

## Issue Paper No. 146

### Share-Based Payments With Non-Employees

#### STATUS

Adopted November 12, 2013

**Original SSAP and Current Authoritative Guidance: SSAP No. 104R**

#### Type of Issue:

Common Area

#### SUMMARY OF ISSUE

1. *SSAP No. 104—Share-Based Payments* provides statutory accounting principles for transactions in which an entity exchanges its equity instruments with employees in share-based payment transactions. SSAP No. 104 (effective Jan. 1, 2013), adopts with modification GAAP guidance for stock options and stock purchase plans within GAAP *Accounting Standards Codification Topic 718: Compensation – Stock Compensation, as amended by ASU 2010-13*. SSAP No. 104 does not currently provide guidance for share-based payment transactions with non-employees.
2. This issue paper provides substantive revisions to adopt, with modification, GAAP *Accounting Standards Codification Topic 505-50, Equity, Equity Payments to Non-Employees* within SSAP No. 104, resulting in a substantively revised SSAP No. 104 (SSAP No. 104R).
3. ASC 505-50 addresses the accounting and reporting for both the issuer (that is the purchaser or grantor) and recipient (that is, the goods or service provider or grantee) for a subset of share-based payment transactions depending on whether the grantee meets the definition of an employee. The guidance in ASC 505-50 addresses transactions in which the grantee receives shares of stock, stock options or other equity instruments in settlement of the entire transaction or, if the transaction is part cash and part equity instruments, in settlement of the portion of the transaction for which the equity instruments constitute the consideration.
4. The adoption, with modification, of ASC 505-50 within this Issue Paper will reflect adoption with modification of the following pre-codification GAAP standards, revising previous statutory accounting conclusions regarding these standards:
  - a. *EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*: EITF 96-18 is currently listed as rejected as not applicable in *INT 99-00: Compilation of Rejected EITFs*. Under the guidance in this issue paper, and the adoption of a substantively revised SSAP to adopt with modification ASC 505-50, the GAAP Cross-Reference to SAP (Appendix D) will be revised to identify that EITF 96-18 is adopted with modification in SSAP No. 104R.
  - b. *EITF 00-08, Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services*: EITF 00-08 is currently adopted with modification in INT 00-32. Under the guidance in this issue paper, and the adoption of a substantively revised SSAP to adopt with modification ASC 505-50, the GAAP Cross-Reference to SAP (Appendix D) will be revised to identify that EITF 00-08 is adopted with modification in SSAP No.104R, and INT 00-32 will be nullified.
  - c. *EITF 00-18, Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees*: EITF 00-18 is currently pending

statutory review. Under the guidance in this issue paper, and the adoption of a substantively revised SSAP to adopt with modification ASC 505-50, the GAAP Cross-Reference to SAP (Appendix D) will be revised to identify that EITF 00-18 is adopted with modification in SSAP No.104R.

## SUMMARY CONCLUSION

5. This issue paper provides statutory accounting principles for transactions in which an entity exchanges its equity instruments to non-employees in share-based payment transactions. It incorporates the GAAP objective for these transactions, requiring recognition in the financial statements of the most reliably measurable fair values of such transactions. Furthermore, it indicates that the accounting for these share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how the transactions are structured.

6. The adoption, with modification, of ASC 505-50 will be reflected in a substantively revised SSAP No. 104R. The tracked changes to reflect this guidance are in Illustration A.

## DISCUSSION

7. Per information received from industry representatives, share-based payments with non-employees are conducted by insurers, and consideration of related GAAP guidance should occur, with expansion of SSAP No. 104 for these transactions.

8. Similar to the conclusions reached in *Issue Paper No. 129, Share-Based Payment, A Replacement of SSAP No. 13—Stock Options and Stock Purchase Plans*, which are adopted in SSAP No. 104, the statutory accounting revisions predominantly adopt GAAP guidance for share-based payments with limited modifications to reflect existing statutory accounting concepts. As such, this issue paper adopts the GAAP guidance in ASC 505-50 with modifications as follows:

- a. To reduce variations from the GAAP guidance, this issue paper does not restrict a reporting entity from recognizing a prepaid asset to reflect the cost for the exchange of share-based payment before the receipt of goods or services. However, consistent with statutory accounting principles in *SSAP No. 29—Prepaid Expenses*, these assets are nonadmitted as they are not readily available to satisfy policyholder obligations.
- b. Pursuant to the statutory accounting concept of consistency, this issue paper clarifies that the minimum value method is not an acceptable method for determining the fair value of non-employee awards for all (public/non-public) entities.
- c. Consistent with guidance in *SSAP No. 5R—Liabilities, Contingencies and Impairments of Assets* for recognition of loss contingency estimates, the recognition of expected costs based on different possible outcomes, the amount recognized should reflect management's best estimate. If an amount within a range of possible outcomes cannot be deemed a better estimate, the midpoint of the range shall be recognized. This is different from the GAAP guidance that allows recognition of the lowest aggregate amount within a range.
- d. GAAP references are revised to reflect applicable statutory accounting guidance.

## EFFECTIVE DATE

9. Upon adoption of this issue paper, the NAIC will release a Statement of Statutory Accounting Principles (SSAP) for comment. The SSAP will contain the adopted Summary Conclusion of this issue paper. Users of the Accounting Practices and Procedures Manual should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions

reached in this issue paper should not be applied until the corresponding SSAP has been adopted by the Plenary of the NAIC. It is expected that the SSAP will contain an effective date of reporting periods beginning on or after January 1, 2014, with early adoption permitted.

## **RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE**

### **Statutory Accounting**

- *SSAP No. 104—Share-Based Payments*

### **Generally Accepted Accounting Principles**

- *Accounting Standards Codification Topic 505-50, Equity, Equity Payments to Non-Employees*

*The GAAP guidance in the ASC 505-50 has not been duplicated within this issue paper. This is similar to the process reflected in Issue Paper No. 129—Share-Based Payments, A Replacement of SSAP No. 13—Stock Options and Stock Purchase Plans (Issue Paper No. 129) as the GAAP guidance reflected the bulk of the proposed statutory guidance. (A similar process was also followed for Issue Paper No. 132—Accounting for Pensions, A Replacement of SSAP No. 89, Issue Paper No. 133—Accounting for Postretirement Benefits Other Than Pensions, A Replacement of SSAP No. 14, and Issue Paper No. 134—Servicing Assets/Liabilities, An Amendment of SSAP No. 91.) The tracked changes to reflect ASC 505-50 in SSAP No. 104R are shown in illustration A.*

**ILLUSTRATION A – SSAP NO. 104 - REVISED****SCOPE OF STATEMENT**

1. This statement provides statutory accounting principles for transactions in which an entity exchanges its equity instruments to employees and non-employees in share-based payment transactions. This statement does not provide statutory accounting principles for employee share ownership plans; those transactions are addressed in *SSAP No. 12—Employee Stock Ownership Plans*.

**SUMMARY OF ISSUE**

2. The objective of accounting for transactions under share-based payment arrangements with employees is to recognize in the financial statements the employee services received in exchange for equity instruments issued or liabilities incurred and the related cost to the entity as those services are consumed. The objective of accounting for share-based payment transactions with non-employees is to recognize in the financial statements the most reliably measurable fair values of such transactions. This statement uses the terms compensation and payment in their broadest senses to refer to the consideration paid for employee services and goods and services regardless of whether the supplier is an employee.

3. The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. This statement requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This statement establishes fair value as the measurement objective in accounting for share-based payment arrangements and requires all entities to apply a fair-value-based measurement method<sup>1</sup> in accounting for share-based payment transactions with employees except for equity instruments held by employee stock ownership plans.

**Scope and Scope Exceptions**

4. Employees - This statement applies to all share-based payment transactions in which an entity acquires employee services by issuing (or offering to issue) its shares, share options, or other equity instruments or by incurring liabilities to an employee that meet either of the following conditions:

- a. The amounts are based, at least in part<sup>2</sup>, on the price of the entity's shares or other equity instruments. ~~(The phrase "at least in part" is used because an award of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a market, performance, or service condition.)~~
- b. The awards require or may require settlement by issuing the entity's equity shares or other equity instruments.

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<sup>1</sup> Accounting pronouncements that require fair value measurements but that are excluded from *SSAP No. 100—Fair Value Measurements* is limited to this statement addressing share-based payment transactions. The fair value measurement objective in this statement is generally consistent with the fair value measurement objective in *SSAP No. 100*. However, for certain share-based payment transactions with employees, the measurements at the grant date are fair-value-based measurements, not fair value measurements. Although some measurements in this statement are fair value measurements, for practical reasons this statement is excluded in its entirety from *SSAP No. 100*. To be consistent with GAAP guidance on share-based payment transactions, the definition of fair value for use in this statement is: "the amount at which the asset (or liability) could be bought (or incurred) or sold (settled) in a current transaction between willing parties, that is, other than in a forced or liquidation sale." Observable market prices of identical or similar equity or liability instruments in active markets are the best estimate of fair value and, if available, should be used as the basis for the measurement of equity and liability instruments awarded in a share-based payment transaction with employees.

<sup>2</sup> The phrase "at least in part" is used because an award of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a market, performance, or service condition.

5. Share-based payments awarded to an employee of the reporting entity by a related party or other holder of an economic interest in the entity as compensation for services provided to the entity are share-based payment transactions to be accounted for under this statement unless the transfer is clearly for a purpose other than compensation for services to the reporting entity. The substance of such a transaction is that the economic interest holder makes a capital contribution to the reporting entity, and that entity makes a share-based payment to its employee in exchange for services rendered. An example of a situation in which such a transfer is not compensation is a transfer to settle an obligation of the economic interest holder to the employee that is unrelated to employment by the entity.

6. ~~The guidance in this statement does not apply to share-based transactions for other than employee services.~~ Non-Employees - This statement applies to all share-based payment transactions in which an entity acquires goods or services by issuing (or offering to issue) its shares, share-options, or other equity instruments or by incurring liabilities to a goods or service provider that is not an employee in amounts based, at least in part<sup>3</sup>, on the price of the entity's shares or other equity instruments or that require or may require settlement by issuing the entity's equity shares or other equity instrument.

7. The guidance in this statement does not apply to equity instruments held by an employee stock ownership plan. Such equity instruments shall follow the guidance in *SSAP No. 12—Employee Stock Ownership Plans* (SSAP No. 12). The guidance in this statement does not apply to transactions involving equity instruments either issued to a lender or investor that provides financing to the issuer or issued in a business combination.

