

## **FASB STAFF POSITION**

### **No. FAS 123(R)-5**

**Title:** Amendment of FASB Staff Position FAS 123(R)-1

**Date Posted:** October 10, 2006

### **Introduction**

1. This FASB Staff Position (FSP) addresses whether a modification of an instrument in connection with an equity restructuring should be considered a modification for purposes of applying FSP FAS 123(R)-1, “Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R).”

### **Background**

2. In August 2005, the Board issued FSP FAS 123(R)-1 to defer indefinitely the effective date of paragraphs A230–A232 of FASB Statement No. 123 (revised 2004), *Share-Based Payment*, and thereby require entities to apply the recognition and measurement provisions of Statement 123(R) throughout the life of an instrument, unless the instrument is modified when the holder is no longer an employee. The recognition and measurement of an instrument that is modified when the holder is no longer an employee should be determined by other applicable generally accepted accounting principles (GAAP). Paragraph 5 of FSP FAS 123(R)-1 states:

A freestanding financial instrument issued to an employee in exchange for past or future employee services that is subject to Statement 123(R) or was subject to Statement 123(R) upon initial adoption of that Statement shall continue to be subject to the recognition and measurement provisions of Statement 123(R) throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. Modifications of that instrument shall be subject to the modification guidance in paragraph A232 of Statement 123(R). Following modification, recognition and measurement of the instrument should be determined through reference to other applicable GAAP. [Footnote reference omitted.]

3. Subsequent to the issuance of FSP FAS 123(R)-1, a question was raised as to whether an entity that executes an equity restructuring must, in all cases, reassess whether the recognition and measurement of an instrument whose holder is no longer an employee becomes subject to other applicable GAAP (such as EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock”). Paragraph 53 of Statement 123(R) states:

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 Statement.

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4. For instruments that were originally issued as employee compensation and then modified, and that modification is made to the terms of the instrument **solely** to reflect an equity restructuring that occurs when the holders are no longer employees, no change in the recognition or the measurement (due to a change in classification) of those instruments will result if both of the following conditions are met:

- a. There is no increase in fair value of the award (or the ratio of intrinsic value to the exercise price of the award is preserved, that is, the holder is made whole), or the antidilution provision is not added to the terms of the award in contemplation of an equity restructuring; and
- b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

Therefore, paragraph 5 of FSP FAS 123(R)-1 is amended as follows: [Added text is underlined and deleted text is ~~struck-out~~.]

A freestanding financial instrument issued to an employee in exchange for past or future employee services<sup>1</sup> that is subject to Statement 123(R) or was subject to Statement 123(R) upon initial adoption of that Statement shall continue to be subject to the recognition and measurement provisions of Statement 123(R) throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. Only for purposes of this FSP, a modification does not include a change to the terms of an award if that change is made solely to reflect an equity restructuring provided that (a) there is no increase in fair value of the award (or the ratio of intrinsic value to the exercise price of the award is preserved, that is, the holder is made whole) or the antidilution provision is not

added to the terms of the award in contemplation of an equity restructuring and (b) all holders of the same class of equity instruments (for example, stock options) are treated in the same manner. Other modifications ~~Modifications~~ of that instrument that take place when the holder is no longer an employee shall be subject to the modification guidance in paragraph A232 of Statement 123(R). Following modification, recognition and measurement of the instrument should be determined through reference to other applicable GAAP.

**Effective Date and Transition**

5. The provisions in this FSP shall be applied in the first reporting period beginning after the date the FSP is posted to the FASB website. If in applying Statement 123(R) an entity did so in a manner consistent with the provisions of this FSP, then that entity would continue to apply the provisions in this FSP to prior periods. However, if an entity did not apply Statement 123(R) in a manner consistent with the provisions of this FSP, then that entity would be required to retrospectively apply the provisions in this FSP to prior periods when those periods' financial statements are included for comparative purposes with current-period financial statements. Early application of this FSP is permitted in periods for which financial statements have not yet been issued.