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

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Compensation—Stock Compensation (Topic 718)

Improvements to Nonemployee Share-Based Payment Accounting

An Amendment of the FASB Accounting Standards Codification®

Financial Accounting Standards Board
Accounting Standards Update 2018-07

Compensation—Stock Compensation (Topic 718)

Improvements to Nonemployee Share-Based Payment Accounting

June 2018

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Summary

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

The Board is issuing this Update as part of its Simplification Initiative. The objective of the Simplification Initiative is to maintain or improve the usefulness of the information provided to the users of financial statements while reducing cost and complexity in financial reporting.

The areas for simplification in this Update involve several aspects of the accounting for nonemployee share-based payment transactions resulting from expanding the scope of Topic 718, Compensation—Stock Compensation, to include share-based payment transactions for acquiring goods and services from nonemployees. Some of the areas for simplification apply only to nonpublic entities. The accounting for nonemployee share-based payment transactions was identified as an area for simplification through (1) outreach for the Simplification Initiative, (2) ongoing dialogue with the Private Company Council about making improvements to the accounting for share-based payments, and (3) the August 2014 Post-Implementation Review Report on FASB Statement No. 123 (revised 2004), Share-Based Payment.

Who Is Affected by the Amendments in This Update?

The amendments in this Update affect all entities that enter into share-based payment transactions for acquiring goods and services from nonemployees.

What Are the Main Provisions?

The amendments in this Update expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees. An entity should apply the requirements of Topic 718 to nonemployee awards except for specific guidance on inputs to an option pricing model and the attribution of cost (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period). The amendments specify that Topic 718 applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in a grantor’s own operations by issuing share-based payment awards. The amendments also clarify that Topic 718 does not apply to share-based payments used to effectively provide (1) financing to the issuer or (2) awards granted in conjunction with selling goods or services to customers as part of a contract accounted for under Topic 606, Revenue from Contracts with Customers.
How Do the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Are They an Improvement?

Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees, addresses aspects of the accounting for nonemployee share-based payment transactions. The accounting requirements addressed by Subtopic 505-50 are significantly different from the requirements for employee share-based payment transactions within the scope of Topic 718.

Expanding the scope of Topic 718 through the amendments in this Update improves the following areas of nonemployee share-based payment accounting:

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<td><strong>Overall Measurement Objective:</strong> Nonemployee share-based payment awards are measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever can be more reliably measured.</td>
<td>Consistent with the accounting requirement for employee share-based payment awards, nonemployee share-based payment awards within the scope of Topic 718 are measured at grant-date fair value of the equity instruments that an entity is obligated to issue when the good has been delivered or the service has been rendered and any other conditions necessary to earn the right to benefit from the instruments have been satisfied.</td>
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<td><strong>Measurement Date:</strong> The measurement date for equity-classified nonemployee share-based payment awards is the earlier of the date at which a commitment for performance by the counterparty is reached and the date at which the counterparty’s performance is complete.</td>
<td>Equity-classified nonemployee share-based payment awards are measured at the grant date. The definition of the term grant date is amended to generally state the date at which a grantor and a grantee reach a mutual understanding of the key terms and conditions of a share-based payment award.</td>
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<td><strong>Awards with Performance Conditions:</strong> Nonemployee share-based payment awards with performance conditions are measured at the lowest aggregate fair value.</td>
<td>Consistent with the accounting for employee share-based payment awards, an entity considers the probability of satisfying performance conditions when nonemployee share-</td>
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**Current GAAP** | **Summary of Amendments**
---|---
Based payment awards contain such conditions.

**Classification Reassessment of Certain Equity-Classified Awards:**
Generally, the classification of equity-classified nonemployee share-based payment awards is subject to other GAAP (for example, Topic 815, Derivatives and Hedging) once the good has been delivered or the service has been rendered and any other conditions necessary to earn the right to benefit from the instruments have been satisfied. This often results in the need to reassess the classification of such awards.

Generally, the classification of equity-classified nonemployee share-based payment awards will continue to be subject to the requirements of Topic 718 unless modified after the good has been delivered, the service has been rendered, any other conditions necessary to earn the right to benefit from the instruments have been satisfied, and the nonemployee is no longer providing goods or services. This eliminates the requirement to reassess classification of such awards upon vesting.

**Nonpublic Entity-Specific Amendments**

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<td><strong>Calculated Value:</strong> Inputs to the valuation of equity share options and similar instruments issued to nonemployees include an estimate of the expected volatility.</td>
<td>Historical volatility of an appropriate industry-sector index is used by nonpublic entities for expected volatilities as inputs to the valuation of share options and similar instruments issued to nonemployees when it is not practicable for the nonpublic entity to estimate the expected volatility of its share price.</td>
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| **Intrinsic Value:** Entities are required to measure liability-classified nonemployee share-based payment awards at fair value. | A nonpublic entity can make a one-time election to switch from measuring liability-classified nonemployee share-based payment awards at fair value to intrinsic value. Regardless of the election, liability-classified awards would be subject to remeasurement until exercise. |
When Will the Amendments Be Effective and What Are the Transition Requirements?

The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, but no earlier than an entity’s adoption date of Topic 606.

An entity should only remeasure liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. Upon transition, the entity is required to measure these nonemployee awards at fair value as of the adoption date. The entity must not remeasure assets that are completed. For example, finished goods inventory or equipment that has begun amortization should not be remeasured upon transition.

Disclosures required at transition include the nature of and reason for the change in accounting principle and, if applicable, quantitative information about the cumulative effect of the change on retained earnings or other components of equity.
Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–73. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in bold type. Added text is underlined, and deleted text is struck out.

Issue 1: Expanding the Scope of Topic 718 to Include Share-Based Payment Awards to Nonemployees

2. Under current GAAP, Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees, addresses aspects of the accounting for nonemployee share-based payment transactions. The guidance in Subtopic 505-50 for awards to nonemployees is significantly different from the guidance for awards to employees in Topic 718. The following amendments reflect the Board’s decision to expand the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from nonemployees and to supersede Subtopic 505-50. An entity must apply the requirements of Topic 718 to nonemployee share-based payment transactions except for specific guidance on certain inputs to an option-pricing model and the attribution of cost (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period). Consequently, an entity is required to (a) measure nonemployee share-based payment transactions by estimating the fair value of the equity instruments that it is obligated to issue, (b) measure equity-classified nonemployee share-based payment awards at the grant date, and (c) consider the probability of satisfying performance conditions when accounting for nonemployee share-based payment awards with such conditions. A grantor continues to recognize cost (or reverse previous recognition) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using share-based payment awards. At present, practice analogizes the guidance for employee share-based awards in Topic 718 when there is not direct guidance for similar nonemployee share-based payment awards. The Board expects practice to continue to analogize to the employee model when appropriate despite the inclusion of nonemployee share-based payment guidance in Topic 718. For example, while guidance about recognition of cost for nonemployee share-based payment transactions will be unchanged under the amendments, in many instances the pattern of recognition could be similar between employee and
nonemployee share-based payment transactions because the awards granted to both employees and nonemployees often are similar.

Amendments to Master Glossary

3. Add the following Master Glossary terms to Subtopic 718-10 as follows:

**Contract**

An agreement between two or more parties that creates enforceable rights and obligations.

**Customer (first definition)**

A party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.

4. Amend the following Master Glossary terms, with a link to transition paragraph 718-10-65-11, as follows:

**Award**

The collective noun for multiple instruments with the same terms and conditions granted at the same time either to a single employee grantee or to a group of employees grantees. An award may specify multiple vesting dates, referred to as graded vesting, and different parts of an award may have different expected terms. References to an award also apply to a portion of an award.

**Broker-Assisted Cashless Exercise**

The simultaneous exercise by an employee grantee of a share option and sale of the shares through a broker (commonly referred to as a broker-assisted exercise).

Generally, under this method of exercise:

- a. The employee grantee authorizes the exercise of an option and the immediate sale of the option shares in the open market.
- b. On the same day, the entity notifies the broker of the sale order.
- c. The broker executes the sale and notifies the entity of the sales price.
- d. The entity determines the minimum statutory tax-withholding requirements.
- e. By the settlement day (generally three days later), the entity delivers the stock certificates to the broker.
f. On the settlement day, the broker makes payment to the entity for the exercise price and the minimum statutory withholding taxes and remits the balance of the net sales proceeds to the employee-grantee.

**Cash Consideration**

Cash payments and credits that the customer can apply against trade amounts owed to the vendor. In addition, as indicated in Section 718-10-25505-50-25, consideration in the form of share-based payment awards—equity instruments is recognized in the same period or periods and in the same manner (that is, capitalize versus expense) 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 share-based payment awards—equity instruments. Accordingly, guidance with respect to cash consideration is applicable to consideration that consists of equity instruments (regardless of whether a measurement date has been reached).

**Grant Date**

The date at which an employer grantor and an employee grantee reach a mutual understanding of the key terms and conditions of a share-based payment award. The employer grantor becomes contingently obligated on the grant date to issue equity instruments or transfer assets to an employee grantee who delivers the goods or renders the requisite service. Awards made under an arrangement that is subject to shareholder approval are not deemed to be granted until that approval is obtained unless approval is essentially a formality (or perfunctory), for example, if management and the members of the board of directors control enough votes to approve the arrangement. Similarly, individual awards that are subject to approval by the board of directors, management, or both are not deemed to be granted until all such approvals are obtained. The grant date for an award of equity instruments is the date that an employee grantee begins to benefit from, or be adversely affected by, subsequent changes in the price of the employer’s grantor’s equity shares. Paragraph 718-10-25-5 provides guidance on determining the grant date. See **Service Inception Date**.

**Nonvested Shares**

Shares that an entity has not yet issued because the agreed-upon consideration, such as the delivery of specified goods or employee services and any other conditions necessary to earn the right to benefit from the instruments, has not yet been satisfied received. Nonvested shares cannot be sold. The restriction on sale of nonvested shares is due to the forfeitability of the shares if specified events occur (or do not occur).

**Option**

Unless otherwise stated, a call option that gives the holder the right to purchase shares of common stock from the reporting entity in accordance with an agreement
upon payment of a specified amount. Options include, but are not limited to, options granted to employees and stock purchase agreements entered into with employees. Options are considered securities. See Call Option.

Performance Condition

A condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that relates to both of the following:

a. An employee’s rendering of goods for a specified (either explicitly or implicitly) period of time
b. Achieving a specified performance target that is defined solely by reference to the employer’s own operations (or activities) or by reference to the grantee’s performance related to the employer’s own operations (or activities).

Attaining a specified growth rate in return on assets, obtaining regulatory approval to market a specified product, selling shares in an initial public offering or other financing event, and a change in control are examples of performance conditions. A performance target also may be defined by reference to the same performance measure of another entity or group of entities. For example, attaining a growth rate in earnings per share (EPS) that exceeds the average growth rate in EPS of other entities in the same industry is a performance condition. A performance target might pertain either to the performance of the entity as a whole or to some part of the entity, such as a division or an individual employee, or to the performance of the grantee if such performance is in accordance with the terms of the award and solely relates to the grantor’s own operations (or activities).

Reload Feature and Reload Option

A reload feature provides for automatic grants of additional options whenever an employee exercises previously granted options using the entity’s shares, rather than cash, to satisfy the exercise price. At the time of exercise using shares, the employee is automatically granted a new option, called a reload option, for the shares used to exercise the previous option.

Restricted Share

A share for which sale is contractually or governmentally prohibited for a specified period of time. Most grants of shares to employees are better termed nonvested shares because the limitation on sale stems solely from the forfeitability of the shares before employees have satisfied the necessary service or performance condition(s) necessary to earn the rights to the shares. Restricted shares issued for consideration other than for goods or employee services, on the other hand, are fully paid for immediately. For those shares, there is no period analogous to an employee’s requisite service period or
a nonemployee’s vesting period during which the issuer is unilaterally obligated to issue shares when the purchaser pays for those shares, but the purchaser is not obligated to buy the shares. The term restricted shares refers only to fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time. Vested equity instruments that are transferable to a grantee’s employee’s immediate family members or to a trust that benefits only those family members are restricted if the transferred instruments retain the same prohibition on sale to third parties. See Nonvested Shares.

Service Condition

A condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that depends solely on an employee rendering service to the employer for the requisite service period or a nonemployee delivering goods or rendering services to the grantor over a vesting period. A condition that results in the acceleration of vesting in the event of an employee’s grantee’s death, disability, or termination without cause is a service condition.

Service Inception Date

The date at which the employee’s requisite service period or the nonemployee’s vesting period begins. The service inception date usually is the grant date, but the service inception date may differ from the grant date (see Example 6 [see paragraph 718-10-55-107] for an illustration of the application of this term to an employee award).

Share Option

A contract that gives the holder the right, but not the obligation, either to purchase (to call) or to sell (to put) a certain number of shares at a predetermined price for a specified period of time. Most share options granted to employees under share-based compensation arrangements are call options, but some may be put options.

Vest

To earn the rights to. A share-based payment award becomes vested at the date that the employee’s grantee’s right to receive or retain shares, other instruments, or cash under the award is no longer contingent on satisfaction of either a service condition or a performance condition. Market conditions are not vesting conditions.

The stated vesting provisions of an award often establish the employee’s requisite service period or the nonemployee’s vesting period, and an award that has reached the end of the applicable requisite service period is vested. However, as indicated in the definition of requisite service period and equally applicable to a nonemployee’s vesting period, the stated vesting period may differ from those periods for the requisite service period in certain circumstances. Thus, the more
precise (but cumbersome) terms would be options, shares, or awards for which the requisite good has been delivered or service has been rendered and the end of the employee’s requisite service period or the nonemployee’s vesting period.

5. Supersede the Master Glossary term Counterparty Performance Conditions, with a link to transition paragraph 718-10-65-11, as follows:

**Counterparty Performance Conditions**

Conditions that relate to the achievement of a specified performance target, for example, attaining a specified increase in market share for a specified product. A counterparty performance condition might pertain either to the performance of the entity as a whole or to some part of the entity, such as a division.

Amendments to Subtopic 230-10

6. Amend paragraph 230-10-45-15, with a link to transition paragraph 718-10-65-11, as follows:

**Statement of Cash Flows—Overall**

**Other Presentation Matters**

> Classification

> > Cash Flows from Financing Activities

**230-10-45-15** All of the following are cash outflows for financing activities:

a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity’s equity instruments. Cash paid to a tax authority by an employee’s grantor when withholding shares from an employee’s grantee’s award for tax-withholding purposes shall be considered an outlay to reacquire the entity’s equity instruments.

b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to the principal.

c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase
of property, plant, and equipment or other productive assets are financing cash outflows.

d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.

e. Payments for debt issue costs.

f. Payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-17(ee).

g. Payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.

Amendments to Subtopic 260-10

7. Amend paragraphs 260-10-45-22, 260-10-45-28 through 45-28A, 260-10-45-29 through 45-30, 260-10-45-32, and 260-10-45-45, with a link to transition paragraph 718-10-65-11, as follows:

Earnings Per Share—Overall

Other Presentation Matters

> Diluted EPS and Related Topics

> > Options, Warrants, and Their Equivalents and the Treasury Stock Method

260-10-45-22 The dilutive effect of outstanding call options and warrants (and their equivalents) issued by the reporting entity shall be reflected in diluted EPS by application of the treasury stock method unless the provisions of paragraphs 260-10-45-35 through 45-36 and 260-10-55-8 through 55-11 require that another method be applied. Equivalents of options and warrants include nonvested stock granted to employees under a share-based payment arrangement, stock purchase contracts, and partially paid stock subscriptions (see paragraph 260-10-55-23). Antidilutive contracts, such as purchased put options and purchased call options, shall be excluded from diluted EPS.
Share-Based Payment Arrangements

260-10-45-28 The provisions in paragraphs 260-10-45-28A through 45-31 apply to share-based awards issued to employees under a share-based compensation arrangement and to other than employees in exchange for goods and services.

260-10-45-28A Awards of share options and nonvested shares (as defined in Topic 718) to be issued to an employee under a share-based compensation arrangement are considered options for purposes of computing diluted EPS. Such share-based awards shall be considered to be outstanding as of the grant date for purposes of computing diluted EPS even though their exercise may be contingent upon vesting. Those share-based awards are included in the diluted EPS computation even if the employee may not receive (or be able to sell) the stock until some future date. Accordingly, all shares to be issued shall be included in computing diluted EPS if the effect is dilutive. The dilutive effect of share-based payment arrangements shall be computed using the treasury stock method. If the equity share options or other equity instruments are outstanding for only part of a period, the shares issuable shall be weighted to reflect the portion of the period during which the equity instruments were outstanding. See Example 8 (paragraph 260-10-55-68).

260-10-45-29 In applying the treasury stock method described in paragraph 260-10-45-23, the assumed proceeds shall be the sum of all of the following:

a. The amount, if any, the employee must pay upon exercise.

b. The amount of compensation cost attributed to share-based payment awards (within the scope of Topic 718 on stock compensation) not yet recognized. This amount includes share-based payment awards that are not contingent upon satisfying certain conditions as described in paragraph 260-10-45-32 and contingently issuable shares that have been determined to be included in the computation of diluted EPS as described in paragraphs 260-10-45-48 through 45-57, future services and not yet recognized. (This provision applies only to those share-based awards for which compensation cost will be recognized in the financial statements in accordance with Topic 718.)

c. Subparagraph superseded by Accounting Standards Update No. 2016-09.

260-10-45-29A Under paragraphs 718-10-35-1D and 718-10-35-3, the effect of forfeitures is taken into account by recognizing compensation cost only for those instruments for which the employee’s requisite service has been rendered or the nonemployee’s vesting conditions have been met and no compensation cost shall be recognized for instruments that grantees forfeit because a service or performance condition is not satisfied. Requisite service has been rendered, and no compensation cost shall be recognized for instruments that employees forfeit because a service condition or a performance condition is not
satisfied. See Example 8 (paragraph 260-10-55-68) for an illustration of this guidance.

260-10-45-30 If stock-based payment compensation arrangements are payable in common stock or in cash at the election of either the entity or the employee-grantee, the determination of whether such stock-based awards are potential common shares shall be made based on the provisions in paragraph 260-10-45-45. If an entity has a tandem award (as defined in Topic 718) that allows the entity or the employee-grantee to make an election involving two or more types of equity instruments, diluted EPS for the period shall be computed based on the terms used in the computation of compensation expense cost for that period.

260-10-45-32 Fixed employee-grantee stock options (fixed awards) and nonvested stock (including restricted stock) shall be included in the computation of diluted EPS based on the provisions for options and warrants in paragraphs 260-10-45-22 through 45-27. Even though their issuance may be contingent upon vesting, they shall not be considered to be contingently issuable shares (see Section 815-15-55 and paragraph 260-10-45-48). However, because issuance of performance-based stock options (and performance-based nonvested stock) is contingent upon satisfying conditions in addition to the mere passage of time, those options and nonvested stock shall be considered to be contingently issuable shares in the computation of diluted EPS. A distinction shall be made only between time-related contingencies and contingencies requiring specific achievement.

>> Contracts That May Be Settled in Stock or Cash

260-10-45-45 If an entity issues a contract that may be settled in common stock or in cash at the election of either the entity or the holder, the determination of whether that contract shall be reflected in the computation of diluted EPS shall be made based on the facts available each period. It shall be presumed that the contract will be settled in common stock and the resulting potential common shares included in diluted EPS (in accordance with the relevant provisions of this Topic) if the effect is more dilutive. Share-based payment Stock-based compensation arrangements that are payable in common stock or in cash at the election of either the entity or the employee-grantee shall be accounted for pursuant to this paragraph and the following paragraph 260-10-45-46. An example of such a contract is a written put option that gives the holder a choice of settling in common stock or in cash.

8. Amend paragraphs 260-10-55-33, 260-10-55-69, and 260-10-60-1A, with a link to transition paragraph 718-10-65-11, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

>> Contracts That May Be Settled in Stock or Cash
The references in paragraphs 260-10-45-30 and 260-10-45-45 for share-based payments and stock-based compensation arrangements that are payable in common stock or in cash at the election of either the entity or the employee-grantee refer to using the guidance in paragraph 260-10-45-45 for purposes of determining whether shares issuable in accordance with such plans are included in the denominator for purposes of computing diluted EPS amounts. Accordingly, the numerator is not adjusted in those circumstances. Paragraph 260-10-55-36A illustrates these requirements.

> Illustrations

> > Example 8: Application of the Treasury Stock Method to a Share-Based Payment Arrangement

This Example illustrates the guidance in paragraph 260-10-45-28A for the application of the treasury stock method when share options are forfeited.

Entity A adopted a share option plan on January 1, 20X7, and granted 900,000 at-the-money share options with an exercise price of $30. All share options vest at the end of three years (cliff vesting). Entity A’s accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-1D or 718-10-35-3. At the grant date, Entity A assumes an annual forfeiture rate of 3 percent and therefore expects to receive the requisite service for 821,406 [900,000 × (.97 to the third power)] share options. On January 1, 20X7, the fair value of each share option granted is $14.69. Employees-Grantees forfeited 15,000 stock options ratably during 20X7.