8. The guidance for share-based payments to employees is contained in paragraphs 9-114, and the guidance for share-based payments to non-employees is contained in paragraphs 115-142. The guidance for employees is further in this statement is divided as follows:

- a. Compensatory Share-Based Payment Plans: Paragraphs 9-104.
- b. Noncompensatory Share-Based Payment Plans: Paragraphs 105-111.
- c. Consolidated/Holding Company Share-Based Payment Plans: Paragraphs 112-114.

### **Employee Share-Based Payments - Compensatory Share-Based Payment Plans**

#### **RECOGNITION**

#### **Recognition Principle for Share-Based Payment Transactions**

9. Stock purchase and stock option plans that do not meet the criteria of a non-compensatory plan (paragraphs 105-111) and are not otherwise excluded from the scope of this statement shall be classified as compensatory and follow the recognition, measurement and disclosure guidance in paragraphs 10-104.

10. An entity shall recognize the services received in a share-based payment transaction with an employee as services are received. Employee services themselves are not recognized before they are received. The entity shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria (see paragraphs 14-27). As the services are consumed, the entity shall recognize the related cost.

11. The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. For example, the rights and obligations embodied in a transfer of equity shares to an employee for a note that provides no recourse to other assets of the employee (that is, other

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<sup>3</sup> See Footnote 2

than the shares) are substantially the same as those embodied in a grant of equity share options. Thus, that transaction shall be accounted for as a substantive grant of equity share options.

12. Assessment of both the rights and obligations in a share-based payment award and any related arrangement and how those rights and obligations affect the fair value of an award requires the exercise of judgment in considering the relevant facts and circumstances.

#### Determining the Grant Date

13. As a practical accommodation, in determining the grant date of an award subject to this statement, assuming all other criteria in the grant date definition have been met, a mutual understanding of the key terms and conditions of an award to an individual employee shall be presumed to exist at the date the award is approved in accordance with the relevant corporate governance requirements (that is, by the Board or management with the relevant authority) if both of the following conditions are met:

- a. The award is a unilateral grant and, therefore, the recipient does not have the ability to negotiate the key terms and conditions of the award with the employer.
- b. The key terms and conditions of the award are expected to be communicated to an individual recipient within a relatively short time period from the date of approval. A relatively short time period is that period in which an entity could reasonably complete all actions necessary to communicate the awards to the recipients in accordance with the entity's customary human resource practices.

#### Determining Whether to Classify a Financial Instrument as a Liability or As Equity

14. ~~This paragraph~~ Paragraphs 14 through paragraph 27, provides guidance for determining whether certain financial instruments awarded in share-based payment transactions are liabilities. In determining whether an instrument not specifically discussed in those paragraphs shall be classified as a liability or as equity, an entity shall apply statutory accounting principles applicable to financial instruments issued in transactions not involving share-based payment.

15. Unless paragraphs 16-27 require otherwise, an entity shall apply the classification criteria in Appendix A, as they are effective at the reporting date, in determining whether to classify as a liability a freestanding financial instrument given to an employee in a share-based payment transaction. Paragraphs 64-68 provide criteria for determining when instruments subject to this statement subsequently become subject to other applicable statutory accounting principles.

16. In determining the classification of an instrument, an entity shall take into account the classification requirements that are effective for that specific entity at the reporting date as established by Appendix A. In addition, a call option written on an instrument that is not classified as a liability under those classification requirements also shall be classified as equity so long as those equity classification requirements for the entity continue to be met, unless liability classification is required under the provisions of paragraphs 19 and 20.

17. Appendix A does not apply to outstanding shares embodying a conditional obligation to transfer assets, for example, shares that give the employee the right to require the employer to repurchase them for cash equal to their fair value (puttable shares). A put right may be granted to the employee in a transaction that is related to a share-based compensation arrangement. If exercise of such a put right would require the entity to repurchase shares issued under the share-based compensation arrangement, the shares shall be accounted for as puttable shares. A puttable (or callable) share awarded to an employee as compensation shall be classified as a liability if either of the following conditions is met:

- a. The repurchase feature permits the employee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time from the date the requisite service is rendered and the share is issued. An employee begins to bear the risks and rewards normally associated with equity share ownership when all the requisite service has been rendered. A repurchase feature that can be exercised only upon the occurrence of a contingent event that is outside the employee's control (such as an initial public offering) would not meet this condition until it becomes probable that the event will occur within the reasonable period of time.
- b. It is probable that the employer would prevent the employee from bearing those risks and rewards for a reasonable period of time from the date the share is issued.

For this purpose, a period of six months or more is a reasonable period of time.

18. A puttable (or callable) share that does not meet either of those conditions shall be classified as equity.

19. Options or similar instruments on shares shall be classified as liabilities if either of the following conditions is met:

- a. The underlying shares are classified as liabilities.
- b. The entity can be required under any circumstances to settle the option or similar instrument by transferring cash or other assets. A cash settlement feature that can be exercised only upon the occurrence of a contingent event that is outside the employee's control (such as an initial public offering) would not meet this condition until it becomes probable that event will occur.

20. For example, a reporting entity that is a Securities and Exchange Commission (SEC) registrant may grant an option to an employee that, upon exercise, would be settled by issuing a mandatorily redeemable share. Because the mandatorily redeemable share would be classified as a liability under Appendix A (as well as under *SSAP No. 72—Surplus and Quasi-Reorganizations*), the option also would be classified as a liability.

21. An award may be indexed to a factor in addition to the entity's share price. If that additional factor is not a market, performance, or service condition, the award shall be classified as a liability for purposes of this statement, and the additional factor shall be reflected in estimating the fair value of the award.

22. For this purpose, an award of equity share options granted to an employee of an entity's foreign operation that provides for a fixed exercise price denominated either in the foreign operation's functional currency or in the currency in which the employee's pay is denominated shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, such an award is not required to be classified as a liability if it otherwise qualifies as equity. For example, equity share options with an exercise price denominated in euros granted to employees of a U.S. entity's foreign operation whose functional currency is the euro are not required to be classified as liabilities if those options otherwise qualify as equity. In addition, such options are not required to be classified as liabilities even if the functional currency of the foreign operation is the U.S. dollar, provided that the employees to whom the options are granted are paid in euros.

23. The accounting for an award of a share-based payment shall reflect the substantive terms of the award and any related arrangement. Generally, the written terms provide the best evidence of the substantive terms of an award. However, an entity's past practice may indicate that the substantive terms of an award differ from its written terms. For example, an entity that grants a tandem award under which an employee receives either a stock option or a cash-settled stock appreciation right is obligated to pay

cash on demand if the choice is the employee's, and the entity thus incurs a liability to the employee. In contrast, if the choice is the entity's, it can avoid transferring its assets by choosing to settle in stock, and the award qualifies as an equity instrument. However, if an entity that nominally has the choice of settling awards by issuing stock predominately settles in cash or if the entity usually settles in cash whenever an employee asks for cash settlement, the entity is settling a substantive liability rather than repurchasing an equity instrument. In determining whether an entity that has the choice of settling an award by issuing equity shares has a substantive liability, the entity also shall consider whether:

- a. It has the ability to deliver the shares. (Federal securities law generally requires that transactions involving offerings of shares under employee share option arrangements be registered, unless there is an available exemption. For purposes of this statement, such requirements do not, by themselves, imply that an entity does not have the ability to deliver shares and thus do not require an award that otherwise qualifies as equity to be classified as a liability.)
- b. It is required to pay cash if a contingent event occurs (see paragraphs 19-20).

24. A provision that permits employees to effect a broker-assisted cashless exercise of part or all of an award of share options through a broker does not result in liability classification for instruments that otherwise would be classified as equity if both of the following criteria are satisfied:

- a. The cashless exercise requires a valid exercise of the share options.
- b. The employee is the legal owner of the shares subject to the option (even though the employee has not paid the exercise price before the sale of the shares subject to the option).

25. A broker that is a related party of the entity must sell the shares in the open market within a normal settlement period, which generally is three days, for the award to qualify as equity.

26. Similarly, a provision for either direct or indirect (through a net-settlement feature) repurchase of shares issued upon exercise of options (or the vesting of nonvested shares), with any payment due employees withheld to meet the employer's minimum statutory withholding requirements resulting from the exercise, does not, by itself, result in liability classification of instruments that otherwise would be classified as equity. However, if an amount in excess of the minimum statutory requirement is withheld, or may be withheld at the employee's discretion, the entire award shall be classified and accounted for as a liability.

27. Minimum statutory withholding requirements are to be based on the applicable minimum statutory withholding rates required by the relevant tax authority (or authorities, for example, federal, state, and local), including the employee's share of payroll taxes that are applicable to such supplemental taxable income.

#### Market, Performance, and Service Conditions

28. Accruals of compensation cost for an award with a performance condition shall be based on the probable outcome of that performance condition—compensation cost shall be accrued if it is probable that the performance condition will be achieved and shall not be accrued if it is not probable that the performance condition will be achieved. If an award has multiple performance conditions (for example, if the number of options or shares an employee earns varies depending on which, if any, of two or more performance conditions is satisfied), compensation cost shall be accrued if it is probable that a performance condition will be satisfied. In making that assessment, it may be necessary to take into account the interrelationship of those performance conditions.



29. If an award requires satisfaction of one or more market, performance, or service conditions (or any combination thereof), compensation cost shall be recognized if the requisite service is rendered, and no compensation cost shall be recognized if the requisite service is not rendered.

#### Payroll Taxes

30. A liability for employee payroll taxes on employee stock compensation shall be recognized on the date of the event triggering the measurement and payment of the tax to the taxing authority (for a nonqualified option in the United States, generally the exercise date). Payroll taxes, even though directly related to the appreciation on stock options, are operating expenses and shall be reflected as such in the statement of operations.

#### **Initial Measurement**

31. While some of the material in paragraphs 31-34 was written in terms of awards classified as equity, it applies equally to awards classified as liabilities. The subparagraphs of paragraph 36 provide specific guidance for awards classified as liabilities.

32. A share-based payment transaction with employees shall be measured based on the fair value (or in certain situations specified in this statement, a calculated value or intrinsic value) of the equity instruments issued.

