FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: November 17, 2016
Comments Due: January 6, 2017

Compensation—Stock Compensation (Topic 718)

Scope of Modification Accounting

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 718 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2016-360, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until January 6, 2017. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2016-360
- Sending a letter to "Technical Director, File Reference No. 2016-360, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Proposed Accounting Standards Update

Compensation—Stock Compensation (Topic 718)

Scope of Modification Accounting

November 17, 2016

Comment Deadline: January 6, 2017

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Summary and Questions for Respondents

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

The Board is issuing this proposed Update to provide clarity and reduce diversity in practice, as well as to reduce cost and complexity, when applying the guidance in Topic 718, Compensation—Stock Compensation, about a change to the terms or conditions of a share-based payment award.

An entity may change the terms or conditions of a share-based payment award for many different reasons, and the nature and effect of the change can vary significantly. The Master Glossary of the *FASB Accounting Standards Codification*® defines the term *modification* as "a change in any of the terms or conditions of a share-based payment award."

Stakeholders have observed that the definition of the term *modification* is broad and that it results in diversity in practice. Some entities evaluate whether a change to the terms or conditions of an award is substantive. When those entities conclude that a change is substantive, they apply modification accounting in Topic 718. When those entities conclude that a change is not substantive, they do not apply modification accounting. Topic 718 does not contain guidance about what changes are substantive.

Other entities apply modification accounting for any change to an award, except for a change they deem to be purely administrative in nature. However, Topic 718 does not provide guidance about what changes are purely administrative. Still, other entities apply modification accounting when a change to an award changes the fair value, the vesting, or the classification of the award. In such cases, it appears that an evaluation of a change in fair value, vesting, or classification may be used in practice to evaluate whether a change is substantive.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect any entity that changes the terms or conditions of a share-based payment award.

What Are the Main Provisions?

The amendments in this proposed Update would provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718.

An entity would account for the effects of a modification unless all the following are the same immediately before and after the modification:

1. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the award
2. The vesting conditions of the award
3. The classification of the award as an equity instrument or a liability instrument.

The current disclosure requirements in Topic 718 would apply regardless of whether an entity is required to apply modification accounting under the amendments in this proposed Update.

What Are the Transition Provisions and When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied prospectively to awards modified on or after the effective date. The effective date will be determined after the Board considers stakeholder feedback on the proposed amendments.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree with the amendments in this proposed Update about when an entity is required to apply modification accounting? If not, why?

Question 2: Should new or different disclosures be included in Topic 718 as a result of the amendments in this proposed Update? If yes, what are those disclosures and why would they be useful to financial statement users?

Question 3: Are the transition requirements appropriate? If not, what transition approach is more appropriate and why?

Question 4: How much time would be needed to adopt the amendments in this proposed Update? Should the amount of time needed to apply the amendments in this proposed Update by entities other than public business entities be different from the amount of time needed by public business entities? Should early adoption be permitted? If yes to either question, please explain why.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

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

Amendments to Master Glossary

2. Amend the Master Glossary term *Modification,* with a link to transition paragraph 718-20-65-1, as follows:

Modification

A change in ~~any of~~ the terms or conditions of a share-based payment award.

Amendments to Subtopic 718-20

3. Add paragraph 718-20-35-2A and amend paragraph 718-20-35-3, with a link to transition paragraph 718-20-65-1, as follows:

Compensation—Stock Compensation—Awards Classified as Equity

Subsequent Measurement

> Modification of an Award

<u>**718-20-35-2A** An entity shall account for the effects of a **modification**, as described in paragraphs 718-20-35-3 through 35-9, unless all of the following are the same immediately before and after the modification:</u>

- <u>a. The fair value (or **calculated value** or **intrinsic value**, if such an alternative measurement method is used) of the award</u>
- <u>b. The vesting conditions of the award</u>
- <u>c. The classification of the award as an equity instrument or a liability instrument.</u>

The disclosure requirements in paragraphs 718-10-50-1 through 50-4 apply regardless of whether an entity is required to apply modification accounting.