Relationships

> Compensation—Stock Compensation

For the effects of employee equity share options granted in share-based payment arrangements, nonvested shares, and similar equity instruments in computing diluted EPS, see Section 718-10-45.

Amendments to Subtopic 323-10

9. Amend paragraphs 323-10-25-3 through 25-6 and their related heading, with a link to transition paragraph 718-10-65-11, as follows:

Investments—Equity Method and Joint Ventures—Overall

Recognition
> Stock-Based Compensation Granted to Employees and Nonemployees of an Equity Method Investee

323-10-25-3 The guidance in the following paragraph and paragraph 323-10-25-5 addresses the accounting for stock-based compensation based on the investor’s stock granted to employees of an investee accounted for under the equity method if Paragraphs 323-10-25-4 through 25-6 provide guidance on accounting for share-based payment awards granted by an investor to employees or nonemployees of an equity method investee that provide goods or services to the investee that are used or consumed in the investee’s operations when no proportionate funding by the other investors occurs and the investor does not receive any increase in the investor’s relative ownership percentage of the investee. That guidance assumes that the investor’s grant of share-based payment awards stock-based compensation to employees or nonemployees of the equity method investee was not agreed to in connection with the investor’s acquisition of an interest in the investee. That guidance applies to share-based payment awards stock-based compensation granted to employees or nonemployees of an investee by an investor based on that investor’s stock (that is, stock of the investor or other equity instruments indexed to, and potentially settled in, stock of the investor).

323-10-25-4 In the circumstances described in the preceding paragraph 323-10-25-3, a contributing investor shall expense the cost of share-based payment awards stock-based compensation granted to employees and nonemployees of an equity method investee as incurred (that is, in the same period the costs are recognized by the investee) to the extent that the investor’s claim on the investee’s book value has not been increased.

323-10-25-5 In the circumstances described in paragraph 323-10-25-3, other equity method investors in an investee (that is, noncontributing investors) shall recognize income equal to the amount that their interest in the investee’s net book value has increased (that is, their percentage share of the contributed capital recognized by the investee) as a result of the disproportionate funding of the compensation costs. Further, those other equity method investors shall recognize their percentage share of earnings or losses in the investee (inclusive of any expense recognized by the investee for the share-based stock-based compensation funded on its behalf).

323-10-25-6 Example 2 (see paragraph 323-10-55-19) illustrates the application of this guidance for share-based compensation granted to employees of an equity method investee.

10. Amend paragraph 323-10-30-3 and its related heading, with a link to transition paragraph 718-10-65-11, as follows:

**Initial Measurement**
Stock-Based Share-Based Compensation Granted to Employees and Nonemployees of an Equity Method Investee

323-10-30-3 Share-based stock-based compensation cost recognized in accordance with paragraph 323-10-25-4 shall be measured initially at fair value in accordance with Topic 718 and Subtopic 505-50. Example 2 (see paragraph 323-10-55-19) illustrates the application of this guidance.

11. Amend paragraphs 323-10-55-19 through 55-26 and their related heading, with a link to transition paragraph 718-10-65-11, as follows:

Implementation Guidance and Illustrations

Illustrations

Example 2: Share-Based Stock-Based Compensation Granted to Employees of an Equity Method Investee

323-10-55-19 This Example illustrates the guidance in paragraphs 323-10-25-3 and 323-10-30-3 for share-based stock-based compensation by an investor granted to employees of an equity method investee. This Example is equally applicable to share-based awards granted by an investor to nonemployees that provide goods or services to an equity method investee that are used or consumed in the investee's operations.

323-10-55-20 Entity A owns a 40 percent interest in Entity B and accounts for its investment under the equity method. On January 1, 2001 (20X1), Entity A grants 10,000 stock options (in the stock of Entity A) to employees of Entity B. The stock options cliff-vest in three years. If an employee of Entity B fails to vest in a stock option, the option is returned to Entity A (that is, Entity B does not retain the underlying stock). The owners of the remaining 60 percent interest in Entity B have not shared in the funding of the stock options granted to employees of Entity B on any basis and Entity A was not obligated to grant the stock options under any preexisting agreement with Entity B or the other investors. Entity B will capitalize the share-based stock-based compensation costs recognized over the first year of the three-year vesting period as part of the cost of an internally constructed fixed asset (the internally constructed fixed asset will be completed on December 31, 2001 (20X1)).

323-10-55-21 Before granting the stock options, Entity A’s investment balance is $800,000, and the book value of Entity B’s net assets equals $2,000,000. Entity B will not begin depreciating the internally constructed fixed asset until it is complete and ready for its intended use and, therefore, no related depreciation expense (or compensation expense relating to the stock options) will be recognized between January 1, 2001 (20X1), and December 31, 2001 (20X1). For the years ending December 31, 2002 (20X2), and December 31, 2003 (20X3). Entity B will recognize depreciation expense (on the internally constructed fixed asset) and compensation.
expense (for the cost of the stock options relating to Years 2 and 3 of the vesting period). After recognizing those expenses, Entity B has net income of $200,000 for the fiscal years ending December 31, 2004, 2005, 2006, and 2007, and recognizes the remaining cost (40 percent) as an increase to its investment in Entity B.

323-10-55-22 Entity C also owns a 40 percent interest in Entity B. On January 1, 2004, before granting the stock options, Entity C’s investment balance is $800,000.

323-10-55-23 Assume that the fair value of the stock options granted by Entity A to employees of Entity B is $120,000, $150,000, and $120,000, on January 1, 2004, December 31, 2004, December 31, 2005, and December 31, 2006, respectively. Under Subtopic 505-50Topic 718, the fair value of share-based compensation shall be measured at the grant date and remeasured at each reporting date until a measurement date occurs. In this Example, assume that the measurement date occurs when the employees of Entity B vest in the stock options. This Example assumes that the stock options issued are classified as equity and ignores the effect of forfeitures.

323-10-55-24 Entity A would make the following journal entries.

<table>
<thead>
<tr>
<th>Date</th>
<th>Investment in Entity B</th>
<th>Additional paid-in capital</th>
<th>Equity in earnings of Entity B</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>$16,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2002</td>
<td>$36,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2003</td>
<td>$24,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
</tbody>
</table>

Entity B (Investee)

<table>
<thead>
<tr>
<th>Date</th>
<th>Investment in Entity B</th>
<th>Additional paid-in capital</th>
<th>Equity in earnings of Entity B</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>$16,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2002</td>
<td>$36,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2003</td>
<td>$24,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
</tbody>
</table>

Entity C (Noncontributing Investor)

<table>
<thead>
<tr>
<th>Date</th>
<th>Investment in Entity B</th>
<th>Additional paid-in capital</th>
<th>Equity in earnings of Entity B</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>$16,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2002</td>
<td>$36,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2003</td>
<td>$24,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
</tbody>
</table>

To record Entity A’s and Entity C’s share of the earnings of investee (same entry for both Entity A and Entity C)

<table>
<thead>
<tr>
<th>Date</th>
<th>Investment in Entity B</th>
<th>Additional paid-in capital</th>
<th>Equity in earnings of Entity B</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>$16,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2002</td>
<td>$36,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2003</td>
<td>$24,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
</tbody>
</table>

Consolidated impact of all the entries made by Entity A and Entity C

<table>
<thead>
<tr>
<th>Date</th>
<th>Investment in Entity B</th>
<th>Additional paid-in capital</th>
<th>Equity in earnings of Entity B</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>$16,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2002</td>
<td>$36,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
<tr>
<td>12/31/2003</td>
<td>$24,000</td>
<td>$40,000</td>
<td>$16,000</td>
</tr>
</tbody>
</table>

(a) Entity A recognizes as an expense the portion of the costs incurred that benefits the other investors (in this Example, 60 percent of the cost or $24,000 in 2004, 2005, 2006, and 2007) and recognizes the remaining cost (40 percent) as an increase to its investment in Entity B. Entity B has recognized the cost associated with the stock-based compensation incurred on its behalf, the portion of the cost recognized by Entity A as an increase to its investment in Entity B (40 percent) is expensed in the appropriate period when Entity A recognizes its share of the earnings of Entity B.

(b) It may be appropriate to classify the debit (expense) within the same income statement caption as equity in earnings of Entity B.

(c) This amount represents Entity C’s 40 percent interest in the additional paid-in capital recognized by Entity B related to the cost incurred by the third-party investor. It may be appropriate to classify the credit (income) within the same income statement caption as equity in earnings of Entity B.
323-10-55-25 A rollforward of Entity B’s net assets and a reconciliation to Entity A’s and Entity C’s ending investment accounts follows.

<table>
<thead>
<tr>
<th>Date</th>
<th>Net assets of Entity B</th>
<th>Entity A’s and Entity C’s share</th>
<th>Entity A’s and Entity C’s equity in net assets of Entity B</th>
<th>Entity A’s and Entity C’s ending investment balance</th>
<th>Remaining unamortized basis difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>12/31/2001</td>
<td>$ 2,000,000</td>
<td>$ 2,480,000</td>
<td>$ 896,000</td>
<td>$ 200,000</td>
<td>$ -</td>
</tr>
<tr>
<td>12/31/20X1</td>
<td>$ 2,240,000</td>
<td>$ 2,500,000</td>
<td>$ 992,000</td>
<td>$ 200,000</td>
<td>$ -</td>
</tr>
<tr>
<td>12/31/20X2</td>
<td>$ 2,480,000</td>
<td>$ 2,720,000</td>
<td>$ 992,000</td>
<td>$ 200,000</td>
<td>$ -</td>
</tr>
</tbody>
</table>

323-10-55-26 A summary of the calculation of share-based stock-based compensation cost by year follows.

<table>
<thead>
<tr>
<th>Year Ended</th>
<th>A = Grant Date Fair Value of Options</th>
<th>B = % Vested</th>
<th>C = (A x B) Amount of Cumulative Compensation Cost to Be Recognized</th>
<th>D = Cumulative Cost Previously Recognized</th>
<th>E = C – D Current Year Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>2001/20X1</td>
<td>$ 120,000</td>
<td>33%</td>
<td>$ 40,000</td>
<td>$ -</td>
<td>$ 40,000</td>
</tr>
<tr>
<td>2002/20X2</td>
<td>$ 150,000</td>
<td>66%</td>
<td>$ 100,000</td>
<td>$ 40,000</td>
<td>$ 60,000</td>
</tr>
<tr>
<td>2003/20X3</td>
<td>$ 120,000</td>
<td>100%</td>
<td>$ 120,000</td>
<td>$ 100,000</td>
<td>$ 20,000</td>
</tr>
</tbody>
</table>

Amendments to Subtopic 440-10

12. Supersede paragraph 440-10-60-4 and its related heading, with a link to transition paragraph 718-10-65-11, as follows:

**Commitments—Overall**

**Relationships**

> Equity

440-10-60-4 Paragraph superseded by Accounting Standards Update No. 2018-07. For a performance commitment to earn equity instruments, see Subtopic 505-50.

Amendments to Subtopic 470-20

13. Amend paragraphs 470-20-30-22 through 30-25, with a link to transition paragraph 718-10-65-11, as follows:
Debt—Debt with Conversion and Other Options

Initial Measurement

> Convertible Instruments Issued to Nonemployees for Goods and Services

470-20-30-22 To determine the fair value of a convertible instrument granted as part of a share-based payment transaction issued to a nonemployee in exchange for goods or services (or a combination of goods or services and cash) that is equity in form or, if debt in form, that can be converted into equity instruments of the issuer, the entity shall first apply Subtopic 505-50 Topic 718 on stock compensation.

470-20-30-23 The requirements of this Subtopic shall then be applied such that the fair value determined pursuant to Subtopic 505-50 Topic 718 is considered the proceeds from issuing the instrument for purposes of determining whether a beneficial conversion option exists. The measurement of the intrinsic value, if any, of the conversion option under paragraph 470-20-25-5 shall then be computed by comparing the proceeds received for the instrument (the instrument's fair value under Subtopic 505-50 Topic 718) to the fair value of the common stock that the counterparty grantee would receive upon exercising the conversion option. For purposes of determining whether a convertible instrument contains a beneficial conversion feature under paragraph 470-20-25-5, an entity shall use the effective conversion price based on the proceeds allocated to the convertible instrument to compute the intrinsic value, if any, of the embedded conversion option.

470-20-30-24 The measurement date under Subtopic 505-50 Topic 718 shall be used both to measure the fair value of the convertible instrument and to measure the intrinsic value, if any, of the conversion option as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested. That is, in measuring the intrinsic value of the conversion option under paragraph 470-20-25-5, the fair value of the issuer’s equity securities into which the instrument can be converted shall be determined as of the date the convertible instrument granted as part of a share-based payment award becomes fully vested on the measurement date under Subtopic 505-50, and not on the commitment date specified in this Subtopic.

470-20-30-25 All of the following guidelines for determining the fair value of convertible instruments shall be used:

a. Subparagraph superseded by Accounting Standards Update No. 2018-07. If the fair value of the goods or services received is reliably determinable, and the issuer has not recently issued similar convertible instruments, the fair value of the goods or services shall be used to measure the transaction.
b. Recent issuances of similar convertible instruments for cash to parties that only have an investor relationship with the issuer may provide the best evidence of fair value of the convertible instrument.

c. If reliable information under (a) or (b) is not available, the fair value of the convertible instrument shall be deemed to be no less than the fair value of the equity shares into which it can be converted.

470-20-30-26 If an entity issues a convertible instrument for cash proceeds that indicate that the instrument includes a beneficial conversion option and the purchaser of the instrument also provides (receives) goods or services to (from) the issuer that are the subject of a separate contract, the terms of both the agreement for goods or services and the convertible instrument shall be evaluated to determine whether their separately stated pricing is equal to the fair value of the goods or services and convertible instrument. If that is not the situation, the terms of the respective transactions shall be adjusted by measuring the convertible instrument initially at its fair value with a corresponding increase or decrease in the purchase or sales price of the goods or services. It may be difficult to evaluate whether the separately stated pricing of a convertible instrument is equal to its fair value. If an instrument issued to a goods or services provider (or purchaser) is part of a larger issuance, a substantive investment in the issuance by unrelated investors (who are not also providers or purchasers of goods or services) may provide evidence that the price charged to the goods or services provider represents the fair value of the convertible instrument.

Amendments to Subtopic 480-10

14. Amend paragraph 480-10-15-8, with a link to transition paragraph 718-10-65-11, as follows:

Distinguishing Liabilities from Equity—Overall

Scope and Scope Exceptions

> Topics and Subtopics Not within Scope

> > Share-Based Compensation

480-10-15-8 The guidance in the Distinguishing Liabilities from Equity Topic does not apply to an obligation under share-based compensation arrangements if that obligation is accounted for under Topic 718 or Subtopic 505-50. For example, employee stock ownership plan shares or freestanding agreements to repurchase those shares are not within the scope of this Topic because those shares are accounted for under Subtopic 718-40 through the point of redemption. However, this Topic does apply to a freestanding financial instrument that was issued under a share-based compensation arrangement but is no longer subject
to Topic 718 or Subtopic 505-50. For example, this Topic applies to a mandatorily redeemable share issued upon a grantee’s exercise of an employee’s exercise of an employee share option. (Topic 718 and Subtopic 505-50 provide accounting guidance for dividends on allocated shares, redemption of shares, recognition of expense, and computing earnings per share [EPS].) However, employee stock ownership plan shares that are mandatorily redeemable or freestanding agreements to repurchase those shares continue to be subject to other applicable guidance related to Subtopic 718-40.

Amendments to Subtopic 505-10

15. Amend paragraphs 505-10-05-1 and 505-10-25-3, with a link to transition paragraph 718-10-65-11, as follows:

**Equity—Overall**

**Overview and Background**

505-10-05-1 The Equity Topic includes the following Subtopics:

a. Overall
b. Stock Dividends and Stock Splits
c. Treasury Stock
d. Subparagraph superseded by Accounting Standards Update No. 2018-07 Equity-Based Payments to Nonemployees
e. Spinoffs and Reverse Spinoffs.

**Recognition**

505-10-25-3 Paragraphs 323-10-25-3 through 25-5 provide guidance on accounting for stock-based share-based compensation granted by an investor to employees or nonemployees of an equity method investee that provide goods or services to the investee that are used or consumed in the investee’s operations. An investee shall recognize the costs of the stock-based compensation share-based payment incurred by the investor on its behalf, and a corresponding capital contribution, as the costs are incurred on its behalf (that is, in the same period(s) as if the investor had paid cash to employees and nonemployees of the investee following the guidance in Subtopic 505-50 Topic 718 on stock compensation).

Amendments to Subtopic 505-50

16. Supersede Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees, with a link to transition paragraph 718-10-65-11. [Paragraphs 505-
50-15-3(c), 505-50-25-2, and 505-50-25-4 amended and moved to paragraphs 718-10-15-5(b), 718-10-25-2B, and 718-10-25-2C; paragraphs 505-50-25-6 through 25-10 amended and moved to paragraphs 718-10-35-1A through 35-1C and 718-10-35-1E through 718-10-35-1F; and paragraph 505-50-45-1 amended and moved to paragraph 718-10-45-3

Amendments to Subtopic 606-10

17. Amend paragraph 606-10-32-25, with a link to transition paragraph 718-10-65-11, as follows:

Revenue from Contracts with Customers—Overall

Measurement

> Determining the Transaction Price

> > Consideration Payable to a Customer

606-10-32-25 Consideration payable to a customer includes cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity’s goods or services from the customer). Consideration payable to a customer also includes credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity’s goods or services from the customer). Consideration payable to a customer also includes equity instruments (liability or equity classified) granted in conjunction with selling goods or services (for example, shares, share options, or other equity instruments). An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs 606-10-25-18 through 25-22) that the customer transfers to the entity. If the consideration payable to a customer includes a variable amount, an entity shall estimate the transaction price (including assessing whether the estimate of variable consideration is constrained) in accordance with paragraphs 606-10-32-5 through 32-13.

Amendments to Subtopic 718-10

18. Amend paragraphs 718-10-05-1 through 05-3, 718-10-10-1 through 10-2, and 718-10-15-2 through 15-5 and add paragraphs 718-10-15-3A and 718-10-15-5A, with a link to transition paragraph 718-10-65-11, as follows:

Compensation—Stock Compensation—Overall
Overview and Background

718-10-05-1 The Compensation—Stock Compensation Topic provides guidance on share-based payment transactions with employees. This Topic includes the following Subtopics:

a. Overall
b. Awards Classified as Equity
c. Awards Classified as Liabilities
d. Employee Stock Ownership Plans
e. Employee Stock Purchase Plans
f. Income Taxes.

718-10-05-2 This Topic does not provide guidance for employee and nonemployee share-based payment transactions. See Subtopic 505-50 for guidance on nonemployee share transactions.

718-10-05-3 This Subtopic provides general guidance related to share-based payment arrangements with employees. This Subtopic and Subtopics 718-20 and 718-30 are interrelated and the required guidance may be located in either this Subtopic or one of the other Subtopics. In general, material that relates to both equity and liability instruments is included in this Subtopic, while material more specifically related to either equity or liability instruments is included in their respective Subtopics. Guidance referencing grantees is intended to be applicable to recipients of both employee and nonemployee awards, and guidance referencing employees or nonemployees is only applicable to those specific types of awards.

Objectives

718-10-10-1 The objective of accounting for transactions under share-based payment arrangements with employees is to recognize in the financial statements the employee goods or services received in exchange for equity instruments issued, granted or liabilities incurred and the related cost to the entity as those goods or services are received. This Topic uses the terms compensation and payment in their broadest senses to refer to the consideration paid for employee goods or services.

718-10-10-2 This Topic requires that the cost resulting from all share-based payment transactions be recognized in the financial statements. This Topic 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 in accounting for share-based payment transactions with employees except for equity instruments held by employee stock ownership plans.
Scope and Scope Exceptions

> Entities

718-10-15-2 The guidance in the Compensation—Stock Compensation Topic applies to all entities that enter into share-based payment transactions with employees.

> Transactions

718-10-15-3 The guidance in the Compensation—Stock Compensation Topic applies to all share-based payment transactions in which a grantor an entity acquires goods or services to be used or consumed in the grantor’s own operations by issuing (or offering to issue) its shares, share options, or other equity instruments or by incurring liabilities to an employee or a nonemployee that meet either of the following conditions:

a. The amounts are based, at least in part, 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.

718-10-15-3A Paragraphs 323-10-25-3 through 25-5 provide guidance on accounting for share-based compensation granted by an investor to employees or nonemployees of an equity method investee that provide goods or services to the investee that are used or consumed in the investee’s operations.

718-10-15-4 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 goods or services provided to the reporting entity are share-based payment transactions to be accounted for under this Topic unless the transfer is clearly for a purpose other than compensation for goods or 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 or goods received. 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 goods or services to be used or consumed in a grantor’s own operations.

