

Client Alert

FASB Clarifies the Scope of Modification Accounting Under Topic 718

EXEQUITY

Independent Board and
Management Advisors

On May 10, 2017, the Financial Accounting Standards Board (FASB) issued an Accounting Standards Update (ASU) with respect to Topic 718, Stock Compensation.¹ The purpose of this ASU is to provide clarity and reduce cost, complexity, and diversity in practice.

Summary of Changes/Clarifications

The ASU addresses what constitutes a “modification” for purposes of Topic 718, which has specific accounting implications, including the potential for additional cost to be recognized. In particular, the ASU describes conditions in which changes to an award’s terms or conditions will not give rise to treatment as a modification (and therefore potentially heightened accounting charges). The ASU provides guidance regarding what changes to the terms and conditions of a share-based payment award require an entity to apply the modification accounting provisions of Topic 718.

The ASU generally requires companies to account for the effect of a modification when they modify a share-based payment award **unless all the following requirements are met:**

- The **fair market value** of the modified award is the **same** as the fair market value of the original award immediately before the original award is modified. If the modification does not affect any of the inputs to the valuation technique that the company uses to value the award, the company is not required to estimate the value immediately before and after the modification.
- The **vesting conditions** of the modified award are the **same** as the original award immediately before the original award is modified.
- The **classification** of the modified award **as an equity or a liability** instrument is the **same** as the classification of the original award immediately before the original award is modified.

Note: An example of a modification that generally should not result in modification accounting under Topic 718 is the modification of a share-based award to permit share withholding at up to the maximum applicable tax rate (where the original award only permitted share withholding at up to the minimum applicable tax rate).

¹ FASB Accounting Standards Update No. 2017-09 (May 2017), Compensation—Stock Compensation (Topic 718), Scope of Modification Accounting, available at: http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176169021134&mc_cid=dabb8a9bf2&mc_eid=b48d97fedb.

Timing

The ASU changes to Topic 718 are effective for all entities for annual periods, and interim periods within those annual periods, **beginning on or after December 15, 2017**.

Early adoption is permitted, including adoption in any interim period, for (1) public companies for reporting periods for which financial statements have not yet been issued and (2) all other entities for reporting periods for which financial statements have not yet been made available for issuance.



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PUB/CA/Topic 718 Scope of Modification Acctng_20170517

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