

FASB STAFF POSITION

No. FAS 123(R)-6

Title: Technical Corrections of FASB Statement No. 123(R)

Date Posted: October 20, 2006

Introduction

1. This FASB Staff Position (FSP) addresses certain technical corrections of FASB Statement No. 123 (revised 2004), *Share-Based Payment*. Specifically, it amends (a) paragraph A240(d)(1) to exempt nonpublic entities from disclosing the aggregate intrinsic value of outstanding fully vested share options (or share units) and share options expected to vest, (b) paragraph A102 of Illustration 4(b) to revise the computation of the minimum compensation cost that must be recognized to comply with paragraph 42 of Statement 123(R), (c) paragraph A170 of Illustration 13(e) to indicate that at the date that the illustrative awards were no longer probable of vesting, any previously recognized compensation cost should have been reversed, and (d) paragraph E1 to amend the definition of *short-term inducement* to exclude an offer to settle an award.

Background—Disclosure Requirements for Nonpublic Entities

2. Paragraph A240(d)(2) of Statement 123(R) explicitly exempts nonpublic entities from the requirement to disclose the aggregate intrinsic value of currently exercisable (or convertible) share options (or share units). However, paragraph A240(d)(1) does not exempt nonpublic entities from the requirement to disclose the aggregate intrinsic value of outstanding fully vested share options (or share units) and share options expected to vest. Paragraph A240(d) states:

For fully vested share options (or share units) and share options expected to vest at the date of the latest statement of financial position:

- (1) The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value, and weighted-average remaining contractual term of options (or share units) outstanding.
- (2) The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (**except for nonpublic entities**), and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible). [Emphasis added.]

3. By requiring a nonpublic entity to disclose the aggregate intrinsic value of outstanding fully vested share options (or share units) and share options expected to vest at the date of the latest statement of financial position (paragraph A240(d)(1)), a nonpublic entity would be required to determine the fair value of its underlying equity at each reporting date.

FASB Staff Position—Disclosure Requirements for Nonpublic Entities

4. Paragraph A240(d)(1) of Statement 123(R) is amended as follows: [Added text is underlined.]

The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and weighted-average remaining contractual term of options (or share units) outstanding.

Background—Amendment of Illustration 4(b)

5. Paragraph 42 of Statement 123(R) provides two alternative methods to recognize compensation cost for awards with graded vesting that have only a service condition:

- a. A straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards
- b. A straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award).

However, the amount of compensation cost recognized at any date is subject to a floor equal to the portion of the grant-date value of the award that is vested at that date.

6. Illustration 4(b) provides an example of the accounting for an award with a graded vesting schedule, including computation of the minimum compensation cost required to be recognized when an entity uses the straight-line method and has determined a specific value for each separately vesting portion of the award. The last sentence in paragraph A102 changes one of the assumptions used in the example and recomputes the floor amount based on the revised assumption. The revised computation is not consistent with the recognition provisions in paragraph 42 of Statement 123(R) because it (a) fails to take into consideration the change in the aggregate value of the award that would result from the change to a front-loaded vesting schedule and (b) implies the use of an average value per award based on the aggregate award

value, despite the fact that the example utilizes specific value information for each separately vesting portion of the award that is vested as of the date of the computation.

7. Consistent with footnote 86 of Statement 123(R), an entity can use a single weighted-average expected life to value an award. Using a single weighted-average expected life would result in a single value for the entire award that can be attributed on either (a) a straight-line basis over the requisite service period for each separately vesting portion of the award as if the award was, in substance, multiple awards or (b) a straight-line basis over the requisite service period for the entire award.

FASB Staff Position—Amendment of Illustration 4(b)

8. Paragraph A102 of Statement 123(R) is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

Entity T could use the same computation of estimated cost, as in Table 3 above, but could elect to recognize compensation cost on a straight-line basis for all graded vesting awards. In that case, total compensation cost to be attributed on a straight-line basis over each year in the 3-year vesting period is approximately \$3,988,868 ($\$11,966,606 \div 3$).⁸⁶ However, this Statement requires that compensation cost recognized at any date must be at least equal to the amount attributable to options that are vested at that date. For example, if 50 percent of this same option award vested in the first year of the 3-year vesting period, \$5,983,303 ($\$11,966,606 \div 2$) 436,500 options [$2,910 \times 150 (300 \times 50\%)$] would be vested at the end of 20X5. Compensation cost amounting to \$5,866,560 ($436,500 \times \13.44) attributable to the vested awards would be recognized in the first year.