718-10-15-5 The guidance in this Topic does not apply to the following payment transactions:
a. Subparagraph superseded by Accounting Standards Update No. 2018-07. Share-based transactions for other than employee services (see Subtopic 505-50 for guidance on those transactions).

b. Transactions involving equity instruments granted either issued to a lender or investor that provides financing to the issuer or issued in a business combination. [Content amended as shown and moved from paragraph 505-50-15-3(c)]

c. Transactions involving equity instruments granted in conjunction with selling goods or services to customers as part of a contract (for example, sales incentives) accounted for under Topic 606 on revenue from contracts with customers (specifically, the guidance on consideration payable to a customer in paragraphs 606-10-32-25 through 32-27).

718-10-15-5A If consideration payable to a customer is payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers as described in paragraph 606-10-32-26. Therefore, share-based payment awards granted to a customer for a distinct good or service to be used or consumed in the grantor’s own operations are accounted for under this Topic.

19. Amend paragraphs 718-10-25-2 through 25-3, 718-10-25-5, 718-10-25-7 through 25-9, 718-10-25-11 through 25-12, 718-10-25-14 through 25-16, and 718-10-25-20 through 25-21 and add paragraphs 718-10-25-2A through 25-2C, with a link to transition paragraph 718-10-65-11, as follows:

**Recognition**

718-10-25-1 The guidance in this Section is organized as follows:

a. Recognition principle for share-based payment transactions
b. Determining the grant date
c. Determining whether to classify a financial instrument as a liability or as equity
d. Market, performance, and service conditions
e. Subparagraph superseded by Accounting Standards Update No. 2012-04.

f. Payroll taxes.

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

718-10-25-2 An entity shall recognize the goods acquired or services received in a share-based payment transaction with an employee when it obtains the goods or as services are received, as further described in paragraphs 718-10-25-2A through 25-2B. Employee services themselves are not recognized before they are
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 718-10-25-6 through 25-1925-19A). As the services are consumed, the entity shall recognize the related cost. For example, as services are consumed, the cost usually is recognized in determining net income of that period, for example, as expenses incurred for employee services. In some circumstances, the cost of services may be initially capitalized as part of the cost to acquire or construct another asset, such as inventory, and later recognized in the income statement when that asset is disposed of or consumed. This Topic refers to recognizing compensation cost rather than compensation expense because any compensation cost that is capitalized as part of the cost to acquire or construct an asset would not be recognized as compensation expense in the income statement.

718-10-25-2A Employee services themselves are not recognized before they are received. As the services are consumed, the entity shall recognize the related cost. For example, as services are consumed, the cost usually is recognized in determining net income of that period, for example, as expenses incurred for employee services. In some circumstances, the cost of services may be initially capitalized as part of the cost to acquire or construct another asset, such as inventory, and later recognized in the income statement when that asset is disposed of or consumed. This Topic refers to recognizing compensation cost rather than compensation expense because any compensation cost that is capitalized as part of the cost to acquire or construct an asset would not be recognized as compensation expense in the income statement.

718-10-25-2B Transactions with nonemployees in which equity instruments share-based payment awards are granted issued in exchange for the receipt of goods or services may involve a contemporaneous exchange of the share-based payment awards equity instruments for goods or services or may involve an exchange that spans several financial reporting periods. Furthermore, by virtue of the terms of the exchange with the grantee-counterparty, the quantity and terms of the share-based payment awards equity instruments to be granted issued may be known or only known within a range not known when the transaction arrangement is established because of specific conditions dictated by the agreement (for example, performance conditions). This Section addresses the recognition approach for any of these transactions if the counterparty to the transaction is other than an employee. Judgment is required in determining the period over which to recognize cost, otherwise known as the nonemployee’s vesting period.

718-10-25-2C This guidance does not address the period(s) or the manner (that is, capitalize versus expense) in which an entity granting the share-based payment awards equity instrument (the purchaser or grantor) to a nonemployee shall recognize the fair-value cost of the share-based payment awards equity instruments.
that will be issued, other than to require that an asset or expense, expense, or sales discount be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services or used cash rebates as a sales discount instead of paying with or using the share-based payment award equity instruments. [Content amended as shown and moved from paragraph 505-50-25-4]

718-10-25-3 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. 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 granteeemployee (that is, other 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.

> Determining the Grant Date

718-10-25-5 As a practical accommodation, in determining the grant date of an award subject to this Topic, 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 employeegrantee 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 grantoremployer.

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.

For additional guidance see paragraphs 718-10-55-80 through 55-83.

> Determining Whether to Classify a Financial Instrument as a Liability or as Equity

718-10-25-6 This paragraph through paragraph 718-10-25-19A provide 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 generally accepted accounting principles (GAAP)
applicable to financial instruments issued in transactions not involving share-based payment.

718-10-25-7 Topic 480 excludes from its scope instruments that are accounted for under this Topic. Nevertheless, unless paragraphs 718-10-25-8 through 25-1925-19A require otherwise, an entity shall apply the classification criteria in Section 480-10-25 and paragraphs 480-10-15-3 through 15-4, as they are effective at the reporting date, in determining whether to classify as a liability a freestanding financial instrument given to an employee grantee in a share-based payment transaction. Paragraphs 718-10-35-9 through 35-14 provide criteria for determining when instruments subject to this Topic subsequently become subject to Topic 480 or to other applicable GAAP.

718-10-25-8 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 Topic 480. In addition, a call option written on an instrument that is not classified as a liability under those classification requirements (for example, a call option on a mandatorily redeemable share for which liability classification is not required for the specific entity under the requirements effective at the reporting date) 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 718-10-25-11 through 25-12.

718-10-25-9 Topic 480 does not apply to outstanding shares embodying a conditional obligation to transfer assets, for example, shares that give the employee grantee the right to require the employer grantor to repurchase them for cash equal to their fair value (puttable shares). A put right may be granted to the employee grantee 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 grantee as compensation shall be classified as a liability if either of the following conditions is met:

a. The repurchase feature permits the employee grantee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time from the date the good is delivered or the requisite service is performed and the share is issued. An employee grantee begins to bear the risks and rewards normally associated with equity share ownership when all the goods are delivered or all the requisite service has been rendered and the share is issued. A repurchase feature that can be exercised only upon the occurrence of a contingent event that is outside the employee grantee’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 (grantor) would prevent the employee (grantee) 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.

718-10-25-10 A puttable (or callable) share that does not meet either of those conditions shall be classified as equity (see paragraph 718-10-55-85).

718-10-25-11 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 (grantee’s) control (such as an initial public offering) would not meet this condition until it becomes probable that event will occur.

718-10-25-12 For example, a Securities and Exchange Commission (SEC) registrant may grant an option to an employee (grantee) that, upon exercise, would be settled by issuing a mandatorily redeemable share. Because the mandatorily redeemable share would be classified as a liability under Topic 480, the option also would be classified as a liability.

718-10-25-13 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 Topic, and the additional factor shall be reflected in estimating the fair value of the award. Paragraph 718-10-55-65 provides examples of such awards.

718-10-25-14 For this purpose, an award of equity share options granted to a grantee (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 foreign operation’s 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 or nonemployees 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 granted to employees and nonemployees 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 foreign operation’s employees to whom the options are granted are paid in euros.

718-10-25-14A For purposes of applying paragraph 718-10-25-13, a share-based payment award with an exercise price denominated in the currency of a market in
which a substantial portion of the entity’s equity securities trades shall not be considered to contain a condition that is not a market, performance, or service condition. Therefore, in accordance with that paragraph, such an award shall not be classified as a liability if it otherwise qualifies for equity classification. For example, a parent entity whose functional currency is the Canadian dollar grants equity share options with an exercise price denominated in U.S. dollars to employees grantees of a Canadian entity with the functional and payroll currency of the Canadian dollar. If a substantial portion of the parent entity’s equity securities trades on a U.S. dollar denominated exchange, the options are not precluded from equity classification.

718-10-25-15 The accounting for an award of 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 grantee 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 grantee’s, and the entity thus incurs a liability to the employee grantee. 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 predominantly settles in cash or if the entity usually settles in cash whenever an employee grantee 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 Topic, such requirements to deliver registered shares 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 718-10-25-11 through 25-12).

718-10-25-16 A provision that permits employees grantees 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/grantee is the legal owner of the shares subject to the option (even though the employee/grantee has not paid the exercise price before the sale of the shares subject to the option).

> Market, Performance, and Service Conditions

718-10-25-20 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/grantee 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. Example 2 (see paragraph 718-20-55-35) provides an illustration of how to account for awards with multiple performance conditions.

718-10-25-21 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 good is delivered or the requisite service is rendered, and no compensation cost shall be recognized if the good is not delivered or the requisite service is not rendered. Paragraphs 718-10-55-60 through 55-63 provide guidance on applying this provision to awards with market, performance, or service conditions (or any combination thereof).

20. Amend paragraphs 718-10-30-2 through 30-3, 718-10-30-5 through 30-6, 718-10-30-8, 718-10-30-10 through 30-14, 718-10-30-17 through 30-19, 718-10-30-20A through 30-20B, 718-10-30-24, and 718-10-30-27 through 30-28 and add paragraphs 718-10-30-10A through 30-10B, with a link to transition paragraph 718-10-65-11, as follows:

Initial Measurement

718-10-30-1 While some of the material in this Section was written in terms of awards classified as equity, it applies equally to awards classified as liabilities.

> Fair-Value-Based

718-10-30-2 A share-based payment transaction with employees shall be measured based on the fair value (or in certain situations specified in this Topic, a calculated value or intrinsic value) of the equity instruments issued.

718-10-30-3 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 Topic. That is, the cost of goods obtained or 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 goods obtained or 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 goods obtained or services received is net of any amount that an employee grantee pays (or becomes obligated to pay) for that instrument when it is granted. For example, if an employee grantee pays $5 at the grant date for an option with a grant-date fair value of $50, the amount attributed to employee service goods or services provided by the grantee is $45.

However, this Topic provides certain exceptions (see paragraph 718-10-30-21) to that measurement method if it is not possible to reasonably estimate the fair value of an award at the grant date. A nonpublic entity also may choose to measure its liabilities under share-based payment arrangements at intrinsic value (see paragraphs 718-10-30-20 and 718-30-30-2).

> > Terms of the Award Affect Fair Value

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 grantee is required to pay nonrefundable interest on the note.

> Measurement Objective—Fair Value at Grant Date

The measurement objective for equity instruments awarded to employees grantees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when grantees have delivered the goods or 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 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, if one is available (see paragraph 718-10-55-10).

Such market prices for equity share options and similar instruments granted in share-based payment transactions 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. Paragraphs 718-10-55-4 through 55-47 provide additional guidance on estimating the fair value of equity instruments, including the factors to be taken into account in estimating the fair value of equity share options or similar instruments as described in paragraphs 718-10-55-21 through 55-22.

> Factors or Restrictions That Impact the Determination of Fair Value at Grant Date

>> Vesting versus Nontransferability

To satisfy the measurement objective in paragraph 718-10-30-6, 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 or the nonemployee’s vesting period. A restriction that continues in effect after an entity has issued awards 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 grantees’ employment termination behavior in estimating fair value (referred to as an option’s expected term).

On an award-by-award basis, an entity may elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award to satisfy the measurement objective in paragraph 718-10-30-6. Otherwise, an entity shall apply the guidance in this Topic in estimating the expected term of a nonemployee award, which may result in a term less than the contractual term of the award.

When a nonpublic entity chooses to measure a nonemployee share-based payment award by estimating its expected term and applies the practical expedient in paragraph 718-10-30-20A, it must apply the practical expedient to all nonemployee awards that meet the conditions in paragraph 718-10-30-20B. However, a nonpublic entity may still elect, on an award-by-award basis, to use the contractual term as the expected term as described in paragraph 718-10-30-10A.

Forfeitability

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 deliver the good or render the requisite service.

> > Performance or Service Conditions

718-10-30-12 Awards of share-based employee-compensation ordinarily specify a performance condition or a service condition (or both) that must be satisfied for an employee grantee 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, for example, instruments for which the good is not delivered or the requisite service is not rendered). Examples 1 through 2 (see paragraphs 718-20-55-4 through 55-40) and Example 1 (see paragraph 718-30-55-1) provide illustrations of how compensation cost is recognized for awards with service and performance conditions.

718-10-30-13 The fair-value-based method described in paragraphs 718-10-30-6 and 718-10-30-10 through 30-14 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 employee's requisite service period or a nonemployee's vesting period are reflected based on the outcomes of those conditions. This Topic refers to the required measure as fair value.

> > Market Conditions

718-10-30-14 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 Topic, are path-dependent options.) Compensation cost thus is recognized for an award with a market condition provided that the good is delivered or the requisite service is rendered, regardless of when, if ever, the market condition is satisfied.

> > Market, Performance, and Service Conditions That Affect Factors Other Than Vesting or Exercisability

718-10-30-15 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. Paragraphs 718-10-55-64
through 55-66 provide additional guidance on the effects of market, performance, and service conditions that affect factors other than vesting or exercisability. Examples 2 (see paragraph 718-20-55-35); 3 (see paragraph 718-20-55-41); 4 (see paragraph 718-20-55-47); 5 (see paragraph 718-20-55-51); and 7 (see paragraph 718-20-55-68) provide illustrations of accounting for awards with such conditions.

>> Nonvested or Restricted Shares

718-10-30-17 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.

718-10-30-18 Nonvested shares granted in share-based payment transactions to employees usually are referred to as restricted shares, but this Topic reserves that term for fully vested and outstanding shares whose sale is contractually or governmentally prohibited for a specified period of time.

718-10-30-19 A restricted share awarded to a grantee 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. Example 8 (see paragraph 718-20-55-71) provides an illustration of accounting for an award of nonvested shares to employees.

[Note: Paragraph 718-10-30-19A and its related heading are added in Issue 4. They are shown here for context.]

>> Nonpublic Entity—Calculated Value for Nonemployee Awards

718-10-30-19A Similar to employee equity share options and similar instruments, a nonpublic entity may not be able to reasonably estimate the fair value of nonemployee awards because it is not practicable for the nonpublic entity to estimate the expected volatility of its share price. In that situation, the nonpublic entity shall account for nonemployee equity share options and similar instruments on the basis of a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the nonpublic entity’s share price (the calculated value) in accordance with paragraph 718-10-30-20. A nonpublic entity’s use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions.

>> Nonpublic Entity—Calculated Value

718-10-30-20 A nonpublic 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 Topic, provisions that apply to accounting for share options and similar instruments at fair value also apply to calculated value. Paragraphs 718-10-55-51 through 55-58 and Example 9 (see paragraph 718-20-55-76) provide additional guidance on applying the calculated value method to equity share options and similar instruments granted by a nonpublic entity.

> Nonpublic Entity—Practical Expedient for Expected Term

**718-10-30-20A** For an award that meets the conditions in paragraph 718-10-30-20B, a nonpublic entity may make an entity-wide accounting policy election to estimate the expected term using the following practical expedient:

a. If vesting is only dependent upon a service condition, a nonpublic entity shall estimate the expected term as the midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term of the award.

b. If vesting is dependent upon satisfying a performance condition, a nonpublic entity first would determine whether the performance condition is probable of being achieved.

1. If the nonpublic entity concludes that the performance condition is probable of being achieved, the nonpublic entity shall estimate the expected term as the midpoint between the employee’s requisite service period (a nonpublic entity shall consider the guidance in paragraphs 718-10-55-69 through 55-79 when determining the requisite service period of the award) or the nonemployee’s vesting period and the contractual term.

2. If the nonpublic entity concludes that the performance condition is not probable of being achieved, the nonpublic entity shall estimate the expected term as either:

   i. The contractual term if the service period is implied (that is, the requisite service period or the nonemployee’s vesting period is not explicitly stated but inferred based on the achievement of the performance condition at some undetermined point in the future)

   ii. The midpoint between the employee’s requisite service period or the nonemployee’s vesting period and the contractual term if the requisite service period is stated explicitly.

Paragraph 718-10-55-50A provides implementation guidance on the practical expedient.

**718-10-30-20B** A nonpublic entity that elects to apply the practical expedient in paragraph 718-10-30-20A shall apply the practical expedient to a share option or similar award that has all of the following characteristics:
a. The share option or similar award is granted at the money.

b. The employee-grantee has only a limited time to exercise the award (typically 30–90 days) if the employee-grantee no longer provides goods or terminates service after vesting.

c. The employee-grantee can only exercise the award. The employee-grantee cannot sell or hedge the award.

d. The award does not include a market condition.

A nonpublic entity that elects to apply the practical expedient in paragraph 718-10-30-20A may always elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award as described in paragraph 718-10-30-10A. However, a nonpublic entity must apply the practical expedient in paragraph 718-10-30-20A for all nonemployee awards that have all the characteristics listed in this paragraph if that nonpublic entity does not elect to use the contractual term as the expected term and that nonpublic entity elects the accounting policy election to apply the practical expedient in paragraph 718-10-30-20A.

> Reload and Contingent Features

718-10-30-23 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.

718-10-30-24 A contingent feature of an award that might cause an employee-grantee 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 (see paragraph 718-10-55-8), shall not be reflected in estimating the grant-date fair value of an equity instrument.

> Market, Performance, and Service Conditions

718-10-30-27 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 employee-grantees 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 (see paragraph 718-10-30-14). For purposes of this Topic, 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.
In some cases, the terms of an award may provide that a performance target that affects vesting could be achieved after an employee completes the requisite service period or a nonemployee satisfies a vesting period. That is, the employee-grantee would be eligible to vest in the award regardless of whether the employee-grantee is rendering service or delivering goods on the date the performance target is achieved. A performance target that affects vesting and that could be achieved after an employee’s requisite service period or a nonemployee’s vesting period shall be accounted for as a performance condition. As such, the performance target shall not be reflected in estimating the fair value of the award at the grant date. Compensation cost shall be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service or goods already have been provided. If the performance target becomes probable of being achieved before the end of the employee’s requisite service period or the nonemployee’s vesting period, the remaining unrecognized compensation cost for which requisite service or goods have not yet been provided shall be recognized prospectively over the remaining employee’s requisite service period or the nonemployee’s vesting period. The total amount of compensation cost recognized during and after the employee’s requisite service period or the nonemployee’s vesting period shall reflect the number of awards that are expected to vest based on the performance target and shall be adjusted to reflect those awards that ultimately vest. An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-1D or 718-10-35-3 shall reverse compensation cost previously recognized, in the period the award is forfeited, for an award that is forfeited before completion of the employee’s requisite service period or the nonemployee’s vesting period. The employee’s requisite service period and the nonemployee’s vesting period end when the employee-grantee can cease rendering service or delivering goods and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated vesting period (which includes the period in which the performance target could be achieved) may differ from the employee’s requisite service period or the nonemployee’s vesting period.

21. Add paragraphs 718-10-35-1A through 35-1F and their related heading and amend the heading preceding paragraph 718-10-35-2 and paragraphs 718-10-35-3, 718-10-35-5 and its related heading, 718-10-35-8 and its related heading, and 718-10-35-15, with a link to transition paragraph 718-10-65-11, as follows:

Subsequent Measurement

This Subtopic is interrelated with Subtopics 718-20 and 718-30. Material that equally applies to both liabilities and equity is generally found in this Subtopic. However, material may have been placed in one of the other Subtopics.

> Recognition of Nonemployee Compensation Costs
A grantor shall recognize the goods acquired or services received in a share-based payment transaction with nonemployees when it obtains the goods or as services are received. A grantor may need to recognize an asset before it actually receives goods or services if it first exchanges a share-based payment for an enforceable right to receive those goods or services. Nevertheless, the goods or services themselves are not recognized before they are received.

If fully vested, nonforfeitable equity instruments are granted issued at the date the grantor and nonemployee grantee enter into an agreement for goods or services (no specific performance is required by the nonemployee grantee to retain those equity instruments), then, because of the elimination of any obligation on the part of the nonemployee counterparty to earn the equity instruments, a measurement date has been reached. A grantor shall recognize the equity instruments when they are granted issued (in most cases, when the agreement is entered into). Whether the corresponding cost is an immediate expense or a prepaid asset (or whether the debit should be characterized as contra-equity under the requirements of paragraph 505-50-45) depends on the specific facts and circumstances. Section 505-50-30 provides guidance on the determination of the measurement date for transactions that are within the scope of this Subtopic.

An entity may grant fully vested, nonforfeitable equity instruments that are exercisable by the nonemployee grantee only after a specified period of time if the terms of the agreement provide for earlier exercisability if the nonemployee 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 share-based payment awards equity instruments.

The total amount of compensation cost recognized for share-based payment awards to nonemployees shall be based on the number of instruments for which a good has been delivered or a service has been rendered. To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all nonemployee share-based payment awards to do either of the following:

a. Estimate the number of forfeitures expected to occur. The entity shall base initial accruals of compensation cost on the estimated number of nonemployee share-based payment awards for which a good is expected to be delivered or a service is expected to be rendered. The entity shall revise that estimate 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
estimates shall be recognized in compensation cost in the period of the change.

b. Recognize the effect of forfeitures in compensation cost when they occur. Previously recognized compensation cost for a nonemployee share-based payment award shall be reversed in the period that the award is forfeited.