33. An entity shall account for the compensation cost from share-based payment transactions with employees in accordance with the fair-value-based method set forth in this statement. That is, the cost of services received from employees in exchange for awards of share-based compensation generally shall be measured based on the grant-date fair value of the equity instruments issued or on the fair value of the liabilities incurred. The cost of services received by an entity as consideration for equity instruments issued or liabilities incurred in share-based compensation transactions with employees shall be measured based on the fair value of the equity instruments issued or the liabilities settled. The portion of the fair value of an instrument attributed to employee service is net of any amount that an employee pays (or becomes obligated to pay) for that instrument when it is granted. For example, if an employee pays \$5 at the grant date for an option with a grant-date fair value of \$50, the amount attributed to employee service is \$45.

34. However, this statement provides certain exceptions (paragraph 49) to that measurement method if it is not possible to reasonably estimate the fair value of an award at the grant date. A reporting entity that is not able to reasonably estimate the fair value of its equity options and similar instruments may measure its liabilities under share-based payment arrangements at intrinsic value (see paragraphs 36.b. and 48).

#### Terms of the Award Affect Fair Value

35. The terms of a share-based payment award and any related arrangement affect its value and, except for certain explicitly excluded features, such as a reload feature, shall be reflected in determining the fair value of the equity or liability instruments granted. For example, the fair value of a substantive option structured as the exchange of equity shares for a nonrecourse note will differ depending on whether the employee is required to pay nonrefundable interest on the note.

#### Measurement Objective – Fair Value at Grant Date

36. The measurement objective for equity instruments awarded to employees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when employees have rendered the requisite service and satisfied any other conditions necessary to earn the right to benefit from the instruments (for example, to exercise share options). That estimate is based on the share price and

other pertinent factors, such as expected volatility, at the grant date. The following subparagraphs provide guidance regarding the measurement objective and measurement date for liability instruments:

- a. **Measurement Objective and Measurement Date for Liabilities:** At the grant date, the measurement objective for liabilities incurred under share-based compensation arrangements is the same as the measurement objective for equity instruments awarded to employees as described in paragraph 36. However, the measurement date for liability instruments is the date of settlement.
- b. **Measurement Objective and Measurement Date for Liabilities of Entities Subject to Paragraph 48:** An entity subject to paragraph 48 shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements at fair value or to measure all such liabilities at intrinsic value. Consistent with the guidance in paragraph 48, an entity that is not able to reasonably estimate the fair value of its equity share options and similar instruments because it is not practicable for it to estimate the expected volatility of its share price shall make a policy choice of whether to measure its liabilities under share-based payment arrangements at calculated value or at intrinsic value.

37. The fair value of an equity share option or similar instrument shall be measured based on the observable market price of an option with the same or similar terms and conditions.

38. Such market prices for equity share options and similar instruments granted to employees are frequently not available; however, they may become so in the future. As such, the fair value of an equity share option or similar instrument shall be estimated using a valuation technique such as an option-pricing model. For this purpose, a similar instrument is one whose fair value differs from its intrinsic value, that is, an instrument that has time value. For example, a share appreciation right that requires net settlement in equity shares has time value; an equity share does not.

### **Factors or Restrictions that Impact the Determination of Fair Value at Grant Date**

#### Vesting Versus Nontransferability

39. To satisfy the measurement objective in paragraph 36, the restrictions and conditions inherent in equity instruments awarded to employees are treated differently depending on whether they continue in effect after the requisite service period. A restriction that continues in effect after an entity has issued instruments to employees, such as the inability to transfer vested equity share options to third parties or the inability to sell vested shares for a period of time, is considered in estimating the fair value of the instruments at the grant date. For equity share options and similar instruments, the effect of nontransferability (and nonhedgeability, which has a similar effect) is taken into account by reflecting the effects of employees' expected exercise and postvesting employment termination behavior in estimating fair value (referred to as an option's expected term).

#### Forfeitability

40. A restriction that stems from the forfeitability of instruments to which employees have not yet earned the right, such as the inability either to exercise a nonvested equity share option or to sell nonvested shares, is not reflected in estimating the fair value of the related instruments at the grant date. Instead, those restrictions are taken into account by recognizing compensation cost only for awards for which employees render the requisite service.

### Performance of Service Conditions

41. Awards of share-based employee compensation ordinarily specify a performance condition or a service condition (or both) that must be satisfied for an employee to earn the right to benefit from the award. No compensation cost is recognized for instruments that employees forfeit because a service condition or a performance condition is not satisfied (that is, instruments for which the requisite service is not rendered).

42. The fair-value-based method described in paragraphs 36 and 39-43 uses fair value measurement techniques, and the grant-date share price and other pertinent factors are used in applying those techniques. However, the effects on the grant-date fair value of service and performance conditions that apply only during the requisite service period are reflected based on the outcomes of those conditions. This statement refers to the required measure as fair value.

### Market Conditions

43. Some awards contain a market condition. The effect of a market condition is reflected in the grant-date fair value of an award. (Valuation techniques have been developed to value path-dependent options as well as other options with complex terms. Awards with market conditions, as defined in this statement, are path-dependent options.) Compensation cost thus is recognized for an award with a market condition provided that the requisite service is rendered, regardless of when, if ever, the market condition is satisfied.

### Market, Performance, and Service Conditions That Affect Conditions Other than Vesting or Exercisability

44. Market, performance, and service conditions (or any combination thereof) may affect an award's exercise price, contractual term, quantity, conversion ratio, or other factors that are considered in measuring an award's grant-date fair value. A grant-date fair value shall be estimated for each possible outcome of such a performance or service condition, and the final measure of compensation cost shall be based on the amount estimated at the grant date for the condition or outcome that is actually satisfied.

### Nonvested or Restricted Shares

45. A nonvested equity share or nonvested equity share unit awarded to an employee shall be measured at its fair value as if it were vested and issued on the grant date.

46. Nonvested shares granted to employees usually are referred to as restricted shares, but this statement reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time.

47. A restricted share awarded to an employee, that is, a share that will be restricted after the employee has a vested right to it, shall be measured at its fair value, which is the same amount for which a similarly restricted share would be issued to third parties.

### Calculated Value for Entities Not Reasonably Able to Estimate Fair Value

48. An entity may not be able to reasonably estimate the fair value of its equity share options and similar instruments because it is not practicable for it to estimate the expected volatility of its share price. In that situation, the entity shall account for its equity share options and similar instruments based on a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity's share price (the calculated value). Throughout the remainder of this statement, provisions that apply to accounting for share options and similar instruments at fair value also apply to calculated value.

### Difficulty of Estimation

49. It should be possible to reasonably estimate the fair value of most equity share options and other equity instruments at the date they are granted. However, in rare circumstances, it may not be possible to reasonably estimate the fair value of an equity share option or other equity instrument at the grant date because of the complexity of its terms.

50. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be accounted for based on its intrinsic value (paragraph 70) for measurement after issue date.

### Reload and Contingent Features

51. The fair value of each award of equity instruments, including an award of options with a reload feature (reload options), shall be measured separately based on its terms and the share price and other pertinent factors at the grant date. The effect of a reload feature in the terms of an award shall not be included in estimating the grant-date fair value of the award. Rather, a subsequent grant of reload options pursuant to that provision shall be accounted for as a separate award when the reload options are granted.

52. A contingent feature of an award that might cause an employee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature shall not be reflected in estimating the grant-date fair value of an equity instrument.

### Requisite Service Period

53. An entity shall make its initial best estimate of the requisite service period at the grant date (or at the service inception date, if that date precedes the grant date) and shall base accruals of compensation cost on that period.

54. The initial best estimate and any subsequent adjustment to that estimate of the requisite service period for an award with a combination of market, performance, or service conditions shall be based on an analysis of all of the following:

- a. All vesting and exercisability conditions
- b. All explicit, implicit, and derived service periods
- c. The probability that performance or service conditions will be satisfied.

### Market, Performance, and Service Conditions

55. Performance or service conditions that affect vesting are not reflected in estimating the fair value of an award at the grant date because those conditions are restrictions that stem from the forfeitability of instruments to which employees have not yet earned the right. However, the effect of a market condition is reflected in estimating the fair value of an award at the grant date (paragraph 43). For purposes of this statement, a market condition is not considered to be a vesting condition, and an award is not deemed to be forfeited solely because a market condition is not satisfied.

### **Subsequent Measurement**

56. Guidance that equally applies to both liabilities and equity is generally found in paragraphs 57-69. Paragraphs 70-78 provide additional subsequent measurement guidance for awards classified as equity and paragraphs 79-82 provide additional subsequent measurement guidance for awards classified as liabilities.

### Recognition of Compensation Costs Over the Requisite Service

57. The compensation cost for an award of share-based employee compensation classified as equity shall be recognized over the requisite service period, with a corresponding credit to equity (generally, paid-in capital). The requisite service period is the period during which an employee is required to provide service in exchange for an award, which often is the vesting period. The requisite service period is estimated based on an analysis of the terms of the share-based payment award.

58. The total amount of compensation cost recognized at the end of the requisite service period for an award of share-based compensation shall be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed). An entity shall base initial accruals of compensation cost on the estimated number of instruments for which the requisite service is expected to be rendered. That estimate shall be revised if subsequent information indicates that the actual number of instruments is likely to differ from previous estimates. The cumulative effect on current and prior periods of a change in the estimated number of instruments for which the requisite service is expected to be or has been rendered shall be recognized in compensation cost in the period of the change. Previously recognized compensation cost shall not be reversed if an employee share option (or share unit) for which the requisite service has been rendered expires unexercised (or unconverted).

59. An entity shall reverse previously recognized compensation cost for an award with a market condition only if the requisite service is not rendered.

### Estimating the Requisite Service Period

60. The requisite service period may be explicit or it may be implicit, being inferred from an analysis of other terms in the award, including other explicit service or performance conditions. The requisite service period for an award that contains a market condition can be derived from certain valuation techniques that may be used to estimate grant-date fair value. An award may have one or more explicit, implicit, or derived service periods; however, an award may have only one requisite service period for accounting purposes unless it is accounted for as in-substance multiple awards. An award with a graded vesting schedule that is accounted for as in-substance multiple awards is an example of an award that has more than one requisite service period (paragraph 63).

61. The service inception date is the beginning of the requisite service period. If the service inception date precedes the grant date, accrual of compensation cost for periods before the grant date shall be based on the fair value of the award at the reporting date. In the period in which the grant date occurs, cumulative compensation cost shall be adjusted to reflect the cumulative effect of measuring compensation cost based on fair value at the grant date rather than the fair value previously used at the service inception date (or any subsequent reporting date).