718-20-35-3 Except as described in paragraph 718-20-35-2A, a~~A~~ **{remove glossary link}modification{remove glossary link}** of the terms or conditions of an equity award shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of equal or greater value, incurring additional compensation cost for any incremental value. The effects of a modification shall be measured as follows:

a. Incremental compensation cost shall be measured as the excess, if any, of the fair value of the modified award determined in accordance with the provisions of this Topic over the fair value of the original award immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. As indicated in paragraph 718-10-30-20, references to fair value throughout this Topic shall be read also to encompass **{remove glossary link}calculated value{remove glossary link}.** The effect of the modification on the number of instruments expected to **vest** also shall be reflected in determining incremental compensation cost. The estimate at the modification date of the portion of the award expected to vest shall be subsequently adjusted, if necessary, in accordance with paragraph 718-10-35-3 and other guidance in Examples 14 through 15 (see paragraphs 718-20-55-107 through 55-121).
b. Total recognized compensation cost for an equity award shall at least equal the fair value of the award at the grant date unless at the date of the modification the performance or service conditions of the original award are not expected to be satisfied. Thus, the total compensation cost measured at the date of a modification shall be the sum of the following:
    1. The portion of the grant-date fair value of the original award for which the requisite service is expected to be rendered (or has already been rendered) at that date
    2. The incremental cost resulting from the modification.

   Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 718-10-35-3 and other guidance in Examples 14 through 15 (see paragraph 718-20-55-107 through 55-121).
c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 718-20-35-1 shall be measured by comparing the intrinsic value of the modified award, if any, with the intrinsic value of the original award, if any, immediately before the modification.

718-20-35-4 Examples 12 through 16 (see paragraphs 718-20-55-93 through 55-144) provide additional guidance on, and illustrate the accounting for, modifications of both vested and nonvested awards, including a modification that changes the classification of the related financial instruments from equity to liability or vice versa, and modifications of vesting conditions. Paragraphs 718-10-35-9 through 35-14 provide additional guidance on accounting for modifications of certain freestanding financial instruments that initially were subject to this Topic but subsequently became subject to other applicable generally accepted accounting principles (GAAP).

> > Short-Term Inducements

718-20-35-5 A **short-term inducement** shall be accounted for as a modification of the terms of only the awards of employees who accept the inducement. Other inducements are modifications of the terms of all awards subject to them and shall be accounted for as such.

> > Equity Restructuring or Business Combination

718-20-35-6 Exchanges of share options or other equity instruments or changes to their terms in conjunction with an **equity restructuring** or a business combination are modifications for purposes of this Subtopic. Except for a modification to add an antidilution provision that is not made in contemplation of an equity restructuring, accounting for a modification in conjunction with an equity restructuring requires a comparison of the fair value of the modified award with the fair value of the original award immediately before the modification in accordance with paragraph 718-20-35-3. If those amounts are the same, for instance, because the modification is designed to equalize the fair value of an award before and after an equity restructuring, no incremental compensation cost is recognized. Example 13 (see paragraph 718-20-55-103) provides further guidance on applying the provisions of this paragraph. See paragraph 718-10-35-10 for an additional exception.

> > Repurchase or Cancellation

718-20-35-7 The amount of cash or other assets transferred (or liabilities incurred) to repurchase an equity award shall be charged to equity, to the extent that the amount paid does not exceed the fair value of the equity instruments repurchased at the repurchase date. Any excess of the repurchase price over the fair value of the instruments repurchased shall be recognized as additional compensation cost. An entity that repurchases an award for which the requisite service has not been rendered has, in effect, modified the requisite service period to the period for which service already has been rendered, and thus the amount of compensation cost measured at the grant date but not yet recognized shall be recognized at the repurchase date.

> > Cancellation and Replacement

718-20-35-8 Cancellation of an award accompanied by the concurrent grant of (or offer to grant) a **replacement award** or other valuable consideration shall be accounted for as a modification of the terms of the cancelled award. (The phrase *offer to grant* is intended to cover situations in which the **service inception date** precedes the grant date.) Therefore, incremental compensation cost shall be measured as the excess of the fair value of the replacement award or other valuable consideration over the fair value of the cancelled award at the cancellation date in accordance with paragraph 718-20-35-3. Thus, the total compensation cost measured at the date of a cancellation and replacement shall be the portion of the grant-date fair value of the original award for which the requisite service is expected to be rendered (or has already been rendered) at that date plus the incremental cost resulting from the cancellation and replacement.

718-20-35-9 A cancellation of an award that is not accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a repurchase for no consideration. Accordingly, any previously unrecognized compensation cost shall be recognized at the cancellation date.