718-10-35-1E A recognized asset or expense, or sales discount shall not be reversed if a stock option that the nonemployee counterparty has the right to exercise expires unexercised. [Content amended as shown and moved from paragraph 505-50-25-9]

718-10-35-1F 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 718-10-25-6 through 25-4925-19A. As the goods or services are disposed of or consumed, the grantor shall recognize the related cost. For example, when inventory is sold, the cost is recognized in the income statement as cost of goods sold, and as services are consumed, the cost usually is recognized in determining net income of that period, for example, as expenses incurred for services. In some circumstances, the cost of services (or goods) may be initially capitalized as part of the cost to acquire or construct another asset, such as inventory, and later recognized in the income statement when that asset is disposed of or consumed. [Content amended as shown and moved from paragraph 505-50-25-10]

> Recognition of Employee Compensation Costs over the Requisite Service Period

718-10-35-2 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.

718-10-35-3 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). 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). To determine the amount of compensation cost to be recognized in each period, an entity shall make an entity-wide accounting policy election for all employee share-based payment awards to do either of the following:
a. Estimate the number of awards for which the requisite service will not be rendered (that is, estimate the number of forfeitures expected to occur). The entity shall base initial accruals of compensation cost on the estimated number of instruments for which the requisite service is expected to be rendered. The entity shall revise that estimate 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.

b. Recognize the effect of awards for which the requisite service is not rendered when the award is forfeited (that is, recognize the effect of forfeitures in compensation cost when they occur). Previously recognized compensation cost for an award shall be reversed in the period that the award is forfeited.

> Estimating the Requisite Service Period for Employee Awards

718-10-35-5 The requisite service period for employee awards 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 (see paragraph 718-10-55-71). 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 (see paragraph 718-10-35-8). Paragraphs 718-10-55-69 through 55-79 and 718-10-55-93 through 55-106 provide guidance on estimating the requisite service period and provide examples of how that period shall be estimated if an award’s terms include more than one explicit, implicit, or derived service period.

> Graded Vesting Employee Awards

718-10-35-8 An entity shall make a policy decision about whether to recognize compensation cost for an employee 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. Example 1, Case B (see paragraph 718-20-55-25) provides an illustration of the accounting for an award with a graded vesting schedule.

[Note: Paragraphs 718-10-35-9 through 35-11 and 718-10-35-14 are amended and paragraph 718-10-35-9A is added in Issue 2. They are shown here for context.]

> Awards May Become Subject to Other Guidance

718-10-35-9 Paragraphs 718-10-35-10 through 35-14 are intended to apply to those instruments issued in share-based payment transactions with employees and nonemployees accounted for under this Topic, and to instruments exchanged in a business combination for share-based payment awards of the acquired business that were originally granted to employees or grantees 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.

718-10-35-9A A convertible instrument award granted to a nonemployee in exchange for goods or services to be used or consumed in a grantor’s own operations is subject to recognition and measurement guidance in this Topic until the award is fully vested. Once vested, a convertible instrument award that is equity in form, or debt in form, that can be converted into equity instruments of the grantor, shall follow recognition and measurement through reference to other applicable generally accepted accounting principles (GAAP), including Subtopic 470-20 on debt with conversion and other options.

718-10-35-10 A freestanding financial instrument issued to an employee or grantee in exchange for goods past or future employee services received (or to be received) that is subject to initial recognition and measurement guidance within this Topic shall continue to be subject to the recognition and measurement provisions of this Topic throughout the life of the instrument, unless its terms are modified when the holder after a nonemployee vests in the award and is no longer providing goods or services, or a grantee 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.

718-10-35-11 Other modifications of that instrument that take place when the holder after a nonemployee vests in the award and is no longer providing goods or services, or a grantee is no longer an employee shall be subject to the modification guidance in paragraph 718-10-35-14. Following modification, recognition and measurement of the instrument shall be determined through reference to other applicable GAAP (generally accepted accounting principles).

718-10-35-12 Once the classification of an instrument is determined, the recognition and measurement provisions of this Topic shall be applied until the instrument ceases to be subject to the requirements discussed in paragraph 718-10-35-10. Topic 480 or other applicable GAAP, such as Topic 815, applies to a freestanding financial instrument that was issued under a share-based payment arrangement but that is no longer subject to this Topic. This guidance is not intended to suggest that all freestanding financial instruments shall be accounted for as liabilities pursuant to Topic 480, but rather that freestanding financial instruments issued in share-based payment transactions may become subject to Topic or other applicable GAAP depending on their substantive characteristics and when certain criteria are met.

718-10-35-13 Paragraph superseded by Accounting Standards Update No. 2016-09.

718-10-35-14 An entity may modify (including cancel and replace) or settle a fully vested, freestanding financial instrument after it becomes subject to Topic 480 or other applicable GAAP. Such a modification or settlement shall be accounted for under the provisions of this Topic unless it applies equally to all financial instruments of the same class regardless of whether the holder of the financial instrument is (or was) an employee (or an employee’s beneficiary). Following the modification, the instrument continues to be accounted for under that Topic or other applicable GAAP. 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 or vendor relationship depending on the terms of the modification or settlement. Thus, such a modification or settlement may be subject to the requirements of this Topic. See paragraph 718-10-35-10 for a discussion of changes to awards made solely to reflect an equity restructuring.

> Change in Classification Due to Change in Probable Settlement Outcome

718-10-35-15 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 performanceservice (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.

22. Amend paragraphs 718-10-45-1 and 718-10-50-1 through 50-2 and add paragraph 718-10-45-3 and its related heading, with a link to transition paragraph 718-10-65-11, as follows:

Other Presentation Matters

> Earnings per Share

718-10-45-1 Topic 260 requires that employee-equity share options, nonvested shares, and similar equity instruments granted under share-based payment transactions to employees be treated as potential common shares in computing diluted earnings per share (EPS). Diluted EPS shall be based on the actual number of options or shares granted and not yet forfeited regardless of the entity’s accounting policy for forfeitures in accordance with paragraphs 718-10-35-1D and 718-10-35-3, unless doing so would be antidilutive. If vesting in or the ability to exercise (or retain) an award is contingent on a performance or market condition, such as the level of future earnings, the shares or share options shall be treated as contingently issuable shares in accordance with paragraphs 260-10-45-48 through 45-57. If equity share options or other equity instruments are outstanding for only part of a period, the shares issuable shall be weighted to reflect the portion of the period during which the equity instruments are outstanding.

718-10-45-2 Paragraphs 260-10-45-29 through 45-34 and Example 8 (see paragraphs 260-10-55-68) provide guidance on applying the treasury stock method for equity instruments granted in share-based payment transactions in determining diluted EPS.

> Classification of Assets Other Than a Note or a Receivable for Nonemployee Awards

718-10-45-3 As discussed in paragraph 505-50-25-718-10-35-1B, a grantor may conclude that an asset (other than a note or a receivable) has been received in
return for fully vested, nonforfeitable, nonemployee share-based payment awards. Equity instruments that are issued at the date the grantor and grantee nonemployee enter into an agreement for goods or services (and no specific performance is required by the nonemployee grantee in order to retain those equity instruments). Such an asset shall not be displayed as contra-equity by the grantor of the award equity instruments. The transferability (or lack thereof) of the equity instruments awards shall not affect the balance sheet display of the asset. This guidance is limited to transactions in which equity instruments awards are transferred to nonemployees other than employees in exchange for goods or services. [Content amended as shown and moved from paragraph 505-50-45-1]

Disclosure

718-10-50-1 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 cost 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
d. The cash flow effects resulting from share-based payment arrangements.

This disclosure is not required for interim reporting. For interim reporting see Topic 270. See Example 9 (paragraphs 718-10-55-134 through 55-137) for an illustration of this guidance.

718-10-50-2 The following list indicates the minimum information needed to achieve the objectives in the preceding paragraph 718-10-50-1 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:
   1. The employee’s requisite service period(s) and, if applicable, the nonemployee’s vesting period and any other substantive conditions (including those related to vesting)
   2. The maximum contractual term of equity (or liability) share options or similar instruments
   3. 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:
   1. The number and weighted-average exercise prices (or conversion ratios) for each of the following groups of share options (or share units):
      i. Those outstanding at the beginning of the year
      ii. Those outstanding at the end of the year
      iii. Those exercisable or convertible at the end of the year
      iv. Those that during the year were:
         01. Granted
         02. Exercised or converted
         03. Forfeited
         04. Expired.
   2. The number and weighted-average grant-date fair value (or calculated value for a nonpublic entity) that uses that method or intrinsic value for awards measured pursuant to paragraph 718-10-30-21) of equity instruments not specified in (c)(1), for all of the following groups of equity instruments:
      i. Those nonvested at the beginning of the year
      ii. Those nonvested at the end of the year
      iii. Those that during the year were:
         01. Granted
         02. Vested
         03. Forfeited.

d. For each year for which an income statement is provided, both of the following:
   1. The weighted-average grant-date fair value (or calculated value for a nonpublic entity that uses that method or intrinsic value for awards measured at that value pursuant to paragraphs 718-10-30-21 through 30-22) of equity options or other equity instruments granted during the year
   2. 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 (or unvested share options for which the employee’s requisite service period or the nonemployee’s vesting period has not been rendered but that are expected to vest based on the achievement of a performance condition, if an entity accounts for forfeitures when they occur in accordance with paragraph 718-10-35-1D or 718-10-35-3) at the date of the latest statement of financial position, both of the following:
   1. The number, weighted-average exercise price (or conversion ratio), aggregate intrinsic value (except for nonpublic entities), and
weighted-average remaining contractual term of options (or share units) outstanding

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

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 718-10-30-21 through 30-22 is not required to disclose the following information for awards accounted for under that method):

1. A description of the method used during the year to estimate the fair value (or calculated value) of awards under share-based payment arrangements

2. 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):
   i. 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’grantees’ expected exercise and postvesting employment termination behavior into the fair value (or calculated value) of the instrument.
   ii. 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. A nonpublic 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.
   iii. 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.
   iv. 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.
   v. 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 (including nonemployee versus employee) 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:
   1. Total compensation cost for share-based payment arrangements
      i. Recognized in income as well as the total recognized tax benefit related thereto
      ii. Capitalized as part of the cost of an asset.
   2. A description of significant modifications, including:
      i. The terms of the modifications
      ii. The number of employees grantees affected
      iii. The total (or lack of) 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. Subparagraph superseded by Accounting Standards Update No. 2016-09

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.

m. If not separately disclosed elsewhere, the policy for estimating expected forfeitures or recognizing forfeitures as they occur.

**Implementation Guidance and Illustrations**

> **Implementation Guidance**

**718-10-55-2** Implementation guidance is provided on the following matters:

a. **Fair value** measurement objectives and application
b. Fair-value-based instruments in a share-based transaction
c. Valuation techniques
d. Selecting assumptions for use in an option pricing model
   1. Consistent use of valuation techniques and methods for selecting assumptions
   2. Selecting or estimating the risk-free rate for the expected term
   3. Selecting or estimating the expected term
   4. Selecting or estimating the expected volatility
   5. Selecting or estimating expected dividends
   6. Dividend protected awards
   7. Selecting or considering credit risk
   8. Contingency features that affect the option pricing model
   9. Consider dilution.

dd. Nonpublic entity—practical expedient for expected term
e. **Calculated value** for certain nonpublic entities
f. **Market, performance, and service conditions**
   1. Market, performance, and service conditions that affect vesting and exercisability
   2. Market, performance, and service conditions that affect factors other than vesting and exercisability
   3. Estimating the employee’s requisite service period
   4. Explicit, implicit, and derived employee’s requisite service periods.
g. Determination of **grant date**
h. **Service inception date** and grant date
i. **Equity restructuring**
j. Classification of certain awards with repurchase features
k. Employee of a physician practice.
In this Section fair value also applies to nonpublic entities that use the calculated value method pursuant to paragraph 718-10-30-20.

> > Fair Value Measurement Objectives and Application

The measurement objective for equity instruments granted in share-based payment transactions awarded to employees is to estimate the grant-date fair value of the equity instruments that the entity is obligated to issue when employees/grantees have delivered the good or have rendered the requisite service and satisfied any other conditions necessary to earn the right to benefit from the instruments. That estimate is based on the share price and other pertinent factors (including those enumerated in paragraphs 718-10-55-21 through 55-22, if applicable) at the grant date and is not remeasured in subsequent periods under the fair-value-based method.

A restriction that continues in effect after the entity has issued instruments to grantees/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 instance, if shares are traded in an active market, post-vesting restrictions may have little, if any, effect on the amount at which the shares being valued would be exchanged. For 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 grantees' expected exercise and post-vesting employment termination behavior in estimating fair value (referred to as an option's expected term).

In contrast, a restriction that stems from the forfeitability of instruments to which employees/grantees 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 the fair value of the instruments at the grant date. Instead, those restrictions are taken into account by recognizing compensation cost only for awards for which employees/grantees deliver the goods or render the requisite service.

Note that performance and service conditions are vesting conditions for purposes of this Topic. Market conditions are not vesting conditions for purposes of this Topic but market conditions may affect exercisability of an award. Market conditions are included in the estimate of the grant-date fair value of awards (see paragraphs 718-10-55-64 through 55-66).

Reload features and contingent features that require an employee/grantee to transfer equity shares earned, or realized gains from the sale of equity instruments earned, to the issuing entity 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 the grant-date fair value of an equity award. Those features are accounted for if and when a reload grant or contingent event occurs.
A clawback feature can take various forms but often functions as a noncompete mechanism. For example, an employee that terminates the employment relationship and begins to work for a competitor is required to transfer to the issuing entity (former employer) equity shares granted and earned in a share-based payment transaction.

718-10-55-9 The fair value measurement objective for liabilities incurred in a share-based payment transaction with employees is the same as for equity instruments awarded to employees. However, awards classified as liabilities are subsequently remeasured to their fair values (or a portion thereof until the promised good has been delivered or the requisite service has been rendered) at the end of each reporting period until the liability is settled.

> > Fair-Value-Based Instruments in a Share-Based Transaction

718-10-55-10 The definition of fair value refers explicitly only to assets and liabilities, but the concept of value in a current exchange embodied in it applies equally to the equity instruments subject to this Topic. Observable market prices of identical or similar equity or liability instruments in active markets are the best evidence of fair value and, if available, shall be used as the basis for the measurement of equity and liability instruments awarded in a share-based payment transaction with employees. Determining whether an equity or liability instrument is similar is a matter of judgment, based on an analysis of the terms of the instrument and other relevant facts and circumstances. For example, awards to employees-grantees of a public entity of shares of its common stock, subject only to a service or performance condition for vesting (nonvested shares), shall be measured based on the market price of otherwise identical (that is, identical except for the vesting condition) common stock at the grant date.

718-10-55-11 If observable market prices of identical or similar equity or liability instruments of the entity are not available, the fair value of equity and liability instruments awarded to employees-grantees shall be estimated by using a valuation technique that meets all of the following criteria:

a. It is applied in a manner consistent with the fair value measurement objective and the other requirements of this Topic.
b. It is based on established principles of financial economic theory and generally applied in that field (see paragraph 718-10-55-16). Established principles of financial economic theory represent fundamental propositions that form the basis of modern corporate finance (for example, the time value of money and risk-neutral valuation).
c. It reflects all substantive characteristics of the instrument (except for those explicitly excluded by this Topic, such as vesting conditions and reload features).

That is, the fair values of equity and liability instruments granted in a share-based payment transaction shall be estimated by applying a valuation technique that
would be used in determining an amount at which instruments with the same characteristics (except for those explicitly excluded by this Topic) would be exchanged.

718-10-55-12 An estimate of the amount at which instruments similar to employee share options and other instruments granted to employees in share-based payment transactions would be exchanged would factor in expectations of the probability that the good would be delivered or requisite service would be rendered and the instruments would vest (that is, that the performance or service conditions would be satisfied). However, as noted in paragraph 718-10-55-4, the measurement objective in this Topic is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue when employees or grantees have delivered the good or rendered the requisite service and satisfied any other conditions necessary to earn the right to benefit from the instruments. Therefore, the estimated fair value of the instruments at grant date does not take into account the effect on fair value of vesting conditions and other restrictions that apply only during the employee’s requisite service period or the nonemployee’s vesting period. Under the fair-value-based method required by this Topic, the effect of vesting conditions and other restrictions that apply only during the employee’s requisite service period or the nonemployee’s vesting period is reflected by recognizing compensation cost only for instruments for which the good is delivered or the requisite service is rendered.

>> Valuation Techniques

718-10-55-13 In applying a valuation technique, the assumptions used shall be consistent with the fair value measurement objective. That is, assumptions shall reflect information that is (or would be) available to form the basis for an amount at which the instruments being valued would be exchanged. In estimating fair value, the assumptions used shall not represent the biases of a particular party. Some of those assumptions will be based on or determined from external data. Other assumptions, such as the employees’ expected exercise behavior, may be derived from the entity’s own historical experience with share-based payment arrangements.

718-10-55-14 The fair value of any equity or liability instrument depends on its substantive characteristics. Paragraphs 718-10-55-21 through 55-22 list the minimum set of substantive characteristics of instruments with option (or option-like) features that shall be considered in estimating those instruments’ fair value. However, a share-based payment award could contain other characteristics, such as a market condition, that should be included in a fair value estimate. Judgment is required to identify an award’s substantive characteristics and, as described in paragraphs 718-10-55-15 through 55-20, to select a valuation technique that incorporates those characteristics.

718-10-55-15 Valuation techniques used for employee share options and similar instruments granted in share-based payment transactions estimate the fair value
of those instruments at a single point in time (for example, at the grant date). The assumptions used in a fair value measurement are based on expectations at the time the measurement is made, and those expectations reflect the information that is available at the time of measurement. The fair value of those instruments will change over time as factors used in estimating their fair value subsequently change, for instance, as share prices fluctuate, risk-free interest rates change, or dividend streams are modified. Changes in the fair value of those instruments are a normal economic process to which any valuable resource is subject and do not indicate that the expectations on which previous fair value measurements were based were incorrect. The fair value of those instruments at a single point in time is not a forecast of what the estimated fair value of those instruments may be in the future.

718-10-55-16 A lattice model (for example, a binomial model) and a closed-form model (for example, the Black-Scholes-Merton formula) are among the valuation techniques that meet the criteria required by this Topic for estimating the fair values of employee share options and similar instruments granted in share-based payment transactions. A Monte Carlo simulation technique is another type of valuation technique that satisfies the requirements in paragraph 718-10-55-11. Other valuation techniques not mentioned in this Topic also may satisfy the requirements in that paragraph. Those valuation techniques or models, sometimes referred to as option-pricing models, are based on established principles of financial economic theory. Those techniques are used by valuation professionals, dealers of derivative instruments, and others to estimate the fair values of options and similar instruments related to equity securities, currencies, interest rates, and commodities. Those techniques are used to establish trade prices for derivative instruments and to establish values in adjudications. As discussed in paragraphs 718-10-55-21 through 55-50, both lattice models and closed-form models can be adjusted to account for the substantive characteristics of share options and similar instruments granted in share-based payment transactions to employees.

718-10-55-17 This Topic does not specify a preference for a particular valuation technique or model in estimating the fair values of employee share options and similar instruments granted in share-based payment transactions. Rather, this Topic requires the use of a valuation technique or model that meets the measurement objective in paragraph 718-10-30-6 and the requirements in paragraph 718-10-55-11. The selection of an appropriate valuation technique or model will depend on the substantive characteristics of the instrument being valued. Because an entity may grant different types of instruments, each with its own unique set of substantive characteristics, an entity may use a different valuation technique for each different type of instrument. The appropriate valuation technique or model selected to estimate the fair value of an instrument with a market condition must take into account the effect of that market condition. The designs of some techniques and models better reflect the substantive characteristics of a particular employee share option or similar instrument granted in share-based payment transactions. Paragraphs 718-10-55-18 through 55-20
discuss certain factors that an entity should consider in selecting a valuation technique or model for its employee share options or similar instruments.

718-10-55-18 The Black-Scholes-Merton formula assumes that option exercises occur at the end of an option’s contractual term, and that expected volatility, expected dividends, and risk-free interest rates are constant over the option’s term. If used to estimate the fair value of instruments in the scope of this Topic, the Black-Scholes-Merton formula must be adjusted to take account of certain characteristics of employee share options and similar instruments that are not consistent with the model’s assumptions (for example, the ability to exercise exercising before the end of the option’s contractual term when estimating expected term). Because of the nature of the formula, those adjustments take the form of weighted-average assumptions about those characteristics. In contrast, a lattice model can be designed to accommodate dynamic assumptions of expected volatility and dividends over the option’s contractual term, and estimates of expected option exercise patterns during the option’s contractual term, including the effect of blackout periods. Therefore, the design of a lattice model more fully reflects the substantive characteristics of a particular employee share option or similar instrument. Nevertheless, both a lattice model and the Black-Scholes-Merton formula, as well as other valuation techniques that meet the requirements in paragraph 718-10-55-11, can provide a fair value estimate that is consistent with the measurement objective and fair-value-based method of this Topic.

718-10-55-19 Regardless of the valuation technique or model selected, an entity shall develop reasonable and supportable estimates for each assumption used in the model, including the employee share option or similar instrument’s expected term, taking into account both the contractual term of the option and the effects of grantees’ employment behavior. The term supportable is used in its general sense: capable of being maintained, confirmed, or made good; defensible. An application is supportable if it is based on reasonable arguments that consider the substantive characteristics of the instruments being valued and other relevant facts and circumstances.