62. An entity shall adjust that initial best estimate in light of changes in facts and circumstances. Whether and how the initial best estimate of the requisite service period is adjusted depends on both the nature of the conditions identified in paragraph 54 and the manner in which they are combined, for example, whether an award vests or becomes exercisable when either a market or a performance condition is satisfied or whether both conditions must be satisfied.

### Graded Vesting Awards

63. An entity shall make a policy decision about whether to recognize compensation cost for an award with only service conditions that has a graded vesting schedule in either of the following ways:

- a. On 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. On 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 must at least equal the portion of the grant-date value of the award that is vested at that date.

#### Awards May Become Subject to Other Guidance

64. Paragraphs 65-68 are intended to apply to those instruments issued in share-based payment transactions with employees accounted for under this statement, and to instruments exchanged in a business combination for share-based payment awards of the acquired business that were originally granted to employees of the acquired business and are outstanding as of the date of the business combination. Instruments issued, in whole or in part, as consideration for goods or services other than employee service shall not be considered to have been issued in exchange for employee service when applying the guidance in those paragraphs, irrespective of the employment status of the recipient of the award on the grant date.

65. A freestanding financial instrument issued to an employee in exchange for past or future employee services that is subject to initial recognition and measurement guidance within this statement shall continue to be subject to the recognition and measurement provisions of this statement throughout the life of the instrument, unless its terms are modified when the holder is no longer an employee. Only for purposes of this paragraph, 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 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.
- b. All holders of the same class of equity instruments (for example, stock options) are treated in the same manner.

66. Other modifications of that instrument that take place when the holder is no longer an employee shall be subject to the modification guidance in paragraph 68. Following modification, recognition and measurement of the instrument should be determined through reference to other applicable statutory accounting principles.

67. Once the classification of an instrument is determined, the recognition and measurement provisions of this statement shall be applied until the instrument ceases to be subject to the requirements discussed in paragraph 65. Other applicable statutory accounting principles applies to a freestanding financial instrument that was issued under a share-based payment arrangement but that is no longer subject to this statement.

68. An entity may modify (including cancel and replace) or settle a fully vested, freestanding financial instrument after it becomes subject to other applicable statutory accounting principles. Such a modification or settlement shall be accounted for under the provisions of this statement unless it applies equally to all financial instruments of the same class regardless of whether the holder is (or was) an employee (or an employee's beneficiary). Following the modification, the instrument continues to be accounted for under other applicable statutory accounting principles. A modification or settlement of a class of financial instrument that is designed exclusively for and held only by current or former employees (or their beneficiaries) may stem from the employment relationship depending on the terms of the modification or settlement. Thus, such a modification or settlement may be subject to the

requirements of this statement. See paragraph 65 for a discussion of changes to awards made solely to reflect an equity restructuring.

#### Change in Classification Due to Change in Probable Settlement Outcome

69. An option or similar instrument that is classified as equity, but subsequently becomes a liability because the contingent cash settlement event is probable of occurring, shall be accounted for similar to a modification from an equity to liability award. That is, on the date the contingent event becomes probable of occurring (and therefore the award must be recognized as a liability), the entity recognizes a share-based liability equal to the portion of the award attributed to past service (which reflects any provision for acceleration of vesting) multiplied by the award's fair value on that date. To the extent the liability equals or is less than the amount previously recognized in equity, the offsetting debit is a charge to equity. To the extent that the liability exceeds the amount previously recognized in equity, the excess is recognized as compensation cost. The total recognized compensation cost for an award with a contingent cash settlement feature shall at least equal the fair value of the award at the grant date. The guidance in this paragraph is applicable only for options or similar instruments issued as part of employee compensation arrangements. That is, the guidance included in this paragraph is not applicable, by analogy or otherwise, to instruments outside employee share-based payment arrangements.

#### **Subsequent Measurement - Awards Classified as Equity**

##### Fair Value Not Reasonably Estimable

70. An equity instrument for which it is not possible to reasonably estimate fair value at the grant date shall be remeasured at each reporting date through the date of exercise or other settlement. The final measure of compensation cost shall be the intrinsic value of the instrument at the date it is settled. Compensation cost for each period until settlement shall be based on the change (or a portion of the change, depending on the percentage of the requisite service that has been rendered at the reporting date) in the intrinsic value of the instrument in each reporting period. The entity shall continue to use the intrinsic value method for those instruments even if it subsequently concludes that it is possible to reasonably estimate their fair value.

##### Contingent Features

71. A contingent feature of an award that might cause an employee to return to the entity either equity instruments earned or realized gains from the sale of equity instruments earned for consideration that is less than fair value on the date of transfer (including no consideration), such as a clawback feature, shall be accounted for if and when the contingent event occurs.

##### Modification of An Award

72. 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. 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 statement 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 48, references to fair value throughout this statement shall be read also to encompass calculated value. 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 58.

- 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:
  - i. 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, and
  - ii. The incremental cost resulting from the modification.

Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 58.

- c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 70 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.

73. Paragraphs 64-68 provide additional guidance on accounting for modifications of certain freestanding financial instruments that initially were subject to this statement but subsequently became subject to other applicable statutory accounting principles.

#### Short-Term Inducements

74. 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

75. 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. 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 72. 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. See paragraph 65 for an additional exception.

#### Repurchase or Cancellation

76. 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

77. 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 72. 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.

78. 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.

### **Subsequent Measurement - Awards Classified as Liabilities**

#### Measurement

79. The fair value of liabilities incurred in share-based payment transactions with employees shall be remeasured at the end of each reporting period through settlement.

80. Changes in the fair value (or intrinsic value for an entity that elects that method) of a liability incurred under a share-based payment arrangement that occur during the requisite service period shall be recognized as compensation cost over that period. The percentage of the fair value (or intrinsic value) that is accrued as compensation cost at the end of each period shall equal the percentage of the requisite service that has been rendered at that date. Changes in the fair value (or intrinsic value) of a liability that occur after the end of the requisite service period are compensation costs of the period in which the changes occur. Any difference between the amount for which a liability award is settled and its fair value at the settlement date as estimated in accordance with the provisions of this statement is an adjustment of compensation cost in the period of settlement.

81. Reporting entities shall measure a liability award under a share-based payment arrangement based on the award's fair value (or calculated value in accordance with paragraph 48) remeasured at each reporting date until the date of settlement. Compensation costs for each period until settlement shall be based on the change (or a portion of the change, depending on the percentage of the requisite service that has been rendered at the reporting date) in the fair value of the instrument for each reporting period.

#### Modification of an Award

82. A modification of a liability award is accounted for as the exchange of the original award for a new award. However, because liability awards are remeasured at their fair value (or calculated value for an entity subject to paragraph 48) at each reporting date, no special guidance is necessary in accounting for a modification of a liability award that remains a liability after the modification.

### **Look-Back Plans**

83. The accounting guidance in this section addresses the accounting for certain employee stock purchase plans with a look-back option. An example of a look-back option is a provision that establishes

the purchase price as an amount based on the lesser of the stock's market price at the grant date or its market price at the exercise date (or purchase date).

84. As with all employee share purchase plans, the objective of the measurement process for employee share purchase plans with a look-back option is to reasonably measure fair value of the award at the grant date. Paragraph 70 provides guidance on the measurement requirements if it is not possible to reasonably estimate fair value at the grant date.

### **Accounting for Tax Effects of Share-Based Compensation Awards**

85. Income tax regulations specify allowable tax deductions for instruments issued under share-based payment arrangements in determining an entity's income tax liability. For example, under tax law, allowable tax deductions may be measured as the intrinsic value of an instrument on a specified date. The time value component, if any, of the fair value of an instrument generally may not be tax deductible. Therefore, tax deductions may arise in different amounts and in different periods from compensation costs recognized in financial statements. Similarly, the amount of expense reported for an employee stock ownership plan during a period may differ from the amount of the related income tax deduction prescribed by income tax rules and regulations.

86. This guidance addresses how temporary differences are recognized for share-based payment arrangement awards that are classified either as equity or as liabilities under the requirements of paragraphs 14-27. Incremental guidance is also provided for issues related to employee stock ownership plans.

#### Tax Effects for Instruments Classified as Equity

87. The cumulative amount of compensation cost recognized for instruments classified as equity that ordinarily would result in a future tax deduction under existing tax law shall be considered to be a deductible temporary difference in applying the requirements of *SSAP No. 101—Income Taxes, a Replacement of SSAP No. 10R and SSAP No. 10* (SSAP No. 101). The deductible temporary difference shall be based on the compensation cost recognized for financial reporting purposes. Compensation cost that is capitalized as part of the cost of an asset, such as inventory, shall be considered to be part of the tax basis of that asset for financial reporting purposes.

88. Recognition of compensation cost for instruments that ordinarily do not result in tax deductions under existing tax law shall not be considered to result in a deductible temporary difference. A future event can give rise to a tax deduction for instruments that ordinarily do not result in a tax deduction. The tax effects of such an event shall be recognized only when it occurs. An example of a future event that would be recognized only when it occurs is an employee's sale of shares obtained from an award before meeting a tax law's holding period requirement, sometimes referred to as a disqualifying disposition, which results in a tax deduction not ordinarily available for such an award.

#### Tax Effects for Instruments Classified as Liability

89. The cumulative amount of compensation cost recognized for instruments classified as liabilities that ordinarily would result in a future tax deduction under existing tax law also shall be considered to be a deductible temporary difference. The deductible temporary difference shall be based on the compensation costs recognized for financial reporting purposes.

#### Accounting for Tax Effects – Initial Measurement

90. SSAP No. 101 requires a deferred tax asset to be evaluated for future realization and to be reduced by a statutory valuation allowance to the amount that is more likely than not to be realized. Differences between the deductible temporary difference computed pursuant to paragraphs 87-88 and the

tax deduction that would result based on the current fair value of the entity's shares shall not be considered in measuring the gross deferred tax asset or determining the need for a valuation allowance for a deferred tax asset recognized under these requirements.

#### Accounting for Tax Effects – Subsequent Measurement

91. If a deduction reported on a tax return for an award of equity instruments exceeds the cumulative compensation cost for those instruments recognized for financial reporting, any resulting realized tax benefit that exceeds the previously recognized deferred tax asset for those instruments is the excess tax benefit. If only a portion of an award is exercised, determination of the excess tax benefits shall be based on the portion of the award that is exercised.