4. Amend paragraphs 718-20-55-97, 718-20-55-104 through 55-105, the heading preceding paragraph 718-20-55-122, 718-20-55-134, and 718-20-55-144, with a link to transition paragraph 718-20-65-1, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 12: Modifications and Settlements

> > > Case B: Share Settlement of Vested Share Options

718-20-55-97 Rather than modify the option terms, Entity T offers to settle the original January 1, 20X5, share options for fully vested equity shares at January 1, 20X9. The fair value of each share option is estimated the same way as shown in Case A, resulting in a fair value of $3.67 per share option. Entity T considers the guidance in paragraph 718-20-35-2A and concludes that the change to the terms or conditions of the award does not change the vesting conditions or the classification of the award. If the payment in fully vested equity shares equals the fair value of the fully vested share options on the date of settlement, there would be no change in fair value, and Entity T would not account for the effects of the settlement. However, if the payment in fully vested shares does not equal the fair value of the fully vested share options on the date of settlement, there would be a change in fair value, and Entity T would account for the effects of the settlement. Entity T would recognize~~recognizes~~ the settlement as the repurchase of an outstanding equity instrument. ~~instrument, and no~~ No additional compensation cost is recognized at the date of settlement unless the payment in fully vested equity shares exceeds ~~$3.67 per~~ the fair value of the fully vested share ~~option~~ options. Previously recognized compensation cost for the fair value of the original share options is not adjusted.

> > Example 13: Modifications Due to an Equity Restructuring

> > > Case A: Original Award Contains Antidilution Provisions

718-20-55-104 In this Case, assume an award contains antidilution provisions. On May 1 there is an announcement of a future equity restructuring. On October 12 the equity restructuring occurs and the terms of the award are modified in accordance with the antidilution provisions. In this Case, the modification occurs on October 12 when the terms of the award are changed. The fair value of the award is compared pre- and postmodification on October 12. The calculation of fair value is necessary to determine if there is any incremental value transferred as a result of the modification, and if so, that incremental value would be recognized as additional compensation cost. If there is no incremental fair value and the modification does not change the vesting conditions or the classification of the award, the entity would not account for the effect of the modification (see paragraph 718-20-35-2A)~~value, no additional compensation cost would be recognized~~.

> > > Case B: Original Award Does Not Contain Antidilution Provisions

718-20-55-105 In this Case, the original award does not contain antidilution provisions. On May 1 there is an announcement of a future equity restructuring. On July 26 the terms of an award are modified to add antidilution provisions in contemplation of an equity restructuring. On September 30 the equity restructuring occurs. In this Case, there are two modifications to account for. The first modification occurs on July 26, when the terms of the award are changed to add antidilution provisions. Because the modification to add antidilution provisions on July 26 is done in contemplation of an equity restructuring, there must be a comparison of the fair value of the award pre- and postmodification on July 26. The premodification fair value is based on the award without antidilution provisions taking into account the effect of the contemplated restructuring on its value. The postmodification fair value is based on an award with antidilution provisions, taking into account the effect of the contemplated restructuring on its value. Any incremental value transferred would be recognized as additional compensation cost. Once the equity restructuring occurs, there is a second modification event on September 30 when the terms of the award are changed in accordance with the antidilution provisions. A second comparison of pre- and postmodification fair values is then required to determine whether any incremental value is transferred as a result of the modification. If there are no changes in fair value, vesting conditions, or classification of the award (see paragraph 718-20-35-2A), then modification accounting would not be applied on September 30. If there are changes, the ~~Changes to the terms of an award in accordance with its antidilution provisions generally would not result in additional compensation cost if the~~

~~antidilution provisions were properly structured. The~~ incremental value transferred, if any, would be recognized as additional compensation cost.

> > Example 16: Modifications <u>Regarding</u> ~~That Change~~ an Award's Classification

718-20-55-122 A modification may affect the classification of an award (for example, change the award from an equity instrument to a liability instrument). If an entity modifies an award in that manner, the Compensation—Stock Compensation Topic requires that the entity account for that modification in accordance with paragraph 718-20-35-3. The following Cases illustrate modifications that change the classification of the award:

a. Equity to liability modification (share-settled share options to cash-settled share options) (Case A)
b. Equity to equity modification (share options to shares) (Case B)
c. Liability to equity modification (cash-settled to share-settled stock appreciation rights) (Case C)
d. Liability to liability modification (cash-settled to cash-settled stock appreciation rights) (Case D)
e. Equity to liability modification (share options to fixed cash payment) (Case E).