> > Selecting Assumptions for Use in an Option Pricing Model

718-10-55-21 If an observable market price is not available for a share option or similar instrument with the same or similar terms and conditions, an entity shall estimate the fair value of that instrument using a valuation technique or model that meets the requirements in paragraph 718-10-55-11 and takes into account, at a minimum, all of the following:

a. The exercise price of the option.
b. The expected term of the option. This should take into account both the contractual term of the option and the effects of
grantees' employees' expected exercise and postvesting employment termination behavior. In a closed-form model, the expected term is an assumption used in (or input to) the model, while in a lattice model, the expected term is an output of the model (see paragraphs 718-10-55-29 through 55-34, which provide further explanation of the expected term in the context of a lattice model).

c. The current price of the underlying share.
d. The expected volatility of the price of the underlying share for the expected term of the option.
e. The expected dividends on the underlying share for the expected term of the option (except as provided in paragraphs 718-10-55-44 through 55-45).
f. The risk-free interest rate(s) for the expected term of the option.

718-10-55-22 The term expected in (b); (d); (e); and (f) in the preceding paragraph relates to expectations at the measurement date about the future evolution of the factor that is used as an assumption in a valuation model. The term is not necessarily used in the same sense as in the term expected future cash flows that appears elsewhere in the Codification. The phrase expected term of the option in (d); (e); and (f) in the preceding paragraph applies to both closed-form models and lattice models (as well as all other valuation techniques). However, if an entity uses a lattice model (or other similar valuation technique, for instance, a Monte Carlo simulation technique) that has been modified to take into account an option's contractual term and grantees' employees' expected exercise and postvesting employment termination behavior, then (d); (e); and (f) in the preceding paragraph apply to the contractual term of the option.

718-10-55-23 There is likely to be a range of reasonable estimates for expected volatility, dividends, and term of the option. If no amount within the range is more or less likely than any other amount, an average of the amounts in the range (the expected value) shall be used. In a lattice model, the assumptions used are to be determined for a particular node (or multiple nodes during a particular time period) of the lattice and not over multiple periods, unless such application is supportable.

718-10-55-24 Historical experience is generally the starting point for developing expectations about the future. Expectations based on historical experience shall be modified to reflect ways in which currently available information indicates that the future is reasonably expected to differ from the past. The appropriate weight to place on historical experience is a matter of judgment, based on relevant facts and circumstances. For example, an entity with two distinctly different lines of business of approximately equal size may dispose of the one that was significantly less volatile and generated more cash than the other. In that situation, the entity might place relatively little weight on volatility, dividends, and perhaps grantees' employees' exercise and postvesting employment termination behavior from the predisposition (or disposition) period in developing reasonable expectations about the future. In contrast, an entity that has not
undergone such a restructuring might place heavier weight on historical experience. That entity might conclude, based on its analysis of information available at the time of measurement, that its historical experience provides a reasonable estimate of expected volatility, dividends, and grantees’ exercise and post-vesting employment termination behavior. This guidance is not intended to suggest either that historical volatility is the only indicator of expected volatility or that an entity must identify a specific event in order to place less weight on historical experience. Expected volatility is an expectation of volatility over the expected term of an employee share option or similar instrument; that expectation shall consider all relevant factors in paragraph 718-10-55-37, including possible mean reversion. Paragraphs 718-10-55-35 through 55-41 provide further guidance on estimating expected volatility.

718-10-55-25 In certain circumstances, historical information may not be available. For example, an entity whose common stock has only recently become publicly traded may have little, if any, historical information on the volatility of its own shares. That entity might base expectations about future volatility on the average volatilities of similar entities for an appropriate period following their going public. A nonpublic entity will need to exercise judgment in selecting a method to estimate expected volatility and might do so by basing its expected volatility on the average volatilities of otherwise similar public entities. For purposes of identifying otherwise similar entities, an entity would likely consider characteristics such as industry, stage of life cycle, size, and financial leverage. Because of the effects of diversification that are present in an industry sector index, the volatility of an index should not be substituted for the average of volatilities of otherwise similar entities in a fair value measurement.

718-10-55-26 This guidance is organized as follows:

a. Selecting consistent assumptions
b. Selecting or estimating the risk-free rate for the expected term
c. Selecting or estimating the expected term
d. Selecting or estimating the expected volatility
e. Selecting or estimating expected dividends
f. Dividend protected awards
g. Selecting or considering credit risk
h. Contingency features that affect the option pricing model
i. Consider dilution.

> > > Consistent Use of Valuation Techniques and Methods for Selecting Assumptions

718-10-55-27 Assumptions used to estimate the fair value of equity and liability instruments granted in share-based payment transactions to employees shall be determined in a consistent manner from period to period. For example, an entity might use the closing share price or the share price at another specified time as the current share price on the grant date in estimating fair value, but whichever
method is selected, it shall be used consistently. The valuation technique an entity selects to estimate fair value for a particular type of instrument also shall be used consistently and shall not be changed unless a different valuation technique is expected to produce a better estimate of fair value. A change in either the valuation technique or the method of determining appropriate assumptions used in a valuation technique is a change in accounting estimate for purposes of applying Topic 250, and shall be applied prospectively to new awards.

> > > Selecting or Estimating the Expected Term

718-10-55-29 The fair value of a traded (or transferable) share option is based on its contractual term because rarely is it economically advantageous to exercise, rather than sell, a transferable share option before the end of its contractual term. Employee share options generally differ from transferable share options in that employees cannot sell (or hedge) their share options—they can only exercise them; because of this, employees generally exercise their options before the end of the options’ contractual term. Thus, the inability to sell or hedge an employee share option effectively reduces the option’s value because exercise prior to the option’s expiration terminates its remaining life and thus its remaining time value. In addition, some employee share options contain prohibitions on exercise during blackout periods. To reflect the effect of those restrictions (which may lead to exercise before the end of the option’s contractual term) on employee options relative to transferable options, this Topic requires that the fair value of an employee share option or similar instrument be based on its expected term, rather than its contractual term (see paragraphs 718-10-55-5 and 718-10-55-21).

718-10-55-29A Paragraph 718-10-30-10A states that, on an award-by-award basis, an entity may elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award to satisfy the measurement objective in paragraph 718-10-30-6. Otherwise, an entity shall apply the guidance in this Topic in estimating the expected term of a nonemployee award, which may result in a term less than the contractual term of the award. If an entity does not elect to use the contractual term as the expected term, similar considerations discussed in paragraph 718-10-55-29, such as the inability to sell or hedge a nonemployee award, apply when estimating its expected term.

> > > Dividend Protected Awards

718-10-55-44 Expected dividends are taken into account in using an option-pricing model to estimate the fair value of a share option because dividends paid on the underlying shares reduce the fair value of those shares and option holders generally are not entitled to receive those dividends. However, an award of share options may be structured to protect option holders from that effect by providing them with some form of dividend rights. Such dividend protection may take a variety of forms and shall be appropriately reflected in estimating the fair value of a share option. For example, if a dividend paid on the underlying shares is applied
to reduce the exercise price of the option, the effect of the dividend protection is appropriately reflected by using an expected dividend assumption of zero.

718-10-55-45 In certain situations, employees grantees may receive the dividends paid on the underlying equity shares while the option is outstanding. Dividends or dividend equivalents paid to employees grantees on the portion of an award of equity shares or other equity instruments that vests shall be charged to retained earnings. If employees grantees are not required to return the dividends or dividend equivalents received if they forfeit their awards, dividends or dividend equivalents paid on instruments that do not vest shall be recognized as additional compensation cost. If an entity’s accounting policy is to estimate the number of awards expected to be forfeited in accordance with paragraph 718-10-35-1D or 718-10-35-3, the estimate of compensation cost for dividends or dividend equivalents paid on instruments that are not expected to vest shall be consistent with an entity’s estimates of forfeitures. Dividends and dividend equivalents shall be reclassified between retained earnings and compensation cost in a subsequent period if the entity changes its forfeiture estimates (or actual forfeitures differ from previous estimates). If an entity’s accounting policy is to account for forfeitures when they occur in accordance with paragraph 718-10-35-1D or 718-10-35-3, the entity shall reclassify to compensation cost in the period in which the forfeitures occur the amount of dividends and dividend equivalents previously charged to retained earnings relating to awards that are forfeited.

> > > Contingency Features That Affect the Option Pricing Model

718-10-55-47 Contingent features that might cause an employee grantee to return to the entity either equity shares earned or realized gains from the sale of equity instruments earned as a result of share-based payment arrangements, such as a clawback feature (see paragraph 718-10-55-8), shall not be reflected in estimating the grant-date fair value of an equity instrument. Instead, the effect of such a contingent feature shall be accounted for if and when the contingent event occurs. For instance, a share-based payment arrangement may stipulate the return of vested equity shares to the issuing entity for no consideration if the employee grantee terminates the employment or vendor relationship to work for a competitor. The effect of that provision on the grant-date fair value of the equity shares shall not be considered. If the issuing entity subsequently receives those shares (or their equivalent value in cash or other assets) as a result of that provision, a credit shall be recognized in the income statement upon the receipt of the shares. That credit is limited to the lesser of the recognized compensation cost associated with the share-based payment arrangement that contains the contingent feature and the fair value of the consideration received. The event is recognized in the income statement because the resulting transaction takes place with an employee (or former employee) grantee as a result of the current (or prior) employment or vendor relationship rather than as a result of the employee grantee’s role as an equity owner. Example 10 (see paragraph 718-20-
55-84) provides an illustration of the accounting for an employee award that contains a clawback feature, which also applies to nonemployee awards.

>> Consider Dilution

718-10-55-48 Traded options ordinarily are written by parties other than the entity that issues the underlying shares, and when exercised result in an exchange of already outstanding shares between those parties. In contrast, exercise of employee-share options as part of a share-based payment transaction results in the issuance of new shares by the entity that wrote the option (the employer-grantor), which increases the number of shares outstanding. That dilution might reduce the fair value of the underlying shares, which in turn might reduce the benefit realized from option exercise.

718-10-55-49 If the market for an entity’s shares is reasonably efficient, the effect of potential dilution from the exercise of employee-share options that are part of a share-based payment transaction will be reflected in the market price of the underlying shares, and no adjustment for potential dilution usually is needed in estimating the fair value of the employee-grantee share options. For a public entity, an exception might be a large grant of options that the market is not expecting, and also does not believe will result in commensurate benefit to the entity. For a nonpublic entity, on the other hand, potential dilution may not be fully reflected in the share price if sufficient information about the frequency and size of the entity’s grants of equity share options is not available for third parties who may exchange the entity’s shares to anticipate the dilutive effect.

>> Nonpublic Entity—Practical Expedient for Expected Term

718-10-55-50A In accordance with paragraph 718-10-30-20A, a nonpublic entity may elect a practical expedient to estimate the expected term. For liability-classified awards, an entity would update the estimate of the expected term each reporting period until settlement. The updated estimate should reflect the loss of time value associated with the award and any change in the assessment of whether a performance condition is probable of being achieved.

>> Calculated Value for Certain Nonpublic Entities

718-10-55-52 This Topic requires all entities to use the fair-value-based method to account for share-based payment arrangements that are classified as equity instruments. However, if it is not practicable for a nonpublic entity to estimate the expected volatility of its share price, paragraphs 718-10-30-19A through 30-20 require paragraph 718-10-30-20 requires it to use the calculated value method. Alternatively, it may not be possible for a nonpublic entity to reasonably estimate the fair value of its equity share options and similar instruments at the date they are granted because the complexity of the award’s terms prevents it from doing so. In that case, paragraphs 718-10-30-21 through 30-22 require that the nonpublic
entity account for its equity instruments at their **intrinsic value**, remeasured at each reporting date through the date of exercise or other settlement.

718-10-55-53 Relatively few small nonpublic entities offer share options to their employees, and those that do often are emerging entities that intend to make a future initial public offering. Many of those nonpublic entities that plan an initial public offering likely will be able to reasonably estimate the fair value of their equity share options and similar instruments using the guidance on selecting an appropriate expected volatility assumption provided in paragraphs 718-10-55-35 through 55-41.

**Market, Performance, and Service Conditions**

718-10-55-59 This guidance is organized as follows:

- Market, performance, and service conditions that affect vesting and exercisability
- Market, performance, and service conditions that affect factors other than vesting and exercisability
- Estimating the employee’s requisite service period
- Explicit, implicit, and derived employee’s requisite service periods.

**Market, Performance, and Service Conditions That Affect Vesting and Exercisability**

718-10-55-60 An employee’s grantee’s share-based payment award becomes vested at the date that the employee’s grantee’s right to receive or retain equity shares, other equity instruments, or assets under the award is no longer contingent on satisfaction of either a performance condition or a **service condition**. This Topic distinguishes among market conditions, performance conditions, and service conditions that affect the vesting or exercisability of an award (see paragraphs 718-10-30-12 and 718-10-30-14).Exercisability is used for market conditions in the same context as vesting is used for performance and service conditions. Other conditions affecting vesting, exercisability, exercise price, and other pertinent factors in measuring fair value that do not meet the definitions of a market condition, performance condition, or service condition are discussed in paragraph 718-10-55-65.

718-10-55-61 Analysis of the market, performance, or service conditions (or any combination thereof) that are explicit or implicit in the terms of an award is required to determine the employee’s requisite service period or the nonemployee’s vesting period over which compensation cost is recognized and whether recognized compensation cost may be reversed if an award fails to vest or become exercisable (see paragraph 718-10-30-27). If exercisability or the ability to retain the award (for example, an award of equity shares may contain a market condition that affects the employee’s grantee’s ability to retain those shares) is based solely on one or more market conditions compensation cost for that award is recognized if the
employee/grantee delivers the promised good or renders the requisite service, even if the market condition is not satisfied. An award containing one or more market conditions may have an explicit, implicit, or derived service period. Paragraphs 718-10-55-69 through 55-79 provide guidance on explicit, implicit, and derived service periods. [Content amended and moved to paragraph 718-10-55-61A] If exercisability (or the ability to retain the award) is based solely on one or more market conditions, compensation cost for that award is reversed if the employee/grantee does not deliver the promised good or render the requisite service, unless the market condition is satisfied prior to the end of the employee’s requisite service period or the nonemployee’s vesting period, in which case any unrecognized compensation cost would be recognized at the time the market condition is satisfied. If vesting is based solely on one or more performance or service conditions, any previously recognized compensation cost is reversed if the award does not vest (that is, the good is not delivered or the requisite service is not rendered or the performance condition is not achieved). Examples 1 through 4 (see paragraphs 718-20-55-4 through 55-50) provide illustrations of awards in which vesting is based solely on performance or service conditions.

718-10-55-61A An employee award containing one or more market conditions may have an explicit, implicit, or derived service period. Paragraphs 718-10-55-69 through 55-79 provide guidance on explicit, implicit, and derived service periods. [Content amended as shown and moved from paragraph 718-10-55-61]

718-10-55-62 Vesting or exercisability may be conditional on satisfying two or more types of conditions (for example, vesting and exercisability occur upon satisfying both a market and a performance or service condition). Vesting also may be conditional on satisfying one of two or more types of conditions (for example, vesting and exercisability occur upon satisfying either a market condition or a performance or service condition). Regardless of the nature and number of conditions that must be satisfied, the existence of a market condition requires recognition of compensation cost if the good is delivered or the requisite service is rendered, even if the market condition is never satisfied.

718-10-55-63 Even if only one of two or more conditions must be satisfied and a market condition is present in the terms of the award, then compensation cost is recognized if the good is delivered or the requisite service is rendered, regardless of whether the market, performance, or service condition is satisfied (see Example 5 [paragraph 718-10-55-100] for provide an example of such an employee award).

> > > Market, Performance, and Service Conditions That Affect Factors Other Than Vesting and Exercisability

718-10-55-66 The following flowchart provides guidance on determining how to account for an award based on the existence of market, performance, or service conditions (or any combination thereof).
Accounting for Awards with Market, Performance, or Service Conditions

(1) Based on the terms of the share-based payment instrument, is the instrument a liability under the provisions of this Subtopic?

Yes

The award is classified and accounted for as a liability.

No

Vesting conditions are based solely on the satisfaction of performance or service conditions (or any combination thereof)\(^{(a)}\). The award is classified and accounted for as equity with reversal of recognized compensation cost if the award fails to vest (that is, the promised good is not delivered or the requisite service is not rendered) (paragraph 718-10-55-61).

(1a) Does the award contain a market condition (paragraph 718-10-55-60)?

Yes\(^{(a)}\)

Regardless of the nature and number of conditions that must be satisfied, the existence of a market condition requires recognition of compensation cost if the good is delivered or the requisite service is rendered, even if the market condition is never satisfied. Even if only one of two or more conditions must be satisfied and a market condition is present in the terms of an award, then compensation cost is recognized if the good is delivered or the requisite service is rendered, regardless of whether the market, performance, or service condition is satisfied (paragraphs 718-10-55-62 through 55-63).

No

(1b) Is exercisability of the award based solely on the satisfaction of one or more market conditions (paragraph 718-10-55-61)?

Yes

Compensation cost is recognized if the good is delivered or the requisite service is rendered, regardless of whether the market condition is satisfied (paragraph 718-10-55-61).

No

(a) The award shall be classified and accounted for as equity. Market conditions are included in the grant-date fair value estimate of the award.

(b) Performance and service conditions that affect vesting are not included in estimating the grant-date fair value of the award. Performance and service conditions that affect the exercise price, contractual term, conversion ratio, or other pertinent factors affecting the fair value of an award are included in estimating the grant-date fair value of the award.
> > > Estimating the Employee’s Requisite Service Period

Paragraph 718-10-35-2 requires that compensation cost be recognized over the requisite service period. The requisite service period for an award that has only a service condition is presumed to be the vesting period, unless there is clear evidence to the contrary. The requisite service period shall be estimated based on an analysis of the terms of the award and other relevant facts and circumstances, including co-existing employment agreements and an entity’s past practices; that estimate shall ignore nonsubstantive vesting conditions. For example, the grant of a deep out-of-the-money share option award without an explicit service condition will have a derived service period. Likewise, if an award with an explicit service condition that was at-the-money when granted is subsequently modified to accelerate vesting at a time when the award is deep out-of-the-money, that modification is not substantive because the explicit service condition is replaced by a derived service condition. If a market, performance, or service condition requires future service for vesting (or exercisability), an entity cannot define a prior period as the requisite service period. The requisite service period for awards with market, performance, or service conditions (or any combination thereof) shall be consistent with assumptions used in estimating the grant-date fair value of those awards.

> > > Explicit, Implicit, and Derived Employee’s Requisite Service Periods

A requisite service period for an employee may be explicit, implicit, or derived. An explicit service period is one that is stated in the terms of the share-based payment award. For example, an award that vests after three years of continuous employee service has an explicit service period of three years, which also would be the requisite service period.

> > Determination of Grant Date

This guidance expands on the guidance provided in paragraph 718-10-25-5.

The definition of grant date requires that an employer grantor and employee grantee have a mutual understanding of the key terms and conditions of the share-based compensation arrangement. Those terms may be established through any of the following:

a. A formal, written agreement
b. An informal, oral arrangement
c. An entity’s past practice.

A mutual understanding of the key terms and conditions means that there is sufficient basis for both the employer grantor and the employee grantee to understand the nature of the relationship established by the award, including both the compensatory relationship and the equity relationship subsequent to the date of grant. The grant date for an award will be the date that an employee grantee...
begins to benefit from, or be adversely affected by, subsequent changes in the price of the employer's grantor's equity shares. In order to assess that financial exposure, the employer-grantor and employee-grantee must agree to the terms; that is, there must be a mutual understanding. Awards made under an arrangement that is subject to shareholder approval are not deemed to be granted until that approval is obtained unless approval is essentially a formality (or perfunctory). Additionally, to have a grant date for an award to an employee, the recipient of that award must meet the definition of an employee.

**718-10-55-83** The determination of the grant date shall be based on the relevant facts and circumstances. For instance, a look-back share option may be granted with an exercise price equal to the lower of the current share price or the share price one year hence. The ultimate exercise price is not known at the date of grant, but it cannot be greater than the current share price. In this case, the relationship between the exercise price and the current share price provides a sufficient basis to understand both the compensatory and equity relationship established by the award; the recipient begins to benefit from subsequent changes in the price of the employer's grantor's equity shares. However, if the award’s terms call for the exercise price to be set equal to the share price one year hence, the recipient does not begin to benefit from, or be adversely affected by, changes in the price of the employer’s grantor’s equity shares until then. Therefore, grant date would not occur until one year hence. Awards of share options whose exercise price is determined solely by reference to a future share price generally would not provide a sufficient basis to understand the nature of the compensatory and equity relationships established by the award until the exercise price is known.

