost in Year 1 of $0.34 million, $0.34 million in Year 2, and $0.31 million in Year 3. In Year 3, the Company also recognizes incremental compensation cost of $0.5million in Year 3 to reflect the final outcome of 150,000 RSUs (150,000 RSUs × 1 employee × $10, less the $1million recognized previously.)