> > > Case B: Equity to Equity Modification (Share Options to Shares)

718-20-55-134 Equity to equity modifications also are addressed in Examples 12 (see paragraph 718-20-55-93) and 14 (see paragraph 718-20-55-107). This Case is based on Example 1, Case A (see paragraph 718-20-55-10), in which Entity T granted its employees 900,000 options with an exercise price of $30 on January 1, 20X5. At January 1, 20X9, after 747,526 share options have vested, the market price of Entity T stock has declined to $8 per share, and Entity T offers to exchange 4 options with an assumed per-share-option fair value of $2 at the date of exchange for 1 share of nonvested stock, with a market price of $8 per share. The nonvested stock will cliff vest after two years of service. All option holders elect to participate, and at the date of exchange, Entity T grants 186,881 (747,526 ÷ 4) nonvested shares of stock. <u>Entity T considers the guidance in paragraph 718-20-35-2A. Because the change in the terms or conditions of the award changes the vesting conditions of the award, Entity T applies modification accounting. However, because</u>~~Because~~ the fair value of the nonvested stock is equal to the fair value of the options, there is no incremental compensation cost. Entity T will not make any additional accounting entries for the shares regardless of whether they vest, other than possibly reclassifying amounts in equity; however, Entity T will need to account for the ultimate income tax effects related to the share-based compensation arrangement.

> > > Case E: Equity to Liability Modification (Share Options to Fixed Cash Payment)

718-20-55-144 Entity T grants the same share options described in Example 1, Case A (see paragraph 718-20-55-10) and records similar journal entries for 20X5 (see paragraphs 718-20-55-12 through 55-16). By January 1, 20X6, Entity T's share price has fallen, and the fair value per share option is assumed to be $2 at that date. Entity T provides its employees with an election to convert each share option into an award of a fixed amount of cash equal to the fair value of each share option on the election date ($2) accrued over the remaining requisite service period, payable upon vesting. The election does not affect vesting; that is, employees must satisfy the original service condition to vest in the award for a fixed amount of cash. <u>Entity T considers the guidance in paragraph 718-20-35-2A and because the change in terms or conditions of the award changes the classification of the award from equity to liability, Entity T would apply modification accounting.</u>~~This transaction is considered a modification because Entity T continues to have an obligation to its employees that is conditional upon the receipt of future employee services.~~ There is no incremental compensation cost because the fair value of the modified award is the same as that of the original award. At the date of the modification, a liability of $547,604 [(821,406 × $2) × (1 year of requisite service rendered ÷ 3-year requisite service period)], which is equal to the portion of the award attributed to past service multiplied by the modified award's fair value, is recognized by reclassifying that amount from additional paid-in capital. The total liability of $1,642,812 (821,406 × $2) should be fully accrued by the end of the requisite service period. Because the possible tax deduction of the modified award is capped at $1,642,812, Entity T also must adjust its deferred tax asset at the date of the modification to the amount that corresponds to the recognized liability of $547,604. That amount is $191,661 ($547,604 ×.35), and the write-off of the deferred tax asset is $1,216,092 ($1,407,753 – $191,661). That write-off would be recognized in the income statement except to the extent that there is any remaining additional paid-in capital from excess tax benefits from previous share-based payment awards available to offset that deficiency. Compensation cost of $4,022,151 and a corresponding increase in additional paid-in capital would be recognized in each of 20X6 and 20X7 for a cumulative total of $12,066,454 (as calculated in Case A); however, that compensation cost has no associated income tax effect (additional deferred tax assets are recognized based only on subsequent increases in the amount of the liability).