> **Classification of Certain Awards with Repurchase Features**

**718-10-55-84** The following paragraph further explains the guidance in paragraphs 718-10-25-9 through 25-12.

**718-10-55-85** An entity may, for example, grant shares under a share-based compensation arrangement that the employee-grantee can put (sell) to the employer-grantor (the entity) shortly after the vesting date for cash equal to the fair value of the shares on the date of repurchase. That award of puttable shares would be classified as a liability because the repurchase feature permits the employee-grantee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time from the date the share is issued (see paragraph 718-10-25-9(a)). Alternatively, an entity might grant its own shares under a share-based compensation arrangement that may be put to the employer-grantor only after the employee-grantee has held them for a reasonable period of time after vesting but at a fixed redemption amount. Those puttable shares also would be classified as liabilities under the requirements of this Topic because the repurchase price is based on a fixed amount rather than variations in the fair value of the employer-grantor’s shares. The employee-grantee cannot bear the risks and rewards normally associated with equity share ownership for a reasonable period of time because of that redemption feature. However, if a share
with a repurchase feature gives the employee-grantee the right to sell shares back to the entity for a fixed amount over the fair value of the shares at the date of repurchase, paragraph 718-20-35-7 requires that the fixed amount over the fair value be recognized and attributed as additional compensation cost over the employee’s requisite service period (with a corresponding liability being accrued). The fixed amount over the fair value of a nonemployee award should be recognized as additional compensation cost over the vesting period (with a corresponding liability being accrued) in accordance with paragraph 718-10-25-2C.

> Illustrations

> > Example 1: Estimating the Employee’s Requisite Service Period

718-10-55-86 This Example illustrates the guidance in paragraphs 718-10-30-25 through 30-26.

> > Example 3: Employee Share-Based Payment Award with a Performance Condition and Multiple Service Periods

718-10-55-92 The following Cases illustrate employee share-based payment awards with a performance condition (see paragraphs 718-10-25-20 through 25-21; 718-10-30-27; and 718-10-35-4) and multiple service dates:

a. Performance targets are set at the inception of the arrangement (Case A).
b. Performance targets are established at some time in the future (Case B).
c. Performance targets established up front but vesting is tied to the vesting of a preceding award (Case C).

> > Example 4: Employee Share-Based Payment Award with a Service Condition and Multiple Service Periods

718-10-55-97 The following Cases illustrate the guidance in paragraph 718-10-30-12 to determine the service period for employee awards with multiple service periods:

a. Exercise price established at subsequent dates (Case A)
b. Exercise price established at inception (Case B).

> > Example 5: Employee Share-Based Payment Award with Market and Service Conditions and Multiple Service Periods

718-10-55-100 The following Cases illustrate the guidance in paragraph 718-10-35-5 applicable to employee awards in circumstances in which an award includes both a market condition and a service condition:

a. When only one condition must be met (Case A)
b. When both conditions must be met (Case B).

>> Example 6: Service Inception Date and Grant Date for Employee Awards

718-10-55-107 The following Example illustrates the guidance in paragraph 718-10-35-6.

>> Example 7: Tandem Awards

718-10-55-116 A tandem award is an award with two or more components in which exercise of one part cancels the other(s). In contrast, a combination award is an award with two or more separate components, all of which can be exercised. The following Cases illustrates one aspect of the guidance in paragraph 718-10-25-15:

a. Share option or cash settled stock appreciation rights (Case A)
b. Phantom shares or share options (Case B).

718-10-55-116A Cases A and B of this Example (see paragraphs 718-10-55-117 through 55-130) describe employee awards. However, the principles on accounting for employee awards, except for compensation cost attribution, are the same for nonemployee awards. Therefore, the guidance in these Cases may serve as implementation guidance for nonemployee awards.

718-10-55-116B Compensation cost attribution for awards to nonemployees may be the same as or different from the attribution for the employee awards in Case A (see paragraph 718-10-55-119) and Case B (see paragraph 718-10-55-130). That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in the Cases could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based transactions.

>> Case A: Share Option or Cash Settled Stock Appreciation Rights

718-10-55-117 This Case illustrates the accounting for a tandem award in which employees have a choice of either share options or cash-settled stock appreciation rights. Entity T grants to its employees an award of 900,000 share options or 900,000 cash-settled stock appreciation rights on January 1, 20X5. The award vests on December 31, 20X7, and has a contractual life of 10 years. If an employee exercises the stock appreciation rights, the related share options are cancelled. Conversely, if an employee exercises the share options, the related stock appreciation rights are cancelled.

718-10-55-118 The tandem award results in Entity T’s incurring a liability because the employees can demand settlement in cash. If Entity T could choose whether to settle the award in cash or by issuing stock, the award would be an equity
instrument unless Entity T’s predominant past practice is to settle most awards in cash or to settle awards in cash whenever requested to do so by the employee, indicating that Entity T has incurred a substantive liability as indicated in paragraph 718-10-25-15. In this Case, however, Entity T incurs a liability to pay cash, which it will recognize over the requisite service period. The amount of the liability will be adjusted each year to reflect changes in its fair value. If employees choose to exercise the share options rather than the stock appreciation rights, the liability is settled by issuing stock.

718-10-55-119 The fair value of the stock appreciation rights at the grant date is $12,066,454, as computed in Example 1 (see paragraph 718-30-55-1), because the value of the stock appreciation rights and the value of the share options are equal. Accordingly, at the end of 20X5, when the assumed fair value per stock appreciation right is $10, the amount of the liability is $8,214,060 (821,406 cash-settled stock appreciation rights expected to vest × $10). One-third of that amount, $2,738,020, is recognized as compensation cost for 20X5. At the end of each year during the vesting period, the liability is remeasured to its fair value for all stock appreciation rights expected to vest. After the vesting period, the liability for all outstanding vested awards is remeasured through the date of settlement.

>> Case B: Phantom Shares or Share Options

718-10-55-120 This Case illustrates a tandem award in which the components have different values after the grant date, depending on movements in the price of the entity’s stock. The employee’s choice of which component to exercise will depend on the relative values of the components when the award is exercised.

718-10-55-121 Entity T grants to its chief executive officer an immediately vested award consisting of the following two parts:

a. 1,000 phantom share units (units) whose value is always equal to the value of 1,000 shares of Entity T’s common stock
b. Share options on 3,000 shares of Entity T’s stock with an exercise price of $30 per share.

718-10-55-122 At the grant date, Entity T’s share price is $30 per share. The chief executive officer may choose whether to exercise the share options or to cash in the units at any time during the next five years. Exercise of all of the share options cancels all of the units, and cashing in all of the units cancels all of the share options. The cash value of the units will be paid to the chief executive officer at the end of five years if the share option component of the tandem award is not exercised before then.

718-10-55-123 With a 3-to-1 ratio of share options to units, exercise of 3 share options will produce a higher gain than receipt of cash equal to the value of 1 share of stock if the share price appreciates from the grant date by more than 50 percent. Below that point, one unit is more valuable than the gain on three share options.
To illustrate that relationship, the results if the share price increases 50 percent to $45 are as follows.

<table>
<thead>
<tr>
<th>Units</th>
<th>Exercise of Options</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market value</td>
<td>$45,000</td>
</tr>
<tr>
<td>Purchase price</td>
<td>-</td>
</tr>
<tr>
<td>Net cash value</td>
<td>$45,000</td>
</tr>
</tbody>
</table>

718-10-55-124 If the price of Entity T's common stock increases to $45 per share from its price of $30 at the grant date, each part of the tandem grant will produce the same net cash payment (ignoring transaction costs) to the chief executive officer. If the price increases to $44, the value of 1 share of stock exceeds the gain on exercising 3 share options, which would be $42 [3 × ($44−$30)]. But if the price increases to $46, the gain on exercising 3 share options, $48 [3 × ($46−$30)], exceeds the value of 1 share of stock.

718-10-55-125 At the grant date, the chief executive officer could take $30,000 cash for the units and forfeit the share options. Therefore, the total value of the award at the grant date must exceed $30,000 because at share prices above $45, the chief executive officer receives a higher amount than would the holder of 1 share of stock. To exercise the 3,000 options, the chief executive officer must forfeit the equivalent of 1,000 shares of stock, in addition to paying the total exercise price of $90,000 (3,000 × $30). In effect, the chief executive officer receives only 2,000 shares of Entity T stock upon exercise. That is the same as if the share option component of the tandem award consisted of share options to purchase 2,000 shares of stock for $45 per share.

718-10-55-126 The cash payment obligation associated with the units qualifies the award as a liability of Entity T. The maximum amount of that liability, which is indexed to the price of Entity T's common stock, is $45,000 because at share prices above $45, the chief executive officer will exercise the share options.

718-10-55-127 In measuring compensation cost, the award may be thought of as a combination—not tandem—grant of both of the following:

a. 1,000 units with a value at grant of $30,000
b. 2,000 options with a strike price of $45 per share.

718-10-55-128 Compensation cost is measured based on the combined value of the two parts.

718-10-55-129 The fair value per share option with an exercise price of $45 is assumed to be $10. Therefore, the total value of the award at the grant date is as follows.

| Units (1,000 × $30) | $30,000 |
| Share options (2,000 × $10) | 20,000 |
| Value of award | $50,000 |
Therefore, compensation cost recognized at the date of grant (the award is immediately vested) would be $30,000 with a corresponding credit to a share-based compensation liability of $30,000. However, because the share option component is the substantive equivalent of 2,000 deep out-of-the-money options, it contains a derived service period (assumed to be 2 years). Hence, compensation cost for the share option component of $20,000 would be recognized over the requisite service period. The share option component would not be remeasured because it is not a liability. That total amount of both components (or $50,000) is more than either of the components by itself, but less than the total amount if both components (1,000 units and 3,000 share options with an exercise price of $30) were exercisable. Because granting the units creates a liability, changes in the liability that result from increases or decreases in the price of Entity T’s share price would be recognized each period until exercise, except that the amount of the liability would not exceed $45,000.

> > Example 8: Book Value Plans for Employees

A nonpublic entity that is not a Securities and Exchange Commission (SEC) registrant has two classes of stock. Class A is voting and held only by the members of the founding family, and Class B (book value shares) is nonvoting and held only by employees. The purchase price of Class B shares is a formula price based on book value. Class B shares require that the employee, six months after retirement or separation from the entity, sell the shares back to the entity for cash at a price determined by using the same formula used to establish the purchase price. Class B shares may not be required to be accounted for as liabilities pursuant to Topic 480 because the entity is a nonpublic entity that is not an SEC registrant. Nevertheless, Class B shares may be classified as liabilities if they are granted as part of a share-based payment transaction and those shares contain certain repurchase features meeting criteria in paragraph 718-10-25-9; this Example assumes that Class B shares do not meet those criteria. Because book value shares of public entities generally are not indexed to their stock prices, such shares would be classified as liabilities pursuant to this Topic.

> > Example 9: Disclosure

This Example illustrates disclosures (see paragraphs 718-10-50-1 through 50-2) of a public entity’s share-based compensation arrangements. The illustration assumes that compensation cost has been recognized in accordance with this Topic for several years. The amount of compensation cost recognized each year includes both costs from that year’s grants and costs from prior years’ grants. The number of options outstanding, exercised, forfeited, or expired each year includes options granted in prior years. Although this Example focuses on employee share-based payment plans, the disclosures are equally applicable to share-based payment awards issued to nonemployees. An entity should refer to the guidance in paragraph 718-10-50-2(g) when evaluating whether separate disclosure of nonemployee share-based payment awards is warranted.
24. Amend paragraphs 718-10-60-1B through 60-2, with a link to transition paragraph 718-10-65-11, as follows:

Relationships

> Derivatives and Hedging

718-10-60-1B For guidance related to equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options granted in share-based payment transactions, see paragraph 815-40-15-5A.

718-10-60-2 For guidance related to stock options in an unrelated entity granted in a share-based payment transaction given to employees, see paragraphs 815-10-55-46 through 55-48.

Amendments to Subtopic 718-20

25. Amend paragraphs 718-20-05-1 and 718-20-15-2, with a link to transition paragraph 718-10-65-11, as follows:

Compensation—Stock Compensation—Awards Classified as Equity

Overview and Background

718-20-05-1 Share-based payment awards to employees may be classified as either equity or liabilities. This Subtopic deals with instruments classified as equity. It is interrelated with Subtopic 718-10, which contains guidance applicable to instruments classified as either equity or liabilities issued in share-based payment transactions. It may also be necessary in some cases to refer to the guidance contained in Subtopic 718-30.

Scope and Scope Exceptions

> Overall Guidance

718-20-15-1 This Subtopic follows the same Scope and Scope Exceptions as outlined in the Overall Subtopic, see Section 718-10-15, with specific transaction qualifications noted below.

> Transactions
The guidance in this Subtopic applies to share-based payment awards to employees that are classified as equity (see paragraphs 718-10-25-6 through 25-1925-19A for a description of what is classified as equity).

26. Amend paragraphs 718-20-35-1 through 35-2, 718-20-35-3 through 35-3A, 718-20-35-5, and 718-20-35-7 through 35-8, with a link to transition paragraph 718-10-65-11, as follows:

Subsequent Measurement

> Fair Value Not Reasonably Estimable

718-20-35-1 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 for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award 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

718-20-35-2 A contingent feature of an award that might cause an employee grantee 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 (see paragraph 718-10-55-8), shall be accounted for if and when the contingent event occurs. Example 10 (see paragraph 718-20-55-84) provides an illustration of an employee award with a clawback feature.

> Modification of an Award

718-20-35-3 Except as described in paragraph 718-20-35-2A, 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 Topic over the fair value of the original award.
immediately before its terms are modified, measured based on the share price and other pertinent factors at that date. As indicated in paragraph 718-10-30-20, references to fair value throughout this Topic shall be read also to encompass 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 718-10-35-1D or 718-10-35-3 and other guidance in Examples 14 through 15 (see paragraphs 718-20-55-107 through 55-121).

b. Total recognized compensation cost for an equity award shall at least equal the fair value of the award at the grant date unless at the date of the modification the performance or service conditions of the original award are not expected to be satisfied. Thus, the total compensation cost measured at the date of a modification shall be the sum of the following:
1. The portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or the requisite service is expected to be rendered (or has already been rendered) at that date
2. The incremental cost resulting from the modification.
Compensation cost shall be subsequently adjusted, if necessary, in accordance with paragraph 718-10-35-1D or 718-10-35-3 and other guidance in Examples 14 through 15 (see paragraphs 718-20-55-107 through 55-121).

c. A change in compensation cost for an equity award measured at intrinsic value in accordance with paragraph 718-20-35-1 shall be measured by comparing the intrinsic value of the modified award, if any, with the intrinsic value of the original award, if any, immediately before the modification.

718-20-35-3A An entity that has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-1D or 718-10-35-3 shall assess at the date of the modification whether the performance or service conditions of the original award are expected to be satisfied when measuring the effects of the modification in accordance with paragraph 718-20-35-3. However, the entity shall apply its accounting policy to account for forfeitures when they occur when subsequently accounting for the modified award.

>> Short-Term Inducements

718-20-35-5 Except as described in paragraph 718-20-35-2A, a short-term inducement shall be accounted for as a modification of the terms of only the awards of employees who accept the inducement, and other inducements shall be accounted for as modifications of the terms of all awards subject to them.
> > Repurchase or Cancellation

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

> > Cancellation and Replacement

718-20-35-8 Except as described in paragraph 718-20-35-2A, cancellation of an award accompanied by the concurrent grant of (or offer to grant) a replacement award or other valuable consideration shall be accounted for as a modification of the terms of the cancelled award. (The phrase offer to grant is intended to cover situations in which the service inception date precedes the grant date.) Therefore, incremental compensation cost shall be measured as the excess of the fair value of the replacement award or other valuable consideration over the fair value of the cancelled award at the cancellation date in accordance with paragraph 718-20-35-3. Thus, the total compensation cost measured at the date of a cancellation and replacement shall be the portion of the grant-date fair value of the original award for which the promised good is expected to be delivered (or has already been delivered) or service is expected to be rendered (or has already been rendered) at that date plus the incremental cost resulting from the cancellation and replacement.


Implementation Guidance and Illustrations

> Illustrations

718-20-55-3 The following Examples are included in this Subtopic because they assume equity classification. However, these Examples would also apply to awards classified as liabilities except that the amounts in the Examples would likely
change due to the requirement under Subtopic 718-30 to remeasure share-based liability awards at **fair value** each reporting period until **settlement**.

718-20-55-3A The following Examples describe awards to employees. However, where specifically identified, guidance for certain aspects of the Examples (for example, changes in total compensation cost to be recognized, forfeiture treatment, taxes, and modifications) also is applicable to nonemployee awards. Therefore, the guidance in those identified instances may serve as implementation guidance for nonemployee awards. Specific valuation amounts used in the Examples could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions. An entity should consider the facts and circumstances of its nonemployee awards and use judgment in applying the guidance.

>> Example 1: Accounting for Share Options with Service Conditions

718-20-55-4 The following Cases illustrate the guidance in paragraphs 718-10-35-1D through 35-1E for nonemployee awards, paragraphs 718-10-35-2 through 35-7 for employee awards, and paragraphs 718-740-25-2 through 25-3 for both nonemployee and employee awards, except for the vesting provisions:

a. Share options with cliff vesting and forfeitures estimated in initial accruals of compensation cost (Case A)

b. Share options with graded vesting and forfeitures estimated in initial accruals of compensation cost (Case B)

c. Share options with cliff vesting and forfeitures recognized when they occur (Case C).

718-20-55-4A Cases A through C (see paragraphs 718-20-55-10 through 55-34G) describe employee awards. However, the principles on accounting for employee awards, except for the compensation cost attribution, are the same for nonemployee awards. Consequently, all of the following in Case A are equally applicable to nonemployee awards with the same features as the awards in Cases A through C (that is, awards with a specified time period for vesting):

a. The assumptions in paragraphs 718-20-55-6 through 55-9

b. **Total compensation cost considerations** (including estimates of forfeitures) in paragraphs 718-20-55-10 through 55-12

c. Changes in the estimation of forfeitures in paragraphs 718-20-55-14 through 55-15

d. **Exercise or expiration considerations** in paragraphs 718-20-55-18 through 55-21 and 718-20-55-23.

Therefore, the guidance in those paragraphs may serve as implementation guidance for nonemployee awards. Similarly, an entity also may elect to account for nonemployee award forfeitures as they occur as illustrated in Case C (see paragraph 718-20-55-34A).
Nonemployee awards may be similar to employee awards (that is, cliff vesting or graded vesting). However, the compensation cost attribution for awards to nonemployees may be the same as or different from employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in the Cases could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

Because of the differences in compensation cost attribution, the accounting policy election illustrated in Case B (see paragraph 718-20-55-25) does not apply to nonemployee awards.

Cases A, B, and C share all of the assumptions in paragraphs 718-20-55-6 through 55-34G, with the following exceptions:

a. In Case C, Entity T has an accounting policy to account for forfeitures when they occur in accordance with paragraph 718-10-35-3.

b. In Cases A and B, Entity T has an accounting policy to estimate the number of forfeitures expected to occur, also in accordance with paragraph 718-10-35-3.

c. In Case B, the share options have graded vesting.

d. In Cases A and C, the share options have cliff vesting.

Entity T, a public entity, grants at-the-money employee share options with a contractual term of 10 years. All share options vest at the end of three years (cliff vesting), which is an explicit service (and requisite service) period of three years. The share options do not qualify as incentive stock options for U.S. tax purposes. The enacted tax rate is 35 percent. In each Case, Entity T concludes that it will have sufficient future taxable income to realize the deferred tax benefits from its share-based payment transactions.

The following table shows assumptions and information about the share options granted on January 1, 20X5 applicable to all Cases, except for expected forfeitures per year, which does not apply in Case C.
A suboptimal exercise factor of two means that exercise is generally expected to occur when the share price reaches two times the share option’s exercise price. Option-pricing theory generally holds that the optimal (or profit-maximizing) time to exercise an option is at the end of the option’s term; therefore, if an option is exercised before the end of its term, that exercise is referred to as suboptimal. Suboptimal exercise also is referred to as early exercise. Suboptimal or early exercise affects the expected term of an option. Early exercise can be incorporated into option-pricing models through various means. In this Case, Entity T has sufficient information to reasonably estimate early exercise and has incorporated it as a function of Entity T’s future stock price changes (or the option’s intrinsic value). In this Case, the factor of 2 indicates that early exercise would be expected to occur, on average, if the stock price reaches $60 per share ($30 × 2). Rather than use its weighted average suboptimal exercise factor, Entity T also may use multiple factors based on a distribution of early exercise data in relation to its stock price.

This Case assumes that each employee receives an equal grant of 300 options. Using as inputs the last 7 items from the table in paragraph 718-20-55-7, Entity T’s lattice-based valuation model produces a fair value of $14.69 per option. A lattice model uses a suboptimal exercise factor to calculate the expected term (that is, the expected term is an output) rather than the expected term being a separate input. If an entity uses a Black-Scholes-Merton option-pricing formula, the expected term would be used as an input instead of a suboptimal exercise factor.