Background—Amendment of Illustration 13(e)

9. Illustration 13(e) in Appendix A of Statement 123(R) provides an illustration of an improbable to probable modification (Type III modification). That illustration assumes the original award is probable of vesting until the entity decides to close the plant in which all of the award holders are employed. When the entity decides to close the plant, the awards are no longer probable of vesting, and the entity should reverse any previously recognized compensation cost. However, the illustration implies that the compensation cost should be reversed on June 30, 20X8 (the date the award is subsequently modified to accelerate the vesting terms of the award). Paragraph A170 of Statement 123(R) states, in part:

At the date of modification [June 30, 20X8], the service condition of the original award is not expected to be satisfied because the employees cannot render the requisite service; therefore, any compensation cost recognized as of the modification date for the original award would be reversed at the modification date.

FASB Staff Position—Amendment of Illustration 13(e)

10. Paragraph A170 of Statement 123(R) is amended as follows:

On January 1, 20X7, Entity Z issues 1,000 at-the-money options with a 4-year explicit service condition to each of 50 employees that work in Plant J. On December 12, 20X7, Entity Z decides to close Plant J and notifies the 50 Plant J employees that their employment relationship will be terminated effective June 30, 20X8. On June 30, 20X8, Entity Z accelerates vesting of all options. The grant date fair value of each option is \$20 on January 1, 20X7, and \$10 on June 30, 20X8, the modification date. At the date Entity Z decides to close Plant J and terminate the employees of modification, the service condition of the original award is not expected to be satisfied because the employees cannot render the requisite service; therefore, any compensation cost recognized as of ~~the modification date for the original award would be reversed at the modification date~~. ~~However, the modified award is fully vested as a result of the vesting acceleration. Therefore, a December 12, 20X7, for the original award would be reversed.~~ At the date of the modification, the fair value of the original award, which is \$0 ($\10×0 options expected to vest under the original terms of the award), is subtracted from the fair value of the modified award \$500,000 ($\$10 \times 50,000$ options expected to vest under the modified award). The total recognized compensation cost of \$500,000 will be less than the fair value of the award at the grant date (\$1 million) because at the date of the modification, the original vesting conditions were not expected to be satisfied.

Background—Amendment of the Definition of Short-Term Inducement

11. The definition of short-term inducement in Appendix E of Statement 123(R) includes the phrase *or settlement of an award*. This reference to settlement raises a question on the interaction of the accounting for a short-term inducement pursuant to paragraph 52 of Statement 123(R) and the accounting for a settlement of an award pursuant to paragraph 55 of Statement 123(R). For example, if an entity offers (for a limited time period) to repurchase a vested equity award for cash (whether at fair value or in excess of fair value), paragraph 55 provides the appropriate accounting guidance, that is, the amount of cash paid to repurchase the award would be charged to equity, to the extent that the amount paid does not exceed the fair value of the equity instrument at the date that the employee accepts the offer. Any excess of the repurchase

price over the fair value of the instrument repurchased would be recognized as additional compensation cost. By contrast, if the offer were considered a short-term inducement based on the definition in Appendix E, the offer to repurchase the award for cash would be accounted for as a modification for those who accept the offer. The Board did not intend for a short-term inducement that is deemed to be a settlement to affect the classification of the award for the period it remains outstanding (for example, change the award from an equity instrument to a liability instrument). Therefore, an offer (for a limited time period) to repurchase an award should be excluded from the definition of a short-term inducement and should not be accounted for as a modification pursuant to paragraph 52 of Statement 123(R). However, if an entity has a history of settling its awards for cash, the entity should consider whether at the inception of the awards it has a substantive liability pursuant to paragraph 34 of Statement 123(R).

FASB Staff Position—Amendment of the Definition of Short-Term Inducement

12. Paragraph E1 of Statement 123(R) is amended as follows:

Short-term inducement

An offer by the entity that would result in modification ~~or settlement~~ of an award to which an award holder may subscribe for a limited period of time.

Effective Date and Transition

13. 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 should 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 should 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.