In addition, amend the following pending content for paragraph 718-20-55-144, as follows:

Pending Content:

Transition Date: *(P) December 16, 2016; (N) December 16, 2017* **| Transition Guidance:** 718-10-65-4

718-20-55-144 Entity T grants the same share options described in Example 1, Case A (see paragraph 718-20-55-10) and records similar journal entries for 20X5 (see paragraphs 718-20-55-12 through 55-16). By January 1, 20X6, Entity T's share price has fallen, and the fair value per share option is assumed to be $2 at that date. Entity T provides its employees with an election to convert each share option into an award of a fixed amount of cash equal to the fair value of each share option on the election date ($2) accrued over the remaining requisite service period, payable upon vesting. The election does not affect vesting; that is, employees must satisfy the original service condition to vest in the award for a fixed amount of cash. <u>Entity T considers the guidance in paragraph 718-20-35-2A and because the change in terms or conditions of the award changes the classification of the award from equity to liability, Entity T would apply modification accounting.</u>~~This transaction is considered a modification because Entity T continues to have an obligation to its employees that is conditional upon the receipt of future employee services.~~ There is no incremental compensation cost because the fair value of the modified award is the same as that of the original award. At the date of the modification, a liability of $547,604 [(821,406 × $2) × (1 year of requisite service rendered ÷ 3-year requisite service period)], which is equal to the portion of the award attributed to past service multiplied by the modified award's fair value, is recognized by reclassifying that amount from additional paid-in capital. The total liability of $1,642,812 (821,406 × $2) should be fully accrued by the end of the requisite service period. Because the possible tax deduction of the modified award is capped at $1,642,812, Entity T also must adjust its deferred tax asset at the date of the modification to the amount that corresponds to the recognized liability of $547,604. That amount is $191,661 ($547,604 ×.35), and the write-off of the deferred tax asset is $1,216,092 ($1,407,753 – $191,661). That write-off would be recognized as income tax expense in the income statement. Compensation cost of $4,022,151 would be recognized in each of 20X6 and 20X7 for a cumulative total of $12,066,454 (as calculated in Case A); of this, $547,604 would be recognized as in increase to the liability balance, with the remaining $3,474,547 recognized as an increase in additional paid-in capital. A deferred tax benefit would be recognized in the income statement, and a corresponding increase to the deferred tax asset would be recognized for the tax effect of the increased liability of $191,661 ($547,604 × .35). The compensation cost recognized in additional paid-in capital in this situation has no associated income tax effect (additional deferred tax assets are recognized based only on subsequent increases in the amount of the liability).

5. Add paragraph 718-20-65-1 and its related heading as follows:

<u>**> Transition Related to Accounting Standards Update No. 2017-XX, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting***</u>

718-20-65-1 The following represents the transition and effective date information related to Accounting Standards Update No. 2017-XX, *Compensation—Stock Compensation (Topic 718): Scope of Modification Accounting:*

a. The pending content that links to this paragraph shall be effective for annual periods, and interim periods within those annual periods, beginning after [date to be inserted after exposure].
b. An entity shall apply the pending content that links to this paragraph prospectively to a **modification** that occurs on or after the effective date.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Daryl E. Buck
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Background Information and Basis for Conclusions

Introduction and Background Information

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

BC2. An entity may change the terms or conditions of a share-based payment award for many different reasons, and the nature and effect of the change can vary significantly. The Master Glossary of the Codification defines the term *modification* as "a change in any of the terms or conditions of a share-based payment award."

BC3. Stakeholders have observed that the definition of the term *modification* is broad and that it results in diversity in practice. Some entities evaluate whether a change to the terms or conditions of an award is substantive. When those entities conclude that a change is substantive, they apply modification accounting in Topic 718. When those entities conclude that a change is not substantive, they do not apply modification accounting. Topic 718 does not contain guidance about which changes are substantive.

BC4. Other entities apply modification accounting for any change to an award, except for a change they deem to be purely administrative in nature. However, Topic 718 does not provide guidance about what changes are considered purely administrative. Still, other entities apply modification accounting when a change to an award changes the fair value, the vesting, or the classification of the award. In such cases, it appears that an evaluation of the change in fair value, vesting, or classification may be used in practice to evaluate whether the change is substantive.

BC5. The issue that would be addressed by the amendments in this proposed Update was raised as part of a technical inquiry to the FASB staff about Accounting Standards Update No. 2016-09, *Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. One of the areas addressed by the amendments in Update 2016-09 relates to statutory tax withholding requirements. Before the amendments in Update 2016-09 become effective, for an award to qualify as an equity classification, the entity cannot partially settle the award in cash in excess of the employer's minimum statutory withholding requirements. The amendments in Update 2016-09 change the threshold to permit withholding *up to the maximum* statutory tax withholding rates in the applicable jurisdictions. After the Board issued the amendments in Update 2016-09, stakeholders questioned whether an amendment to an award that already includes a net settlement feature to permit withholding up to an employer's maximum statutory withholding amount would require an entity to apply modification accounting under Topic 718. The question emerged because the definition of the term *modification* is broad.