92. The amount deductible for an award of equity instruments on the employer's tax return may be less than the cumulative compensation costs recognized for financial reporting purposes. The write-off of a deferred tax asset related to that deficiency, net of the related statutory valuation allowance, if any, shall first be offset to the extent of any remaining gross paid-in and contributed surplus from excess tax benefits arising from previous awards granted, modified, or settled in cash and measured in accordance with a fair value based method of accounting. An entity shall exclude from that amount excess tax benefits from share-based payment arrangements that are outside the scope of this statement, excess tax benefits from employee stock ownership plans, and excess tax benefits that have not been realized pursuant to the requirements established in SSAP No. 101.

93. An excess tax benefit determined pursuant to paragraph 91 shall be recognized as gross paid-in and contributed surplus, except that an excess of a realized tax benefit for an award over the deferred tax asset for that award shall be recognized in the income statement to the extent that the excess stems from a reason other than changes in the fair value of an entity's shares between the measurement date for accounting purposes and a later measurement date for tax purposes.

94. Paragraph 92 contains measurement guidance on how much, if any, of the write-off of a deferred tax asset from a tax deficiency shall be offset against additional paid-in capital. The remaining balance, if any, of the write-off of a deferred tax asset related to a tax deficiency shall be recognized in the income statement.

#### Tax Benefits of Dividends on Share-Based Payment Awards to Employees

95. A realized income tax benefit from dividends or dividend equivalents that are charged to unassigned-funds (surplus) and are paid to employees for any of the following equity classified awards shall be recognized as an increase to gross paid-in and contributed surplus:

- a. Nonvested equity shares
- b. Nonvested equity share units
- c. Outstanding equity share options.

96. The amount recognized in gross paid-in and contributed surplus for the realized income tax benefit from dividends on the awards identified in the preceding paragraph shall be included in the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards.

97. Dividends or dividend equivalents paid to employees for the awards identified in paragraph 95 may result in a tax deduction prior to the actual realization of the related tax benefit because the employer, for example, has a net operating loss carryforward. The income tax benefit of those dividends shall not be recognized until the deduction reduces income taxes payable. Unrealized income tax benefits from dividends on equity-classified employee share-based payment awards shall be excluded from the

pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards.

98. Dividends or dividend equivalents paid to employees on the portion of an award of equity shares or other equity instruments that vests shall be charged to unassigned funds (surplus). If the related award is not expected to vest, dividends or dividend equivalents shall be recognized as compensation costs. Dividends and dividend equivalents shall be reclassified between unassigned funds (surplus) and compensation costs in a subsequent period if the entity changes its forfeiture estimates (or actual forfeitures differ from previous estimates).

99. Adjustments to gross paid-in and contributed surplus for reclassifications of the tax benefits from dividends on the awards discussed in the preceding paragraph in subsequent periods increase or decrease the entity's pool of excess tax benefits available to absorb tax deficiencies by a corresponding amount. Additionally, the tax benefits from dividends that are reclassified from gross paid-in and contributed surplus to the income statement (that is, as a reduction of income tax expense or an increase of income tax benefit) if an entity's estimate of forfeitures increases (or actual forfeitures exceed the entity's estimates) shall be limited to the entity's pool of excess tax benefits available to absorb tax deficiencies on the date of the reclassification.

### Accounting for Rabbi Trusts

100. Rabbi trusts are grantor trusts generally set up to fund compensation for a select group of management or highly paid executives. To qualify as a rabbi trust for income tax purposes, the terms of the trust agreement must explicitly state that the assets of the trust are available to satisfy the claims of general creditors in the event of bankruptcy of the employer.

101. There are four potential scenarios for deferred compensation arrangements where amounts earned by an employee are invested in the stock of the employer and placed in a "rabbi trust."

- Plan A: The plan does not permit diversification and must be settled by the delivery of a fixed number of shares of employer stock.
- Plan B: The plan does not permit diversification and may be settled by the delivery of cash or shares of employer stock.
- Plan C: The plan permits diversification; however, the employee has not diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).
- Plan D: The plan permits diversification and the employee has diversified (the plan may be settled in cash, shares of employer stock, or diversified assets).

102. The accounts of the rabbi trust should be consolidated with the accounts of the employer in the financial statements of the employer.

- a. For Plan A, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as an equity instrument and changes in the fair value of the amount owed to the employee should not be recognized.
- b. For Plans B and C, employer stock held by the rabbi trust should be classified in equity in a manner similar to the manner in which treasury stock is accounted for. Subsequent changes in the fair value of the employer's stock should not be recognized. The deferred compensation obligation should be classified as a liability and adjusted with a

corresponding charge (or credit) to compensation cost, to reflect the changes in the fair value of the amount owed to the employee.

- c. For Plan D, assets held by the rabbi trust should be accounted for in accordance with statutory accounting principles for the particular asset (for example, if the diversified asset is a marketable equity security, that security would be accounted for in accordance with SSAP No. 30). The deferred compensation obligation should be classified as a liability and adjusted, with a corresponding charge (or credit) to compensation cost, to reflect changes in the fair value of the amount owed to the employee. Changes in the fair value of the deferred compensation obligation should not be recorded in unrealized gains or losses, even if changes in the fair value of the assets held by the rabbi trust are recorded in surplus, pursuant to *SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled or affiliated entities)*, ~~in surplus~~.

### **Disclosures – Employee Share-Based Payments**

103. An entity with one or more share-based payment arrangements shall disclose information that enables users of the financial statements to understand all of the following:

- a. The nature and terms of such arrangements that existed during the period and the potential effects of those arrangements on shareholders;
- b. The effect of compensation costs arising from share-based payment arrangements on the income statement;
- c. The method of estimating the fair value of the goods or services received, or the fair value of the equity instruments granted (or offered to grant), during the period; and
- d. The cash flow effects resulting from share-based payment arrangements.

104. The disclosures in paragraph 103 are for annual audited statutory financial statements only. Appendix B ~~provides~~ illustrates the information needed to achieve the objectives in this paragraph.

### **Employee Share-Based Payments - Noncompensatory ~~Employee Share Purchase Plans~~**

#### Overview and Background

105. This section provides guidance to all entities that use employee share purchase plans. The entity must first determine whether the plan is compensatory or noncompensatory. This is determined by the terms of the plan (paragraphs 106-107). A plan with an option feature, for example a look-back feature, is considered compensatory.

#### Recognition

106. An employee share purchase plan that satisfies all of the following criteria does not give rise to recognizable compensation costs (that is, the plan is noncompensatory):

- a. The plan satisfies either of the following conditions:
  - i. The terms of the plan are no more favorable than those available to all holders of the same class of shares. Note that a transaction subject to an employee share purchase plan that involves a class of equity shares designed exclusively for and held only by current or former employees or their beneficiaries may be compensatory depending on the terms of the arrangement.

- ii. Any purchase discount from the market price does not exceed the per-share amount of share issuance costs that would have been incurred to raise a significant amount of capital by a public offering. A purchase discount of 5 percent or less from the market price shall be considered to comply with this condition without further justification. A purchase discount greater than 5 percent that cannot be justified under this condition results in compensation cost for the entire amount of the discount. Note that an entity that justifies a purchase discount in excess of 5 percent shall reassess at least annually, and no later than the first share purchase offer during the fiscal year, whether it can continue to justify that discount pursuant to this paragraph.
- b. Substantially all employees that meet limited employment qualifications may participate on an equitable basis.
- c. The plan incorporates no option features, other than the following:
  - i. Employees are permitted a short period of time—not exceeding 31 days—after the purchase price has been fixed to enroll in the plan.
  - ii. The purchase price is based solely on the market price of the shares at the date of purchase, and employees are permitted to cancel participation before the purchase date and obtain a refund of amounts previously paid (such as those paid by payroll withholdings).

107. A plan provision that establishes the purchase price as an amount based on the lesser of the equity share's market price at date of grant or its market price at date of purchase, commonly called a look-back plan, is an example of an option feature that causes the plan to be compensatory. Similarly, a plan in which the purchase price is based on the share's market price at date of grant and that permits a participating employee to cancel participation before the purchase date and obtain a refund of amounts previously paid contains an option feature that causes the plan to be compensatory.

108. The requisite service period for any compensation cost resulting from an employee share purchase plan is the period over which the employee participates in the plan and pays for the shares.

#### Initial Measurement

109. The objective in paragraph 36 also applies to the fair value measurements associated with grants under a compensatory employee share purchase plan. The objective in this paragraph states that the fair value measurement method is to estimate the fair value of the equity instruments, based on the share price and other measurement assumptions at the grant date, that are issued in exchange for employee services.

#### Subsequent Measurement

110. Changes in total employee withholdings during a purchase period that occur solely as a result of salary increases, commissions, or bonus payments are not plan modifications if they do not represent changes to the terms of the award that was offered by the employer and initially agreed to by the employee at the grant (or measurement) date. Under those circumstances, the only incremental compensation cost is that which results from the additional shares that may be purchased with the additional amounts withheld (using the fair value calculated at the grant date). For example, an employee may elect to participate in the plan on the grant date by requesting that 5 percent of the employee's annual salary be withheld for future purchases of stock. If the employee receives an increase in salary during the term of the award, the base salary on which the 5 percent withholding amount is applied will increase, thus increasing the total amount withheld for future share purchases. That increase in withholdings as a result of the salary increase is not considered a plan modification and thus only increases the total

compensation cost associated with the award by the grant date fair value associated with the incremental number of shares that may be purchased with the additional withholdings during the period. The incremental number of shares that may be purchased is calculated by dividing the incremental amount withheld by the exercise price as of the grant date (for example, 85 percent of the grant date stock price).

111. Any decreases in the withholding amounts (or percentages) shall be disregarded for purposes of recognizing compensation cost unless the employee services that were valued at the grant date will no longer be provided to the employer due to a termination. However, no compensation cost shall be recognized for awards that an employee forfeits because of failure to satisfy a service requirement for vesting. The accounting for decreases in withholdings is consistent with the requirement in paragraph 58 that the total amount of compensation cost that must be recognized for an award be based on the number of instruments for which the requisite service has been rendered (that is, for which the requisite service period has been completed).

### **Employee Share-Based Payments - Consolidated / Holding Company Plans**

112. Except for the disclosure requirement in paragraph 113 below, the provisions of this statement do not apply to a reporting entity, as long as:

- a. The reporting entity is not directly liable for obligations under the share-based payment plan.
- b. Compensation costs associated with share-based payments provided by a related party or holder of an economic interest in the reporting entity, equal to the required contribution to the plan for the period, are included in allocated expenses to the reporting entity. A liability shall be established for any such contributions due and unpaid.