Case A: Share Options with Cliff Vesting and Forfeitures Estimated in Initial Accruals of Compensation Cost

Total compensation cost recognized over the requisite service period (which is the vesting period in this Case) shall be the grant-date fair value of all share options that actually vest (that is, all options for which the requisite service is rendered). This Case assumes that Entity T’s accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3. As a result, Entity T is required to estimate at the grant date the number of share options for which the requisite service is expected to be rendered (which, in this Case, is the number of share options for which vesting is deemed probable). If that estimate changes, it shall be accounted for as a change in estimate and its cumulative effect (from applying the change retrospectively) recognized in the period of change. Entity T estimates at the grant date the number of share options expected to vest and subsequently adjusts compensation cost for changes in the estimated rate of forfeitures and differences between expectations and actual experience. This Case also assumes that none of the compensation cost is capitalized as part of the cost of an asset.

The estimate of the number of forfeitures considers historical employee turnover rates and expectations about the future. Entity T has experienced historical turnover rates of approximately 3 percent per year for

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employees at the grantees’ level, and it expects that rate to continue over the requisite service period of the awards. Therefore, at the grant date Entity T estimates the total compensation cost to be recognized over the requisite service period based on an expected forfeiture rate of 3 percent per year. Actual forfeitures are 5 percent in 20X5, but no adjustments to cumulative compensation cost are recognized in 20X5 because Entity T still expects actual forfeitures to average 3 percent per year over the 3-year vesting period. As of December 31, 20X6, management decides that the forfeiture rate will likely increase through 20X7 and changes its estimated forfeiture rate for the entire award to 6 percent per year. Adjustments to cumulative compensation cost to reflect the higher forfeiture rate are made at the end of 20X6. At the end of 20X7 when the award becomes vested, actual forfeitures have averaged 6 percent per year, and no further adjustment is necessary.

718-20-55-12 The first set of calculations illustrates the accounting for the award of share options on January 1, 20X5, assuming that the share options granted vest at the end of three years. (Case B illustrates the accounting for an award assuming graded vesting in which a specified portion of the share options granted vest at the end of each year.) The number of share options expected to vest is estimated at the grant date to be 821,406 (900,000 × .97³). Thus, the compensation cost to be recognized over the requisite service period at January 1, 20X5, is $12,066,454 (821,406 × $14.69), and the compensation cost to be recognized during each year of the 3-year vesting period is $4,022,151 ($12,066,454 ÷ 3). The journal entries to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows for 20X5.

| Compensation cost | $ 4,022,151 |
| Additional paid-in capital | $ 4,022,151 |

To recognize compensation cost.

| Deferred tax asset | $ 1,407,753 |
| Deferred tax benefit | $ 1,407,753 |

To recognize the deferred tax asset for the temporary difference related to compensation cost ($4,022,151 × .35 = $1,407,753).

718-20-55-13 The net after-tax effect on income of recognizing compensation cost for 20X5 is $2,614,398 ($4,022,151 – $1,407,753).

718-20-55-14 Absent a change in estimated forfeitures, the same journal entries would be made to recognize compensation cost and related tax effects for 20X6 and 20X7, resulting in a net after-tax cost for each year of $2,614,398. However, at the end of 20X6, management changes its estimated employee forfeiture rate from 3 percent to 6 percent per year. The revised number of share options expected to vest is 747,526 (900,000 × .94³). Accordingly, the revised cumulative compensation cost to be recognized by the end of 20X7 is $10,981,157 (747,526 × $14.69). The cumulative adjustment to reflect the effect of adjusting the forfeiture
rate is the difference between two-thirds of the revised cost of the award and the cost already recognized for 20X5 and 20X6. The related journal entries and the computations follow.

At December 31, 20X6, to adjust for new forfeiture rate.

\[
\begin{array}{c|c|c}
\text{Revised total compensation cost} & $10,981,157 \\
\hline
\text{Revised cumulative cost as of December 31, 20X6 ($10,981,157 × \frac{2}{3})} & $7,320,771 \\
\text{Cost already recognized in 20X5 and 20X6 ($4,022,151 × 2)} & $8,044,302 \\
\text{Adjustment to cost at December 31, 20X6} & $723,531 \\
\end{array}
\]

718-20-55-15 The related journal entries are as follows.

<table>
<thead>
<tr>
<th>Account Title</th>
<th>Amount (in $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>723,531</td>
</tr>
<tr>
<td>Compensation cost</td>
<td>723,531</td>
</tr>
</tbody>
</table>

To adjust previously recognized compensation cost and equity to reflect a higher estimated forfeiture rate.

\[
\begin{array}{c|c|c}
\text{Deferred tax expense} & $253,236 \\
\text{Deferred tax asset}    & $253,236 \\
\end{array}
\]

To adjust the deferred tax accounts to reflect the tax effect of increasing the estimated forfeiture rate ($723,531 × .35 = $253,236).

718-20-55-16 Journal entries for 20X7 are as follows.

<table>
<thead>
<tr>
<th>Account Title</th>
<th>Amount (in $)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation cost</td>
<td>3,660,386</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>3,660,386</td>
</tr>
</tbody>
</table>

To recognize compensation cost ($10,981,157 ÷ 3 = $3,660,386).

\[
\begin{array}{c|c|c}
\text{Deferred tax asset} & $1,281,135 \\
\text{Deferred tax benefit} & $1,281,135 \\
\end{array}
\]

To recognize the deferred tax asset for additional compensation cost ($3,660,386 × .35 = $1,281,135).

718-20-55-17 As of December 31, 20X7, the entity would examine its actual forfeitures and make any necessary adjustments to reflect cumulative compensation cost for the number of shares that actually vested.

718-20-55-18 All 747,526 vested share options are exercised on the last day of 20Y2. Entity T has already recognized its income tax expense for the year without
regard to the effects of the exercise of the employee share options. In other words, current tax expense and current taxes payable were recognized based on income and deductions before consideration of additional deductions from exercise of the employee share options. Upon exercise, the amount credited to common stock (or other appropriate equity accounts) is the sum of the cash proceeds received and the amounts previously credited to additional paid-in capital in the periods the services were received (20X5 through 20X7). In this Case, Entity T has no-par common stock and at exercise, the share price is assumed to be $60.

**718-20-55-19** At exercise the journal entries are as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash (747,526 × $30)</td>
<td>$ 22,425,780</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>$ 10,981,157</td>
</tr>
<tr>
<td>Common stock</td>
<td>$ 33,406,937</td>
</tr>
</tbody>
</table>

To recognize the issuance of common stock upon exercise of share options and to reclassify previously recorded paid-in capital.

**718-20-55-20** In this Case, the difference between the market price of the shares and the exercise price on the date of exercise is deductible for tax purposes pursuant to U.S. tax law in effect in 2004 (the share options do not qualify as incentive stock options). Paragraph 718-740-35-2 requires that the tax effect be recognized as income tax expense or benefit in the income statement for the difference between the deduction for an award for tax purposes and the cumulative compensation cost of that award recognized for financial reporting purposes. With the share price of $60 at exercise, the deductible amount is $22,425,780 [747,526 × ($60 – $30)], and the tax benefit is $7,849,023 ($22,425,780 × .35).

**718-20-55-21** At exercise the journal entries are as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax expense</td>
<td>$ 3,843,405</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$ 3,843,405</td>
</tr>
</tbody>
</table>

To write off the deferred tax asset related to deductible share options at exercise ($10,981,157 × .35 = $3,843,405).

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current taxes payable</td>
<td>$ 7,849,023</td>
</tr>
<tr>
<td>Current tax expense</td>
<td>$ 7,849,023</td>
</tr>
</tbody>
</table>

To adjust current tax expense and current taxes payable to recognize the current tax benefit from deductible compensation cost upon exercise of share options.

**718-20-55-22** Paragraph superseded by Accounting Standards Update No. 2016-09.

**718-20-55-23** If instead the share options expired unexercised, previously recognized compensation cost would not be reversed. There would be no deduction on the tax return and, therefore, the entire deferred tax asset of $3,843,405 would be charged to income tax expense.
718-20-55-23A If employees terminated with out-of-the-money vested share options, the deferred tax asset related to those share options would be written off when those options expire.


> > > Case B: Share Options with Graded Vesting

718-20-55-25 Paragraph 718-10-35-8 provides for the following two methods to recognize compensation cost for awards with graded vesting:

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 (graded vesting attribution method)

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), subject to the limitation noted in paragraph 718-10-35-8.

718-20-55-26 The choice of attribution method for awards with graded vesting schedules is a policy decision that is not dependent on an entity’s choice of valuation technique. In addition, the choice of attribution method applies to awards with only service conditions.

718-20-55-27 The accounting is illustrated below for both methods and uses the same assumptions as those noted in Case A except for the vesting provisions.

718-20-55-28 Entity T awards 900,000 share options on January 1, 20X5, that vest according to a graded schedule of 25 percent for the first year of service, 25 percent for the second year, and the remaining 50 percent for the third year. Each employee is granted 300 share options. The following table shows the calculation as of January 1, 20X5, of the number of employees and the related number of share options expected to vest. Using the expected 3 percent annual forfeiture rate, 90 employees are expected to terminate during 20X5 without having vested in any portion of the award, leaving 2,910 employees to vest in 25 percent of the award (75 options). During 20X6, 87 employees are expected to terminate, leaving 2,823 to vest in the second 25 percent of the award. During 20X7, 85 employees are expected to terminate, leaving 2,738 employees to vest in the last 50 percent of the award. That results in a total of 840,675 share options expected to vest from the award of 900,000 share options with graded vesting.
718-20-55-29 The value of the share options that vest over the three-year period is estimated by separating the total award into three groups (or tranches) according to the year in which they vest (because the expected life for each tranche differs). The following table shows the estimated compensation cost for the share options expected to vest. The estimates of expected volatility, expected dividends, and risk-free interest rates are incorporated into the lattice, and the graded vesting conditions affect only the earliest date at which suboptimal exercise can occur (see paragraph 718-20-55-8 for information on suboptimal exercise). Thus, the fair value of each of the 3 groups of options is based on the same lattice inputs for expected volatility, expected dividend yield, and risk-free interest rates used to determine the value of $14.69 for the cliff-vesting share options (see paragraphs 718-20-55-7 through 55-9). The different vesting terms affect the ability of the suboptimal exercise to occur sooner (and affect other factors as well, such as volatility), and therefore there is a different expected term for each tranche.

### Share Option—Graded Vesting—Estimated Amounts

<table>
<thead>
<tr>
<th>Year</th>
<th>Number of Employees</th>
<th>Number of Vested Share Options</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total at date of grant 3,000</td>
<td>840,675</td>
</tr>
<tr>
<td>20X5</td>
<td>3,000 - 90 (3,000 x .03) = 2,910</td>
<td>2,910 x 75 (300 x 25%) = 218,250</td>
</tr>
<tr>
<td>20X6</td>
<td>2,910 - 87 (2,910 x .03) = 2,823</td>
<td>2,823 x 75 (300 x 25%) = 211,725</td>
</tr>
<tr>
<td>20X7</td>
<td>2,823 - 85 (2,823 x .03) = 2,738</td>
<td>2,738 x 150 (300 x 50%) = 410,700</td>
</tr>
</tbody>
</table>

718-20-55-30 Compensation cost is recognized over the periods of requisite service during which each tranche of share options is earned. Thus, the $2,933,280 cost attributable to the 218,250 share options that vest in 20X5 is recognized in 20X5. The $3,000,143 cost attributable to the 211,725 share options that vest at the end of 20X6 is recognized over the 2-year vesting period (20X5 and 20X6). The $6,033,183 cost attributable to the 410,700 share options that vest at the end of 20X7 is recognized over the 3-year vesting period (20X5, 20X6, and 20X7).

### Share Option—Graded Vesting—Estimated Cost

<table>
<thead>
<tr>
<th>Year</th>
<th>Vested Options</th>
<th>Value per Option</th>
<th>Compensation Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X5</td>
<td>218,250</td>
<td>$ 13.44</td>
<td>$ 2,933,280</td>
</tr>
<tr>
<td>20X6</td>
<td>211,725</td>
<td>14.17</td>
<td>3,000,143</td>
</tr>
<tr>
<td>20X7</td>
<td>410,700</td>
<td>14.69</td>
<td>6,033,183</td>
</tr>
<tr>
<td></td>
<td>840,675</td>
<td></td>
<td>$ 11,966,606</td>
</tr>
</tbody>
</table>

718-20-55-31 The following table shows how the $11,966,606 expected amount of compensation cost determined at the grant date is attributed to the years 20X5, 20X6, and 20X7.
Entity T could use the same computation of estimated cost, as in the preceding table, but could elect to recognize compensation cost on a straight-line basis for all graded vesting awards. In that case, total compensation cost to be attributed on a straight-line basis over each year in the 3-year vesting period is approximately $3,988,868 ($11,966,606 ÷ 3). Entity T also could use a single weighted-average expected life to value the entire award and arrive at a different amount of total compensation cost. Total compensation cost could then be attributed on a straight-line basis over the three-year vesting period. However, this Topic requires that compensation cost recognized at any date must be at least equal to the amount attributable to options that are vested at that date. For example, if 50 percent of this same option award vested in the first year of the 3-year vesting period, 436,500 options [2,910 × 150 (300 × 50%)] would be vested at the end of 20X5. Compensation cost amounting to $5,866,560 (436,500 × $13.44) attributable to the vested awards would be recognized in the first year.

Compensation cost is adjusted for awards with graded vesting to reflect differences between estimated and actual forfeitures as illustrated for the cliff-vesting options, regardless of which method is used to estimate value and attribute cost.

Accounting for the tax effects of awards with graded vesting follows the same pattern illustrated in paragraphs 718-20-55-20 through 55-23. However, unless Entity T identifies and tracks the specific tranche from which share options are exercised, it would not know the recognized compensation cost that corresponds to exercised share options for purposes of calculating the tax effects resulting from that exercise. If an entity does not know the specific tranche from which share options are exercised, it should assume that options are exercised on a first-vested, first-exercised basis (which works in the same manner as the first-in, first-out [FIFO] basis for inventory costing).

Case C: Share Options with Cliff Vesting and Forfeitures Recognized When They Occur

This Case uses the same assumptions as Case A except that Entity T’s accounting policy is to account for forfeitures when they occur in accordance with paragraph 718-10-35-3. Consequently, compensation cost previously recognized for an employee share option is reversed in the period in
which forfeiture of the award occurs. Previously recognized compensation cost is not reversed if an employee share option for which the requisite service has been rendered expires unexercised. This Case also assumes that none of the compensation cost is capitalized as part of the cost of an asset.

718-20-55-34B In 20X5, 20X6, and 20X7, share option forfeitures are 45,000, 47,344, and 60,130, respectively.

718-20-55-34C The compensation cost to be recognized over the requisite service period at January 1, 20X5, is $13,221,000 (900,000 × $14.69), and the compensation cost to be recognized (excluding the effect of forfeitures) during each year of the 3-year vesting period is $4,407,000 ($13,221,000 ÷ 3). The journal entries for 20X5 to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>$4,407,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$4,407,000</td>
</tr>
</tbody>
</table>

To recognize compensation cost excluding the effect of forfeitures for 20X5.

<table>
<thead>
<tr>
<th>Deferred tax asset</th>
<th>$1,542,450</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax benefit</td>
<td>$1,542,450</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for the temporary difference related to compensation cost ($4,407,000 × .35).

718-20-55-34D During 20X5, 45,000 share options are forfeited; accordingly, Entity T remeasures compensation cost to reflect the effect of forfeitures when they occur and recognizes compensation costs for 855,000 (900,000 – 45,000) share options (net of forfeitures) at an amount of $12,559,950 (855,000 × $14.69) over the 3-year vesting period, or $4,186,650 each year ($12,559,950 ÷ 3). Therefore, Entity T reverses recognized compensation cost of $220,350 (45,000 share options × $14.69 ÷ 3) to account for forfeitures that occurred during 20X5. The journal entries to recognize the effect of forfeitures during 20X5 and the related reduction in the deferred tax benefit are as follows.

<table>
<thead>
<tr>
<th>Additional paid-in capital</th>
<th>$220,350</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation cost</td>
<td>$220,350</td>
</tr>
</tbody>
</table>

To recognize the effect of forfeitures on compensation cost when they occur for 20X5.

<table>
<thead>
<tr>
<th>Deferred tax benefit</th>
<th>$77,123</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax asset</td>
<td>$77,123</td>
</tr>
</tbody>
</table>

To reverse the deferred tax asset related to the forfeited awards ($220,350 × .35).
As of January 1, 20X6, Entity T determines the compensation cost and related tax effects to recognize during 20X6. The journal entries for 20X6 to recognize compensation cost and related deferred tax benefit at the enacted tax rate of 35 percent are as follows (excluding the effect of forfeitures in 20X6).

<table>
<thead>
<tr>
<th>Compensation cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 4,186,650</td>
</tr>
</tbody>
</table>

To recognize compensation cost excluding the effect of awards that forfeited during 20X6.

<table>
<thead>
<tr>
<th>Deferred tax asset</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 1,465,328</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for the temporary difference related to compensation cost ($4,186,650 × .35).

In 20X6, 47,344 share options are forfeited (that is, 92,344 share options in total have been forfeited by December 31, 20X6); accordingly, Entity T would recognize compensation cost for 807,656 share options over the 3-year vesting period. On the basis of actual forfeitures in 20X5 and 20X6, Entity T should recognize a cumulative compensation cost of $11,864,467 (807,656 × $14.69) for the 3-year vesting period, or $3,954,822 a year ($11,864,467 ÷ 3 years). Therefore, Entity T reverses recognized compensation cost of $231,828 ($4,186,650 – $3,954,822) for 20X5 and 20X6, or $463,656 in total, to account for forfeitures that occurred during 20X6. The journal entries to recognize the effect of forfeitures during 20X6 and the related reduction in the deferred tax benefit are as follows.

<table>
<thead>
<tr>
<th>Additonal paid-capital</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 463,656</td>
</tr>
</tbody>
</table>

To recognize the effect of the forfeitures on compensation cost when they occur for 20X6.

<table>
<thead>
<tr>
<th>Deferred tax benefit</th>
</tr>
</thead>
<tbody>
<tr>
<td>$ 162,280</td>
</tr>
</tbody>
</table>

To reverse the deferred tax asset related to the forfeited awards ($463,656 × .35).

Entity T follows the same approach in 20X7 as it applied in 20X6 to recognize compensation cost and related tax effects.

Example 2: Share Option Award under Which the Number of Options to Be Earned Varies

This Example illustrates the guidance in paragraph 718-10-30-15.
This Example (see paragraphs 718-20-55-36 through 55-40) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, all of the following are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, the number of options earned varies on the basis of the achievement of particular performance conditions):

a. Certain valuation assumptions in paragraph 718-20-55-36
b. Total compensation cost considerations provided in paragraphs 718-20-55-37 through 55-39 (that is, an entity must consider if it is probable that specific performance conditions will be achieved for an award with a specified time period for vesting and performance conditions)
c. Forfeiture adjustments in paragraph 718-20-55-40.

Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

This Example shows the computation of compensation cost if Entity T grants an award of share options with multiple performance conditions. Under the award, employees vest in differing numbers of options depending on the amount by which the market share of one of Entity T’s products increases over a three-year period (the share options cannot vest before the end of the three-year period). The three-year explicit service period represents the requisite service period. On January 1, 20X5, Entity T grants to each of 1,000 employees an award of up to 300 10-year-term share options on its common stock. If market share increases by at least 5 percentage points by December 31, 20X7, each employee vests in at least 100 share options at that date. If market share increases by at least 10 percentage points, another 100 share options vest, for a total of 200. If market share increases by more than 20 percentage points, each employee vests in all 300 share options. Entity T’s share price on January 1, 20X5, is $30 and other assumptions are the same as in Example 1 (see paragraph 718-20-55-4). The grant-date fair value per share option is $14.69. While the vesting conditions in this Example and in Example 1 (see paragraph 718-20-55-4) are different, the equity instruments being valued have the same estimate of grant-date fair value. That is a consequence of the modified grant-date method, which accounts for the effects of vesting requirements or other restrictions that apply during the vesting period by
recognizing compensation cost only for the instruments that actually vest. (This discussion does not refer to awards with market conditions that affect exercisability or the ability to retain the award as described in paragraphs 718-10-55-60 through 55-63.)

718-20-55-37 The compensation cost of the award depends on the estimated number of options that will vest. Entity T must determine whether it is **probable** that any **performance condition** will be achieved, that is, whether the growth in market share over the 3-year period will be at least 5 percent. Accruals of compensation cost are initially based on the probable outcome of the performance conditions—in this case, different levels of market share growth over the three-year vesting period—and adjusted for subsequent changes in the estimated or actual outcome. If Entity T determines that no performance condition is probable of achievement (that is, market share growth is expected to be less than 5 percentage points), then no compensation cost is recognized; however, Entity T is required to reassess at each reporting date whether achievement of any performance condition is probable and would begin recognizing compensation cost if and when achievement of the performance condition becomes probable.

718-20-55-38 Paragraph 718-10-25-20 requires accruals of cost to be based on the probable outcome of performance conditions. Accordingly, this Topic prohibits Entity T from basing accruals of compensation cost on an amount that is not a possible outcome (and thus cannot be the probable outcome). For instance, if Entity T estimates that there is a 90 percent, 30 percent, and 10 percent likelihood that market share growth will be at least 5 percentage points, at least 10 percentage points, and greater than 20 percentage points, respectively, it would not try to determine a weighted average of the possible outcomes because that number of shares is not a possible outcome under the arrangement.