BC6. An entity that modifies an award under Topic 718 is generally required to calculate and record the incremental fair value of the modified award as compensation cost on the date of modification (for vested awards) or over the remaining service period (for unvested awards). The accounting for some modifications is more complex (for example, the modification might result in a new measurement date for some awards that are not considered probable of vesting at the time of modification). Paragraph 718-20-35-3 states, in part:

> A **modification** of the terms or conditions of an equity award shall be treated as an exchange of the original award for a new award. In substance, the entity repurchases the original instrument by issuing a new instrument of equal or greater value, incurring additional compensation cost for any incremental value.

Scope of Modification Accounting

BC7. The amendments in this proposed Update would provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. An entity would account for the effects of a modification, as described in paragraphs 718-20-35-3 through 35-9, unless all the following are the same immediately before and after the modification:

a. The fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the award
b. The vesting conditions of the award
c. The classification of the award as an equity instrument or a liability instrument.

BC8. Paragraphs BC9 and BC10 include examples of changes to the terms or conditions of awards and whether those changes would require an entity to apply modification accounting. The examples are educational in nature, are not all-inclusive, and should not be used to override the guidance in paragraph 718-20-35-2A. Therefore, an entity should evaluate a change to an award on the basis of the guidance in paragraph 718-20-35-2A.

BC9. Examples of changes to awards that the Board believes generally would not require modification accounting include the following:

a. Changes that are administrative in nature, such as a change to the company name, company address, or plan name
b. Changes in an award's net settlement provisions related to tax withholdings that do not affect the classification of the award.

BC10. Examples of changes to awards that the Board believes generally would require modification accounting include the following:

a. Repricing of options that results in a change in value of those options
b. Changes in a service condition
c. Changes in a performance condition or a market condition
d. Changes in an award that results in a reclassification of the award (equity to liability or vice versa)
e. Adding a change in control provision whereby awards are immediately vested upon occurrence of the event.

BC11. For the purpose of assessing the criterion in paragraph 718-20-35-2A(a), an entity would evaluate whether the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) of the award changes immediately before and after the modification and not whether the compensation cost recognized changes. For example, consider a circumstance in which an entity changes the terms or conditions of an award. If the entity concludes that the change results in a Type IV modification (improbable to improbable), the entity might have no change in compensation cost that would be recognized on the modification date. However, the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) typically would change because there is a new measurement date for the award for a Type IV modification. Consequently, the entity would apply modification accounting under paragraph 718-20-35-2A.

BC12. Under the amendments in this proposed Update, one of the considerations in evaluating whether modification accounting would be required would be to determine whether a change to the terms or conditions of an award changes the value of the award. The Board is aware that if there is no change in value, then sometimes there would be no difference in financial reporting outcomes, regardless of whether the entity applies modification accounting. However, the Board decided that the proposed amendments would be an improvement to generally accepted accounting principles (GAAP) because they would clarify when an entity is required to even consider whether the application of modification accounting would have a financial reporting effect.

BC13. In addition, there are circumstances in which the financial reporting outcome (share-based payment disclosure or expense recognition) would change depending on whether modification accounting is applied. Under modification accounting in Topic 718, changes to terms or conditions for some awards result in a new measurement date from the grant date to the modification date, which typically would result in a different value for the award. For example, consider a circumstance in which an entity changes the terms or conditions of awards. As required by the modification accounting guidance in Topic 718, the entity would assess whether it is probable that the awards will or will not vest before and after the modification. If the entity concludes that the change results in a Type III modification (improbable to probable) or a Type IV modification (improbable to improbable), the entity would have a new measurement date for those awards. The new measurement date for those awards would affect disclosures about share-based payment awards and, in some circumstances, affect expense recognition.

BC14. Paragraph 718-20-35-2A(a) addresses whether there is a change in fair value (or calculated value or intrinsic value, if such an alternative measurement method is used) immediately before and after the modification of the award. The Board does not expect that an entity would have to estimate the value immediately before and after the modification in all cases. Rather, the entity might be able to determine whether the modification would affect any of the inputs to the value calculation. If none of the inputs are affected by the modification, the entity likely could conclude that the value immediately before and after the modification would not change.