113. The reporting entity shall disclose in the financial statements that its employees participate in a plan sponsored by the holding company for which the reporting entity has no legal obligation. The amount of the expense incurred and the allocation methodology utilized by the provider of such benefits shall also be disclosed.

114. If the reporting entity is directly liable for the share-based payment plan, then the other provisions of this statement apply.

### **Non-Employee Share-Based Payments**

115. Reporting entities that grant share-based payments to non-employees shall recognize the goods acquired or services received as part of the transaction when it obtains the goods or as services are received. A grantor may need to recognize a *nonadmitted prepaid* asset before it actually receives goods or services if it first exchanges share-based payment for an enforceable right to receive those goods or services. Nonetheless, the goods or services shall not be recognized before they are received. (*The nonadmitted asset recognized prior to the goods and services would be eliminated upon receipt of the goods and services that are recognized.*)

116. If fully vested, nonforfeitable equity instruments are issued at the date the grantor and grantee enter into an agreement for goods or services (no specific performance is required by the grantee to retain those equity instruments), then, because of the elimination of any obligation on the part of the counterparty to earn the equity instruments, a measurement date has been reached. A grantor shall recognize the equity instruments when they are issued (in most cases, when the agreement is entered into). Whether the corresponding cost is an immediate expense or a *nonadmitted prepaid* asset depends on the specific facts and circumstances. A grantor may conclude that an asset (other than a note or a receivable) has been received in return for fully-vested, nonforfeitable equity instruments that are issued at the date the grantor and grantee enter into an agreement for goods or services (and no specific

performance is required by the grantee in order to retain those equity instruments). Such an asset shall not be displayed as contra-equity by the grantor of the equity instrument. The transferability (or lack thereof) of the equity instruments shall not affect the balance sheet display of this *nonadmitted prepaid* asset. This guidance is limited to transactions in which equity instruments are transferred to other than employees in exchange for goods or services.

117. An entity may grant fully vested, nonforfeitable equity instruments that are exercisable by the grantee only after a specified period of time if the terms of the agreement provide for earlier exercisability if the grantee achieves specified performance conditions. Any measured cost of the transaction shall be recognized in the same period(s) and in the same manner as if the entity had paid cash for the goods or services or used cash rebates as a sales discount instead of paying with, or using, the equity instruments.

118. A recognized *nonadmitted prepaid* asset, expense, or sales discount shall not be reversed if a stock option that the counterparty has the right to exercise expires unexercised. As noted in paragraph 115, the goods and services shall not be recognized before they are received.

119. A grantor shall recognize either a corresponding increase in equity or a liability, depending on whether the instruments granted satisfy the equity or liability classification criteria established in paragraphs 14-27 for *employee share-based payments*. As the goods or services are disposed of or consumed, the grantor shall recognize the related cost, unless other statutory accounting principles require costs to be expensed when incurred. In these instances, when the goods or services are received, the grantor shall recognize the related cost.

#### Initial Measurement – Reporting Entity Grantor/Issuer

120. Share-based payment transactions with non-employees shall be measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable.

121. The accounting for all share-based payment transactions shall reflect the rights conveyed to the holder of the instruments and the obligations imposed on the issuer of the instruments, regardless of how those transactions are structured. The terms of a share-based payment award and any related arrangement affect its value and, except for certain explicitly excluded features, such as a reload feature, shall be reflected in determining the fair value of the equity or liability instruments granted. Assessment of both the rights and obligations in a share-based payment award and any related arrangement and how those rights and obligations affect the fair value of an award requires the exercise of judgment in considering the relevant facts and circumstances. The minimum value method (a method that reflects the time value of an option but ignores the volatility value) is not an acceptable method for determining the fair value of non-employee awards.

122. If the fair value of goods or services received in a share-based payment transaction with non-employees is more reliably measurable than the fair value of the equity instruments issued, the fair value of the goods or services received shall be used to measure the transaction. In contrast, if the fair value of the equity instruments issued in a share-based payment transaction with non-employees is more reliably measurable than the fair value of the consideration received, the transaction shall be measured based on the fair value of the equity instruments issued.

123. Sales incentives in the form of equity instruments shall be measured at the fair value of the sales incentive or the fair value of the equity instruments issued, whichever is more reliably measurable.

124. The issuer/*grantor* shall measure the fair value of the equity instruments *provided in share-based payment* transactions using the stock price and other measurement assumptions as of the earlier of the following dates, referred to as the measurement date:



- a. The date at which a commitment for performance by the counterparty to earn the equity instruments is reached (a performance commitment<sup>4</sup>)
- b. The date at which the counterparty's performance is complete.

125. The counterparty's performance is complete when the counterparty has delivered or, in the case of sales incentives, purchased the goods or services, despite the fact that at that date the quantity or all the terms of the equity instruments may yet depend on other events (this would occur, for example, if a target stock price requirement has not been met when the counterparty has delivered the goods or services).

126. Situations may arise in which counterparty performance may be required over a period of time but the equity award granted to the party performing the services is fully vested and nonforfeitable on the date the parties enter into the contract. While this type of arrangement may be rare, because, typically, vesting provisions do exist, the measurement date for an award that is nonforfeitable and that vests immediately could be the date the parties enter into the contract, even though services have not yet been performed.

127. If fully vested, nonforfeitable equity instruments are issued at the date the grantor and grantee enter into an agreement for goods or services (no specific performance is required by the grantee to retain those equity instruments), then, because of the elimination of any obligation on the part of the counterparty to earn the equity instruments, a measurement date has been reached.

128. If an entity grants fully vested, nonforfeitable equity instruments that are exercisable by the grantee only after a specified period of time and the terms of the agreement provide for earlier exercisability if the grantee achieves specified performance conditions, the grantor shall measure the fair value of the equity instruments at the date of grant and shall recognize that measured cost in the same period(s) and in the same manner as if the grantor had paid cash.

#### Initial Measurement – Reporting Entity Grantee/Provider

129. An entity (the grantee or provider) may enter into transactions to provide goods or services in exchange for equity instruments. The grantee shall measure the fair value of the equity instruments in these transactions using the stock price and other measurement assumptions as of the earlier of either of the following dates referred to as the measurement date:

- a. The date the parties come to a mutual understanding of the terms of the equity-based compensation arrangement and a commitment for performance by the grantee to earn the equity instruments (a performance commitment<sup>5</sup>) is reached, or
- b. The date at which the grantee's performance necessary to earn the equity instruments is complete (that is, the vesting date).

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<sup>4</sup> A performance commitment is a commitment under which performance by the grantee to earn the equity instruments is probable because of sufficiently large disincentives for nonperformance. The disincentives must result from the relationship between the grantor and the grantee. Forfeiture of the equity instruments as the sole remedy in the event of the grantee's nonperformance is not considered a sufficiently large disincentive for purposes of applying the guidance. In addition, the ability to sue for nonperformance, in and of itself, does not represent a sufficiently large disincentive to ensure that performance is probable. (A granting entity may always be able to sue for nonperformance but it is not always clear whether any significant damages would result.)

<sup>5</sup> See Footnote 4.

### Measurement Before the Measurement Date

130. In accordance with other accounting guidance, it may be appropriate for an issuer to recognize costs related to share-based payment transactions with non-employees before a measurement date has occurred:

- a. If the quantity and terms of the equity instruments are known up front, the equity instruments shall be measured at their then-current fair values at each interim financial reporting date.
- b. If the quantity and terms of the equity instruments are not known up front, and the transaction is only impacted by market conditions, the equity instruments shall be measured at their then-current fair values at each interim financial reporting date.
- c. If the quantity and terms of the equity instruments are not known up front, and the transaction is only impacted by counterparty performance conditions or both market conditions and counterparty performance conditions, the equity instruments shall be measured at their then-current *best estimate of the possible outcomes*. *When no amount within a range can be deemed a better estimate, then the midpoint of the range shall be used.*

### Measurement at the Measurement Date – Transactions Involve Only Market Conditions

131. The quantity or terms of an equity instrument may be dependent only on market conditions. If, on the measurement date, the quantity or any of the terms of the equity instruments are dependent on the achievement of market conditions, then the issuer shall use the fair value of the equity instruments for recognition purposes. That fair value shall be calculated as the fair value of the equity instruments without regard to the market condition plus the fair value of the issuer's commitment to change the quantity or terms of the equity instruments based on whether the market condition is met.

132. As it relates to a grantee, if on the measurement date the quantity or any of the terms of the equity instrument are dependent on the achievement of a market condition, then the grantee shall measure revenue based on the fair value of the equity instruments inclusive of the adjustment provisions. That fair value would be calculated as the fair value of the equity instruments without regard to the market condition plus the fair value of the commitment to change the quantity or terms of the equity instruments if the market condition is met. That is, the existence of a market condition that, if achieved, results in an adjustment to an equity instrument generally affects the value of the instrument. Pricing models have been adapted to value many of those path-dependent equity instruments.

133. The quantity or terms of an equity instrument may be dependent on counterparty performance conditions. If, on the measurement date, the quantity or any of the terms of the equity instruments are dependent on the achievement of counterparty performance conditions that, based on the different possible outcomes, result in a range of aggregate fair values for the equity instruments as of that date, then the issuer should utilize the *best estimate* (that is, the variable terms times the applicable number of equity instruments) amount within that range for recognition purposes. *When no amount within the range can be deemed a better estimate, then the midpoint of the range shall be used.* The amount may be zero *only if zero is determined to be the best estimate*. This guidance also applies if the quantity or terms of an equity instrument is dependent on both market conditions and counterparty performance conditions.

### Subsequent Measurement

134. After the issuer measures the then-current fair value of the issuer's commitment related to the market condition as described in paragraph 131, the issuer shall, to the extent necessary, recognize and

classify future changes in the fair value of this commitment in accordance with any relevant accounting guidance on financial instruments.

135. Paragraph 133 provides measurement date guidance on the measurement of transactions that involve counterparty performance conditions. As each quantity and term become known and until all the quantities and terms that stem from the counterparty's performance become known, the best estimate or midpoint aggregate fair value measured pursuant to the guidance in that paragraph shall be adjusted, to reflect additional cost of the transaction, using the modification accounting methodology described in paragraphs 72-73. That is, the adjustment shall be measured at the date of the revision of the quantity or terms of the equity instruments as the difference between the then-current fair value of the revised instruments utilizing the then-known quantity or term and the then-current fair value of the old equity instruments immediately before the quantity or term becomes known. The then-current fair value is calculated using the assumptions that result in the *best estimate or midpoint* aggregate fair value (in accordance with paragraph 133) if the quantity or any other terms remain unknown.