BC15. There are instances in which entities make changes to awards solely to preserve the value of the awards after an equity restructuring. An example is the addition of an antidilution provision in contemplation of an equity restructuring event. Under current GAAP, an antidilution provision added in contemplation of an equity restructuring event constitutes a modification and generally results in incremental compensation cost. That is because the fair-value-based measure of the award is higher after the change because it assumes the equity restructuring event occurs with the antidilution provision, whereas the fair-value-based measure before the change does not include the antidilution provision even though it assumes that the equity restructuring event does occur. The Board considered but rejected an alternative that modification accounting under Topic 718 would not be applied in circumstances in which the change is made solely to preserve the value of awards after an equity restructuring.

BC16. The Board rejected that alternative because there is incremental value for the awards (a) when an antidilution provision is added in contemplation of an equity restructuring or (b) when adjustments are made to preserve the value of the awards in an equity restructuring when there is no antidilution provision in place. Therefore, the change should be accounted for as a modification. A few Board members did not agree with the assessment that such modification increases the value of the award; they noted that it seems to preserve the original value of the award. However, the Board agreed that equity restructurings are beyond the scope of the narrow issue being addressed in this project. That also is why the Board did not consider a broader reconsideration of the definition of *modification* in Topic 718.

BC17. The Board also considered but rejected a view that modification accounting would not be applied to changes to awards made as a result of newly effective amendments to the Codification or newly effective laws or regulations if those changes would not result in a change in the fair value (or calculated value or intrinsic value, if such an alternative measurement method is used), vesting conditions, or classification of the awards.

BC18. The Board rejected that alternative, noting that stakeholders have indicated that entities would have difficulty determining, and auditors would have difficulty verifying, that the change is made solely as a result of a new accounting standard, law, or regulation.

Recurring Disclosures

BC19. The Board decided that the recurring disclosures in Topic 718 should not be changed as a result of the amendments in this proposed Update.

BC20. Paragraph 718-10-50-2(h)(2) requires an entity to disclose a description of significant modifications for each year in which an income statement is presented, including:

a. The terms of the modifications
b. The number of employees affected
c. The total incremental compensation cost resulting from the modifications.

BC21. Those disclosure requirements would apply to a modification (that is, a change to an award) regardless of whether an entity is required to apply modification accounting under the amendments in this proposed Update. In the Board's view, the disclosures about modification would provide useful information (for example, risk of dilution and management's future plans as they relate to share-based payment awards) to users of financial statements regardless of whether a change is required to undergo modification accounting.

BC22. The Board does not anticipate that disclosure practices for modifications would change significantly as a result of the amendments in this proposed Update. For example, many entities do not disclose changes to awards that are administrative in nature because, in their view, the administrative changes would not convey useful information. The Board does not expect that practice would change as a result of the proposed amendments.

Effective Date and Transition

BC23. The amendments in this proposed Update would be applied prospectively to changes to awards that occur on or after the effective date. The Board will determine the effective date after it considers stakeholder feedback on the proposed amendments.

BC24. While a retrospective application potentially would improve comparability of financial information across entities, the Board decided not to require retrospective application of the amendments in this proposed Update because the implementation cost likely would outweigh the longer-term cost reduction from the change. The Board does not believe that there would be much benefit to retrospectively evaluating and implementing changes to the awards under the proposed amendments because in current practice entities have been able to determine when to apply the modification guidance in Topic 718.

BC25. The Board considered transition disclosures in Topic 250, Accounting Changes and Error Corrections, but decided that they are not necessary for the amendments in this proposed Update because modifications typically are not a recurring event. An entity might not have any modifications in the year of adoption but may have one several years after adoption. Also, Topic 718 already requires disclosure about a modification when it occurs. Paragraph 718-10-50-2(h)(2) requires disclosure of the terms of modifications.

Benefits and Costs

BC26. 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 Board'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 to quantify the value of improved information in financial statements.

BC27. The objectives of the amendments in this proposed Update are to reduce diversity in practice and reduce cost and complexity in applying the guidance in Topic 718 about a change to the terms or conditions of a share-based payment award. The Board anticipates that the proposed amendments would reduce costs and potentially provide users with more comparable information.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at www.fasb.org and finalized as part of the annual release process.