136. Paragraph 133 also provides measurement date guidance on the measurement of transactions that involve both market conditions and counterparty performance conditions. Through the date the last performance-related condition is resolved, the issuer shall apply modification accounting (paragraphs 72-73) for the resolution of both counterparty performance conditions and market conditions. If, at the time the last counterparty performance-related condition is resolved, any market conditions remain, then the issuer shall measure the then-current fair value of the issuer's commitment to issue additional equity instruments or change the terms of the equity instruments based on whether the market condition is met. This measured amount is an additional cost of the transaction. After the issuer measures the then-current fair value of the issuer's commitment related to the market condition, the issuer shall, to the extent necessary, recognize and classify future changes in the fair value of this commitment in accordance with any relevant accounting literature on financial instruments.

137. Paragraph 128 addresses the situation in which an entity grants fully vested, nonforfeitable equity instruments with terms that provide for potential acceleration of exercisability and establishes that the grantor shall measure the fair value of the equity instruments at the date of grant and shall recognize that measured cost in the same period(s) and in the same manner as if the grantor had paid cash. For these situations, if, after the arrangement date, the grantee performs as specified and exercisability is accelerated, the grantor shall record incremental cost measured at the date of the revision of the terms of the equity instruments (that is, the acceleration date) as the difference between the then-current fair value of the revised instruments utilizing the accelerated exercisability date and the then-current fair value of the old equity instruments immediately before exercisability is accelerated. If the only change in the terms of the equity instruments is the acceleration of exercisability, the application of this methodology will only result in a significant additional charge if the expected dividend on the underlying instrument exceeds the sum of the effect of discounting the exercise price and the loss of time value (exclusive of the effect of discounting the exercise price) resulting from the early exercise of the equity instrument.

#### Subsequent Measurement – Grantee Accounting

138. A grantee may be party to an arrangement in which the terms of the equity instruments are subject to adjustment after the measurement date. Paragraphs 139-140 address transactions in which any of the terms of the equity instruments are subject to adjustment after the measurement date (that is, the terms of the equity instrument are subject to adjustment based on performance above the level committed to in a performance commitment, performance after the instrument is earned, or market conditions) and how the grantee shall account for an increase in fair value as a result of an adjustment (upon resolution of the contingency after the measurement date) as revenue.

139. If, on the measurement date, the quantity or any of the terms of the equity instruments are dependent on the achievement of grantee performance conditions (beyond those conditions for which a performance commitment exists), then changes in fair value of the equity instrument that result from an

adjustment to the instrument upon the achievement of a performance condition shall be measured as additional revenue from the transaction using a methodology consistent with modification accounting described in paragraphs 72-73. That is, the adjustment shall be measured at the date of the revision of the quantity or terms of the equity instrument as the difference between the then-current fair value of the revised instruments utilizing the then-known quantity and terms and the then-current fair value of the old equity instruments immediately before the adjustment.

140. Changes in fair value of the equity instruments after the measurement date unrelated to the achievement of performance conditions shall be accounted for in accordance with any relevant guidance on the accounting and reporting for investments in equity instruments.

### **Disclosures - Non-Employee Share Based Payment**

141. An entity (grantor) that acquires goods or services other than employee services in share-based payment transactions shall provide disclosures similar to those required by paragraphs 103-104 to the extent that those disclosures are important to an understanding of the effects of those transactions on the financial statements. These disclosures, if applicable, are for annual audited statutory financial statements only.

142. An entity (grantee) shall disclose, in each period's financial statements, the amount of gross operating revenue recognized as a result of nonmonetary transactions addressed within this statement. These disclosures, if applicable, are for annual audited statutory financial statements only.

### **Relevant Literature**

445-143. This statement adopts, with modification, GAAP guidance regarding stock options and stock purchase plans reflected in *Topic 718: Compensation – Stock Compensation, as amended by ASU 2010-13, Compensation – Stock Compensation (Topic 18): Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Current of the Market in Which the Underlying Equity Security Trades*, with the exception of FASB Codification *Subtopic 718-40: Employee Stock Ownership Plans*. Statutory guidance on employee stock ownership plans is provided in *SSAP No. 12—Employee Stock Ownership Plans*. This adoption with modification includes the related implementation guidance reflected within the FASB Codification *Topic 718*, not reflected within this standard. Modifications to the adopted GAAP guidance are as follows:

- a. GAAP references are revised to reference applicable statutory accounting guidance;
- b. GAAP reporting line items (either explicitly provided in the statement or adopted by reference – such as the GAAP implementation guidance) shall be replaced to reference applicable statutory annual statement line items. (For example, GAAP references to “other comprehensive income” shall be reflected within “Surplus - Unassigned Funds”).
- c. GAAP guidance to calculate earnings per share is not applicable to statutory accounting and has not been included within the statement.
- d. GAAP effective date and transition, and transition disclosures have not been incorporated. Reporting entities shall follow the effective date and transition elements provided within this statement.
- e. Inclusion of guidance specific to statutory for consolidated/holding company plans.

144. This statement adopts, with modification, GAAP guidance regarding the exchange of equity instruments for goods or services with non-employees as reflected in *Subtopic 505-50 – Equity, Equity-Payments to Non-Employees*. Modifications to this adopted GAAP guidance are as follows:

- a. Prepaid assets are nonadmitted.
- b. Costs for goods and services shall be recognized when the goods or services are received consistent with other statutory accounting principles.
- c. Minimum value method for determining fair value is rejected for all entities.
- d. Estimates of expected costs for the exchange of equity instruments dependent on market conditions or performance obligations shall be determined based on the best estimate of fair values. If a better estimate cannot be determined, then the midpoint (rather than the lowest amount) of aggregate fair values within the range shall be used.
- e. GAAP references are revised to reference applicable statutory accounting guidance.

~~146-145.~~ The adoption, with modification, of FASB Codification Topic 718 and Subtopic 505-50 detailed in paragraphs ~~145~~143-144 also reflects adoption, with modification, of the following pre-codification GAAP standards:

- a. *FAS 123R, Share-Based Payment (FAS 123R);*
- b. *FAS 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (FAS 150) – (Adopted only to the extent referenced in FAS 123R for classifying instruments as equity or liability for application in this statement. Adopted guidance is reflected in Appendix A);*
- c. *FASB Staff Position FAS 123(R)-1: Classification and Measurement of Freestanding Financial Instruments Originally issued in Exchange for Employee Services under FASB Statement No. 123(R) (FAS 123R-1);*
- d. *FASB Staff Position (FSP) FAS 123(R)-2: Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R) (FSP FAS 123R-2);*
- e. *FASB Staff Position (FSP) FAS 123(R)-4: Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event (FSP FAS 123R-4);*
- f. *FASB Staff Position (FSP) FAS 123(R)-5: Amendment of FASB Staff Position FAS 123R-1 (FSP FAS 123R-5);*
- g. *FASB Staff Position (FSP) FAS 123(R)-6: Technical Corrections of FASB Statement No. 123(R) (FSP FAS 123R-6);*
- h. *FASB Emerging Issues Task Force 96-18: Accounting for Equity Instruments That are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.*
- ~~h.i.~~ *FASB Emerging Issues Task Force 97-14: Accounting for Deferred Compensation Arrangements Where Amounts Earned Are Held in a Rabbi Trust and Invested (EITF 97-14);*
- j. *FASB Emerging Issues Task Force 00-08: Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services.*
- ~~i.k.~~ *FASB Emerging Issues Task Force 00-16: Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation (EITF 00-16);* ~~and~~

l. FASB Emerging Issues Task Force 00-18: Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees; and-

j-m. FASB Technical Bulletin 97-01, Accounting under Statement 123 for Certain Employee Stock Purchase Plans with a Look-Back Option (TB 97-01).

117-146. The adoption, with modification of FASB Codification Topic 718 in this statement reflects rejection of the following pre-codification GAAP standards:

- a. *FASB Staff Position (FSP) FAS 123(R)-3: Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards (FSP FAS 123R-3); and*
- b. *FASB Staff Position (FSP) EITF 03-6-1; Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities (FSP EITF 03-6-1).*

### Effective Date and Transition

118-147. This statement shall be effective prospectively (paragraph 119) for years beginning January 1, 2013, with interim and annual financial reporting thereafter. The cumulative effect of initially applying this statement, if any, shall be recognized as of the required effective date as a change in accounting principle under SSAP No. 3. Early adoption is permitted for December 31, 2012, financial statements, with interim and annual reporting thereafter.

119-148. Reporting entities with existing share-based payment instruments that applied the guidance contained in *SSAP No. 13—Stock Options and Stock Purchase Plans* (SSAP No. 13) shall apply the requirements of the adopted SSAP No. 104 prospectively to new awards and to awards modified, repurchased, or cancelled after the required effective date. Those reporting entities shall continue to account for any portion of awards outstanding at the date of initial application using the accounting principles originally applied to those awards (SSAP No. 13).

149. The substantive revisions to this statement to incorporate guidance for share-based payment transactions for non-employees, reflected predominantly in paragraphs 115-142, are effective prospectively initially for years ending December 31, 2014. The cumulative effect of initially applying this statement, if any, shall be recognized as of the required effective date as a change in accounting principle under SSAP No. 3—Accounting Changes and Corrections of Errors (SSAP No. 3).

### REFERENCES

#### Other

- *SSAP No. 12—Employee Stock Ownership Plans*

#### Relevant Issue Papers

- *Issue Paper No. 129—Share-Based Payment, A Replacement of SSAP No. 13*
- *Issue Paper No. 146—Share-Based Payments With Non-Employees*

**APPENDIX A: Classification Criteria: Liability or Equity****Classification Criteria**

1. As detailed in paragraph 14 of the statement, an entity shall apply the classification criteria detailed in paragraphs 14-27 in the statement, as they are effective at the reporting date, in determining whether to classify as a liability a freestanding financial instrument given to an employee in a share-based payment transaction.
2. The guidance in this Section shall be applied to a freestanding financial instrument in its entirety. Any nonsubstantive or minimal features shall be disregarded in applying the classification provisions of this Section. Judgment, based on consideration of all the terms of an instrument and other relevant facts and circumstances, is necessary to distinguish substantive, nonminimal features from nonsubstantive or minimal features.

**Mandatorily Redeemable Financial Instruments**

3. A mandatorily redeemable financial instrument shall be classified as a liability unless the redemption is required to occur only upon the liquidation or termination of the reporting entity.
4. A financial instrument that embodies a conditional obligation to redeem the instrument by transferring assets upon an event not certain to occur becomes mandatorily redeemable if that event occurs, the condition is resolved, or the event becomes certain to occur.
5. In determining if an instrument is mandatorily redeemable, all terms within a redeemable instrument shall be considered. The following items do not affect the classification of a mandatorily redeemable financial instrument as a liability:
  - a. A term extension option
  - b. A provision that defers redemption until a specified liquidity level is reached
  - c. A similar provision that may delay or accelerate the timing of a mandatory redemption.
6. If a financial instrument will be redeemed only upon the occurrence of a conditional event, redemption of that instrument is conditional and, therefore, the instrument does not meet the definition of mandatorily redeemable financial instrument in this statement. However, that financial instrument would be assessed at each reporting period to determine whether circumstances have changed such that the instrument now meets the definition of a mandatorily redeemable instrument (that is, the event is no longer conditional). If the event has occurred, the condition is resolved, or the event has become certain to occur, the financial instrument is reclassified as a liability.

**Obligations to Repurchase Issuer's Equity Shares by Transferring Assets**

7. An entity shall classify as a liability (or an asset in some circumstances) any financial instrument, other than an outstanding share, that, at inception, has both of the following characteristics:
  - a. It embodies an obligation to repurchase the issuer's equity shares, or is indexed to such an obligation, and-
  - b. It requires or may require the issuer to settle the obligation by transferring assets.
8. In this statement, "indexed to" is used interchangeably with "based on variations in the fair value of." The phrase "requires or may require" encompasses instruments that either conditionally or

unconditionally obligate the issuer to transfer assets. If the obligation is conditional, the number of conditions leading up to the transfer of assets is irrelevant.

9. Examples of financial instruments that meet the criteria in paragraph 7 of Appendix A include forward purchase contracts or written put options on the issuer's equity shares that are to be physically settled or net cash settled.

10. All obligations that permit the holder to require the issuer to transfer assets result in liabilities, regardless of whether the settlement alternatives have the potential to differ.

11. Certain financial instruments that embody obligations that are liabilities within the scope of this statement also may contain characteristics of assets but be reported as single items. Some examples include the following:

- a. Net-cash-settled or net-share-settled forward purchase contracts.
- b. Certain combined options to repurchase the issuer's shares.

Those instruments are classified as assets or liabilities initially or subsequently depending on the instrument's fair value on the reporting date.

12. An instrument that requires the issuer to settle its obligation by issuing another instrument (for example, a note payable in cash) ultimately requires settlement by a transfer of assets, accordingly:

- a. When applying paragraphs 7-11 of Appendix A, this also would apply for an instrument settled with another instrument that ultimately may require settlement by a transfer of assets (warrants for puttable shares).
- b. It is clear that a warrant for mandatorily redeemable shares would be a liability under this statement.

#### Certain Obligations to Issue a Variable Number of Shares

13. A financial instrument that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares shall be classified as a liability (or an asset in some circumstances) if, at inception, the monetary value of the obligation is based solely or predominantly on any one of the following:

- a. A fixed monetary amount known at inception (for example, a payable settleable with a variable number of the issuer's equity shares),
- b. Variations in something other than the fair value of the issuer's equity shares (for example, a financial instrument indexed to the Standard and Poor's S&P 500 Index and settleable with a variable number of the issuer's equity shares), or
- c. Variations inversely related to changes in the fair value of the issuer's equity shares (for example, a written put option that could be net share settled).

#### Prohibition on Combining Freestanding Financial Instruments

14. A freestanding financial instrument that is within the scope of this statement shall not be combined with another freestanding financial instrument in applying paragraphs 3-13 of Appendix A. For example, a freestanding written put option that is classified as a liability under this statement shall not be combined with an outstanding equity share.



**Distinguishing Liability from Equity – Scope and Scope Exclusions**

15. The guidance in paragraphs 14-27 of this statement applies to any freestanding financial instrument, including one that has any of the following attributes:

- a. Comprises more than one option or forward contract, or
- b. Has characteristics of both a liability and equity and, in some circumstances, also has characteristics of an asset (for example, a forward contract to purchase the issuer's equity shares that is to be net cash settled). Accordingly, this statement does not address an instrument that has only characteristics of an asset.

For example, an instrument that consists of a written put option for an issuer's equity shares and a purchased call option and nothing else is a freestanding financial instrument. That freestanding financial instrument embodies an obligation to repurchase the issuer's equity shares and is subject to the requirements of this statement.

**APPENDIX B: Disclosure Information**

1. The following list indicates the minimum information needed to achieve the objectives in paragraph 103 and 141 and illustrates how the disclosure requirements might be satisfied. In some circumstances, an entity may need to disclose information beyond the following to achieve the disclosure objectives:

- a. A description of the share-based payment arrangement(s), including the general terms of awards under the arrangement(s), such as:
  - i. The requisite service period(s) and any other substantive conditions (including those related to vesting)
  - ii. The maximum contractual term of equity (or liability) share options or similar instruments
  - iii. The number of shares authorized for awards of equity share options or other equity instruments.
- b. The method it uses for measuring compensation cost from share-based payment arrangements with employees.
- c. For the most recent year for which an income statement is provided, both of the following:
  - i. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or share units):
    - (a) Those outstanding at the beginning of the year
    - (b) Those outstanding at the end of the year
    - (c) Those exercisable or convertible at the end of the year
    - (d) Those that during the year were:
      - (1) Granted
      - (2) Exercised or converted
      - (3) Forfeited
      - (4) Expired.
  - ii. The number and weighted-average grant-date fair value (or calculated value for an entity that uses that method or intrinsic value for awards measured pursuant to paragraph 49) of equity instruments not specified in (c)(1), for all of the following groups of equity instruments:
    - (a) Those nonvested at the beginning of the year
    - (b) Those nonvested at the end of the year

- (c) Those that during the year were:
  - (1) Granted
  - (2) Vested
  - (3) Forfeited.
- d. For each year for which an income statement is provided, both of the following:
  - i. The weighted-average grant-date fair value (or calculated value for an entity that uses that method or intrinsic value for awards measured at that value pursuant to paragraphs 49-50) of equity options or other equity instruments granted during the year, and
  - ii. The total intrinsic value of options exercised (or share units converted), share-based liabilities paid, and the total fair value of shares vested during the year.
- e. For fully vested share options (or share units) and share options expected to vest at the date of the latest statement of financial position, both of the following:
  - i. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value, and weighted-average remaining contractual term of options (or share units) outstanding, and
  - ii. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value, and weighted-average remaining contractual term of options (or share units) currently exercisable (or convertible).
- f. For each year for which an income statement is presented, both of the following (An entity that uses the intrinsic value method pursuant to paragraphs 49-50 is not required to disclose the following information for awards accounted for under that method):
  - i. A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements, and
  - ii. A description of the significant assumptions used during the year to estimate the fair value (or calculated value) of share-based compensation awards, including (if applicable):
    - (a) Expected term of share options and similar instruments, including a discussion of the method used to incorporate the contractual term of the instruments and employees' expected exercise and postvesting employment termination behavior into the fair value (or calculated value) of the instrument.
    - (b) Expected volatility of the entity's shares and the method used to estimate it. An entity that uses a method that employs different volatilities during the contractual term shall disclose the range of expected volatilities used and the weighted-average expected volatility. An entity that uses the calculated value method shall disclose the reasons why it is not practicable for it to estimate the expected volatility of its share price, the

appropriate industry sector index that it has selected, the reasons for selecting that particular index, and how it has calculated historical volatility using that index.

- (c) Expected dividends. An entity that uses a method that employs different dividend rates during the contractual term shall disclose the range of expected dividends used and the weighted-average expected dividends.
  - (d) Risk-free rate(s). An entity that uses a method that employs different risk-free rates shall disclose the range of risk-free rates used.
  - (e) Discount for post-vesting restrictions and the method for estimating it.
- g. An entity that grants equity or liability instruments under multiple share-based payment arrangements with employees shall provide the information specified in paragraph (a) through (f) separately for different types of awards to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation. For example, separate disclosure of weighted-average exercise prices (or conversion ratios) at the end of the year for options (or share units) with a fixed exercise price (or conversion ratio) and those with an indexed exercise price (or conversion ratio) could be important. It also could be important to segregate the number of options (or share units) not yet exercisable into those that will become exercisable (or convertible) based solely on fulfilling a service condition and those for which a performance condition must be met for the options (share units) to become exercisable (convertible). It could be equally important to provide separate disclosures for awards that are classified as equity and those classified as liabilities. In addition, an entity that has multiple share-based payment arrangements with employees shall disclose information separately for different types of awards under those arrangements to the extent that differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation.
- h. For each year for which an income statement is presented, both of the following:
- i. Total compensation cost for share-based payment arrangements
    - (a) Recognized in income as well as the total recognized tax benefit related thereto
    - (b) Capitalized as part of the cost of an asset.
  - ii. A description of significant modifications, including:
    - (a) The terms of the modifications,
    - (b) The number of employees affected,
    - (c) The total incremental compensation cost resulting from the modifications.
- i. As of the latest balance sheet date presented, the total compensation cost related to nonvested awards not yet recognized and the weighted-average period over which it is expected to be recognized.

- j. If not separately disclosed elsewhere, the amount of cash received from exercise of share options and similar instruments granted under share-based payment arrangements and the tax benefit realized from stock options exercised during the annual period.
  - k. If not separately disclosed elsewhere, the amount of cash used to settle equity instruments granted under share-based payment arrangements.
  - l. A description of the entity's policy, if any, for issuing shares upon share option exercise (or share unit conversion), including the source of those shares (that is, new shares or treasury shares). If as a result of its policy, an entity expects to repurchase shares in the following annual period, the entity shall disclose an estimate of the amount (or a range, if more appropriate) of shares to be repurchased during that period.
2. In addition to the information required by this statement, an entity may disclose supplemental information that it believes would be useful to investors and creditors, such as a range of values calculated on the basis of different assumptions, provided that the supplemental information is reasonable and does not lessen the prominence and credibility of the information required by this statement. The alternative assumptions shall be described to enable users of the financial statements to understand the basis for the supplemental information.

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