718-20-55-39 The following table shows the compensation cost that would be recognized in 20X5, 20X6, and 20X7 if Entity T estimates at the grant date that it is probable that market share will increase at least 5 but less than 10 percentage points (that is, each employee would receive 100 share options). That estimate remains unchanged until the end of 20X7, when Entity T’s market share has increased over the 3-year period by more than 10 percentage points. Thus, each employee vests in 200 share options.

718-20-55-40 As in Example 1, Case A (see paragraph 718-20-55-10), Entity T experiences actual forfeiture rates of 5 percent in 20X5, and in 20X6 changes its estimate of forfeitures for the entire award from 3 percent to 6 percent per year. In 20X6, cumulative compensation cost is adjusted to reflect the higher forfeiture rate. By the end of 20X7, a 6 percent forfeiture rate has been experienced, and no further adjustments for forfeitures are necessary. Through 20X5, Entity T estimates that 913 employees (1,000 × .97 3) will remain in service until the vesting date. At the end of 20X6, the number of employees estimated to remain in service is adjusted for the higher forfeiture rate, and the number of employees estimated to remain in service is 831 (1,000 × .94 2). The compensation cost of the award is
initially estimated based on the number of options expected to vest, which in turn is based on the expected level of performance and the fair value of each option. That amount would be adjusted as needed for changes in the estimated and actual forfeiture rates and for differences between estimated and actual market share growth. The amount of compensation cost recognized (or attributed) when achievement of a performance condition is probable depends on the relative satisfaction of the performance condition based on performance to date. Entity T determines that recognizing compensation cost ratably over the three-year vesting period is appropriate with one-third of the value of the award recognized each year.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Value of Award</th>
<th>Pretax Cost for Year</th>
<th>Cumulative Pretax Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X5</td>
<td>$1,341,197 ($14.69 × 100 × 913)</td>
<td>$447,066 ($1,341,197 ÷ 3)</td>
<td>$447,066</td>
</tr>
<tr>
<td>20X6</td>
<td>$1,220,739 ($14.69 × 100 × 831)</td>
<td>$366,760 ($1,220,739 × 2/3) − $447,066</td>
<td>$813,826</td>
</tr>
<tr>
<td>20X7</td>
<td>$2,441,478 ($14.69 × 200 × 831)</td>
<td>$1,627,652 ($2,441,478 − $813,826)</td>
<td>$2,441,478</td>
</tr>
</tbody>
</table>

>> Example 3: Share Option Award under Which the Exercise Price Varies

**718-20-55-41** This Example illustrates the guidance in paragraph 718-10-30-15.

**718-20-55-41A** This Example (see paragraphs 718-20-55-42 through 55-46) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, both of the following are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, an immediately vested and exercisable award with an exercise price that varies on the basis of the achievement of particular performance conditions):

a. Certain valuation assumptions in paragraphs 718-20-55-42 through 55-43
b. The total compensation cost considerations provided in paragraphs 718-20-55-44 through 55-46 (that is, an entity must consider if it is probable that specific performance conditions will be achieved).

Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

**718-20-55-41B** Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.
This Example shows the computation of compensation cost if Entity T grants a share option award with a performance condition under which the exercise price, rather than the number of shares, varies depending on the level of performance achieved. On January 1, 20X5, Entity T grants to its chief executive officer 10-year share options on 10,000 shares of its common stock, which are immediately vested and exercisable (an explicit service period of zero). The share price at the grant date is $30, and the initial exercise price also is $30. However, that price decreases to $15 if the market share for Entity T’s products increases by at least 10 percentage points by December 31, 20X6, and provided that the chief executive officer continues to be employed by Entity T and has not previously exercised the options (an explicit service period of 2 years, which also is the requisite service period).

Entity T estimates at the grant date the expected level of market share growth, the exercise price of the options, and the expected term of the options. Other assumptions, including the risk-free interest rate and the service period over which the cost is attributed, are consistent with those estimates. Entity T estimates at the grant date that its market share growth will be at least 10 percentage points over the 2-year performance period, which means that the expected exercise price of the share options is $15, resulting in a fair value of $19.99 per option. Option value is determined using the same assumptions noted in paragraph 718-20-55-7 except the exercise price is $15 and the award is not exercisable at $15 per option for 2 years.

Total compensation cost to be recognized if the performance condition is satisfied would be $199,900 (10,000 × $19.99). Paragraph 718-10-30-15 requires that the fair value of both awards with service conditions and awards with performance conditions be estimated as of the date of grant. Paragraph 718-10-35-3 also requires recognition of cost for the number of instruments for which the requisite service is provided. For this performance award, Entity T also selects the expected assumptions at the grant date if the performance goal is not met. If market share growth is not at least 10 percentage points over the 2-year period, Entity T estimates a fair value of $13.08 per option. Option value is determined using the same assumptions noted in paragraph 718-20-55-7 except the award is immediately vested.

Total compensation cost to be recognized if the performance goal is not met would be $130,800 (10,000 × $13.08). Because Entity T estimates that the performance condition would be satisfied, it would recognize compensation cost of $130,800 on the date of grant related to the fair value of the fully vested award and recognize compensation cost of $69,100 ($199,900 – $130,800) over the 2-year requisite service period related to the condition. Because of the nature of the performance condition, the award has multiple requisite service periods that affect the manner in which compensation cost is attributed. Paragraphs 718-10-55-67 through 55-79 provide guidance on estimating the requisite service period.
During the two-year requisite service period, adjustments to reflect any change in estimate about satisfaction of the performance condition should be made, and, thus, aggregate cost recognized by the end of that period reflects whether the performance goal was met.

> > Example 4: Share Option Award with Other Performance Conditions

This Example illustrates the guidance in paragraph 718-10-30-15.

This Example (see paragraphs 718-20-55-48 through 55-50) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, the concepts about valuation, expected term, and total compensation cost that should be recognized (that is, the consideration of whether it is probable that performance conditions will be achieved) in paragraphs 718-20-55-48 through 55-50 are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, awards with performance conditions that affect inputs to an award’s fair value). Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

While performance conditions usually affect vesting conditions, they may affect exercise price, contractual term, quantity, or other factors that affect an award’s fair value before, at the time of, or after vesting. This Topic requires that all performance conditions be accounted for similarly. A potential grant-date fair value is estimated for each of the possible outcomes that are reasonably determinable at the grant date and associated with the performance condition(s) of the award (as demonstrated in Example 3 [see paragraph 718-20-55-41]). Compensation cost ultimately recognized is equal to the grant-date fair value of the award that coincides with the actual outcome of the performance condition(s).

To illustrate the notion described in the preceding paragraph and attribution of compensation cost if performance conditions have different service periods, assume Entity C grants 10,000 at-the-money share options on its common stock to an employee. The options have a 10-year contractual term. The share options vest upon successful completion of phase-two clinical trials to satisfy regulatory testing requirements related to a developmental drug therapy. Phase-
two clinical trials are scheduled to be completed (and regulatory approval of that phase obtained) in approximately 18 months; hence, the implicit service period is approximately 18 months. Further, the share options will become fully transferable upon regulatory approval of the drug therapy (which is scheduled to occur in approximately four years). The implicit service period for that performance condition is approximately 30 months (beginning once phase-two clinical trials are successfully completed). Based on the nature of the performance conditions, the award has multiple requisite service periods (one pertaining to each performance condition) that affect the pattern in which compensation cost is attributed. Paragraphs 718-10-55-67 through 55-79 and 718-10-55-86 through 55-88 provide guidance on estimating the requisite service period of an award. The determination of whether compensation cost should be recognized depends on Entity C's assessment of whether the performance conditions are probable of achievement. Entity C expects that all performance conditions will be achieved. That assessment is based on the relevant facts and circumstances, including Entity C's historical success rate of bringing developmental drug therapies to market.

718-20-55-50 At the grant date, Entity C estimates that the potential fair value of each share option under the 2 possible outcomes is $10 (Outcome 1, in which the share options vest and do not become transferable) and $16 (Outcome 2, in which the share options vest and do become transferable). The difference in estimated fair values of each outcome is due to the change in estimate of the expected term of the share option. Outcome 1 uses an expected term in estimating fair value that is less than the expected term used for Outcome 2, which is equal to the award's 10-year contractual term. If a share option is transferable, its expected term is equal to its contractual term (see paragraph 718-10-55-29). If Outcome 1 is considered probable of occurring, Entity C would recognize $100,000 (10,000 × $10) of compensation cost ratably over the 18-month requisite service period related to the successful completion of phase-two clinical trials. If Outcome 2 is considered probable of occurring, then Entity C would recognize an additional $60,000 [10,000 × ($16 – $10)] of compensation cost ratably over the 30-month requisite service period (which begins after phase-two clinical trials are successfully completed) related to regulatory approval of the drug therapy. Because Entity C believes that Outcome 2 is probable, it recognizes compensation cost in the pattern described. However, if circumstances change and it is determined at the end of Year 3 that the regulatory approval of the developmental drug therapy is likely to be obtained in six years rather than four, the requisite service period for Outcome 2 is revised, and the remaining unrecognized compensation cost would be recognized prospectively through Year 6. On the other hand, if it becomes probable that Outcome 2 will not occur, compensation cost recognized for Outcome 2, if any, would be reversed.

>> Example 5: Share Option with a Market Condition—Indexed Exercise Price

718-20-55-51 This Example illustrates the guidance in paragraph 718-10-30-15.
This Example (see paragraphs 718-20-55-52 through 55-60) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, the concepts about valuation in paragraphs 718-20-55-52 through 55-60 are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, awards with market conditions that affect exercise prices). Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

Entity T grants share options whose exercise price varies with an index of the share prices of a group of entities in the same industry, that is, a market condition. Assume that on January 1, 20X5, Entity T grants 100 share options on its common stock with an initial exercise price of $30 to each of 1,000 employees. The share options have a maximum term of 10 years. The exercise price of the share options increases or decreases on December 31 of each year by the same percentage that the index has increased or decreased during the year. For example, if the peer group index increases by 10 percent in 20X5, the exercise price of the share options during 20X6 increases to $33 ($30 × 1.10). On January 1, 20X5, the peer group index is assumed to be 400. The dividend yield on the index is assumed to be 1.25 percent.

Each indexed share option may be analyzed as a share option to exchange 0.0750 (30 ÷ 400) shares of the peer group index for a share of Entity T stock—that is, to exchange one noncash asset for another noncash asset. A share option to purchase stock for cash also can be thought of as a share option to exchange one asset (cash in the amount of the exercise price) for another (the share of stock). The intrinsic value of a cash share option equals the difference between the price of the stock upon exercise and the amount—the price—of the cash exchanged for the stock. The intrinsic value of a share option to exchange 0.0750 shares of the peer group index for a share of Entity T stock also equals the difference between the prices of the two assets exchanged.

To illustrate the equivalence of an indexed share option and the share option above, assume that an employee exercises the indexed share option when Entity T’s share price has increased 100 percent to $60 and the peer group index has increased 75 percent, from 400 to 700. The exercise price of the indexed share option thus is $52.50 ($30 × 1.75).
That is the same as the intrinsic value of a share option to exchange 0.0750 shares of the index for 1 share of Entity T stock.

Option-pricing models can be extended to value a share option to exchange one asset for another. The principal extension is that the volatility of a share option to exchange two noncash assets is based on the relationship between the volatilities of the prices of the assets to be exchanged—their cross-volatility. In a share option with an exercise price payable in cash, the amount of cash to be paid has zero volatility, so only the volatility of the stock needs to be considered in estimating that option’s fair value. In contrast, the fair value of a share option to exchange two noncash assets depends on possible movements in the prices of both assets—in this Example, fair value depends on the cross-volatility of a share of the peer group index and a share of Entity T stock. Historical cross-volatility can be computed directly based on measures of Entity T’s share price in shares of the peer group index. For example, Entity T’s share price was 0.0750 shares at the grant date and 0.0857 (60 ÷ 700) shares at the exercise date. Those share amounts then are used to compute cross-volatility. Cross-volatility also can be computed indirectly based on the respective volatilities of Entity T stock and the peer group index and the correlation between them. The expected cross-volatility between Entity T stock and the peer group index is assumed to be 30 percent.

In a share option with an exercise price payable in cash, the assumed risk-free interest rate (discount rate) represents the return on the cash that will not be paid until exercise. In this Example, an equivalent share of the index, rather than cash, is what will not be paid until exercise. Therefore, the dividend yield on the peer group index of 1.25 percent is used in place of the risk-free interest rate as an input to the option-pricing model.

The initial exercise price for the indexed share option is the value of an equivalent share of the peer group index, which is $30 (0.0750 × $400). The fair value of each share option granted is $7.55 based on the following inputs.
In this Example, the suboptimal exercise factor is 1.1. In Example 1 (see paragraph 718-20-55-4), the suboptimal exercise factor is 2.0. See paragraph 718-20-55-8 for an explanation of the meaning of a suboptimal exercise factor of 2.0.

The indexed share options have a three-year explicit service period. The market condition affects the grant-date fair value of the award and its exercisability; however, vesting is based solely on the explicit service period of three years. The at-the-money nature of the award makes the derived service period irrelevant in determining the requisite service period in this Example; therefore, the requisite service period of the award is three years based on the explicit service period. The accrual of compensation cost would be based on the number of options for which the requisite service is rendered or is expected to be rendered depending on an entity’s accounting policy in accordance with paragraph 718-10-35-3 (which is not addressed in this Example). That cost would be recognized over the requisite service period as shown in Example 1 (see paragraph 718-20-55-4).

Example 6: Share Unit with Performance and Market Conditions

This Example illustrates the guidance in paragraphs 718-10-25-20 through 25-21, 718-10-30-27, and 718-10-35-4.

This Example (see paragraphs 718-20-55-62 through 55-67) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, both of the following are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, awards with a specified time period for vesting and the recognition of compensation cost based on the achievement of particular performance conditions):

a. The performance conditions in paragraph 718-20-55-62
b. Concepts about valuation, compensation cost reversal, and total compensation cost that should be recognized (that is, the consideration of whether it is probable that performance conditions will be achieved) in paragraphs 718-20-55-63 and 718-20-55-65 through 55-67.

Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share...
options and similar instruments when valuing nonemployee share-based payment transactions.

718-20-55-62 Entity T grants 100,000 share units to each of 10 vice presidents (1 million share units in total) on January 1, 20X5. Each share unit has a contractual term of three years and a vesting condition based on performance. The performance condition is different for each vice president and is based on specified goals to be achieved over three years (an explicit three-year service period). If the specified goals are not achieved at the end of three years, the share units will not vest. Each share unit is convertible into shares of Entity T at contractual maturity as follows:

a. If Entity T’s share price has appreciated by a percentage that exceeds the percentage appreciation of the S&P 500 index by at least 10 percent (that is, the relative percentage increase is at least 10 percent), each share unit converts into 3 shares of Entity T stock.

b. If the relative percentage increase is less than 10 percent but greater than zero percent, each share unit converts into 2 shares of Entity T stock.

c. If the relative percentage increase is less than or equal to zero percent, each share unit converts into 1 share of Entity T stock.

d. If Entity T’s share price has depreciated, each share unit converts into zero shares of Entity T stock.

718-20-55-63 Appreciation or depreciation for Entity T’s share price and the S&P 500 index is measured from the grant date.

718-20-55-64 This market condition affects the ability to retain the award because the conversion ratio could be zero; however, vesting is based solely on the explicit service period of three years, which is equal to the contractual maturity of the award. That set of circumstances makes the derived service period irrelevant in determining the requisite service period; therefore, the requisite service period of the award is three years based on the explicit service period.

718-20-55-65 The share units’ conversion feature is based on a variable target stock price (that is, the target stock price varies based on the S&P 500 index); hence, it is a market condition. That market condition affects the fair value of the share units that vest. Each vice president’s share units vest only if the individual’s performance condition is achieved; consequently, this award is accounted for as an award with a performance condition (see paragraphs 718-10-55-60 through 55-63). This Example assumes that all share units become fully vested; however, if the share units do not vest because the performance conditions are not achieved, Entity T would reverse any previously recognized compensation cost associated with the nonvested share units.

718-20-55-66 The grant-date fair value of each share unit is assumed for purposes of this Example to be $36. Certain option-pricing models, including Monte Carlo simulation techniques, have been adapted to value path-dependent options and other complex instruments. In this case, the entity concludes that a Monte Carlo
simulation technique provides a reasonable estimate of fair value. Each simulation represents a potential outcome, which determines whether a share unit would convert into three, two, one, or zero shares of stock. For simplicity, this Example assumes that no forfeitures will occur during the vesting period. The grant-date fair value of the award is $36 million (1 million × $36); management of Entity T expects that all share units will vest because the performance conditions are probable of achievement. Entity T recognizes compensation cost of $12 million ($36 million ÷ 3) in each year of the 3-year service period; the following journal entries are recognized by Entity T in 20X5, 20X6, and 20X7.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>$12,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$12,000,000</td>
</tr>
</tbody>
</table>

To recognize compensation cost.

<table>
<thead>
<tr>
<th>Deferred tax asset</th>
<th>$4,200,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax benefit</td>
<td>$4,200,000</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for the temporary difference related to compensation cost ($12,000,000 × .35 = $4,200,000).

718-20-55-67 Upon contractual maturity of the share units, four outcomes are possible; however, because all possible outcomes of the market condition were incorporated into the share units’ grant-date fair value, no other entry related to compensation cost is necessary to account for the actual outcome of the market condition. However, if the share units’ conversion ratio was based on achieving a performance condition rather than on satisfying a market condition, compensation cost would be adjusted according to the actual outcome of the performance condition (see Example 4 [paragraph 718-20-55-47]).

> > Example 7: Share Option with Exercise Price That Increases by a Fixed Amount or Fixed Percentage

718-20-55-68 This Example illustrates the guidance in paragraph 718-10-30-15.

718-20-55-68A This Example (see paragraphs 718-20-55-69 through 55-70) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, the concepts about valuation in paragraphs 718-20-55-69 through 55-70 are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, awards with exercise prices that increase by a fixed amount or fixed percentage). Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

718-20-55-68B Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C.
Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

718-20-55-69 Some entities grant share options with exercise prices that increase by a fixed amount or a constant percentage periodically. For example, the exercise price of the share options in Example 1 (see paragraph 718-20-55-4) might increase by a fixed amount of $2.50 per year. Lattice models and other valuation techniques can be adapted to accommodate exercise prices that change over time by a fixed amount. Such an arrangement has a market condition and may have a derived service period.

718-20-55-70 Share options with exercise prices that increase by a constant percentage also can be valued using an option-pricing model that accommodates changes in exercise prices. Alternatively, those share options can be valued by deducting from the discount rate the annual percentage increase in the exercise price. That method works because a decrease in the risk-free interest rate and an increase in the exercise price have a similar effect—both reduce the share option value. For example, the exercise price of the share options in Example 1 (see paragraph 718-20-55-4) might increase at the rate of 1 percent annually. For that example, Entity T’s share options would be valued based on a risk-free interest rate less 1 percent. Holding all other assumptions constant from that Example, the value of each share option granted by Entity T would be $14.34.

> > Example 8: Employee Share Award Granted by a Nonpublic Entity

718-20-55-71 The Example illustrates the guidance in paragraphs 718-10-30-17 through 30-19 and 718-740-25-2 through 25-4 for employee awards. The accounting demonstrated in this Example also would be applicable to a public entity that grants share awards to its employees. The same measurement method and basis is used for both nonvested share awards and restricted share awards (which are a subset of nonvested share awards).

718-20-55-72 On January 1, 20X6, Entity W, a nonpublic entity, grants 100 shares of stock to each of its 100 employees. The shares cliff vest at the end of three years. Entity W estimates that the grant-date fair value of 1 share of stock is $7. The grant-date fair value of the share award is $70,000 (100 × 100 × $7). The fair value of shares, which is equal to their intrinsic value, is not subsequently remeasured. For simplicity, the example assumes that no forfeitures occur during the vesting period. Because the requisite service period is 3 years, Entity W recognizes $23,333 ($70,000 ÷ 3) of compensation cost for each annual period as follows.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>$23,333</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$23,333</td>
</tr>
</tbody>
</table>

To recognize compensation cost.
To recognize the deferred tax asset for the temporary difference related to compensation cost ($23,333 \times .35 = $8,167).

718-20-55-73 After three years, all shares are vested. For simplicity, this Example assumes that no employees made an Internal Revenue Service (IRS) Code §83(b) election and Entity W has already recognized its income tax expense for the year in which the shares become vested without regard to the effects of the share award. (IRS Code §83(b) permits an employee to elect either the grant date or the vesting date for measuring the fair market value of an award of shares.)

718-20-55-74 The fair value per share on the vesting date, assumed to be $20, is deductible for tax purposes. Paragraph 718-740-35-2 requires that the tax effect be recognized as income tax expense or benefit in the income statement for the difference between the deduction for an award for tax purposes and the cumulative compensation cost of that award recognized for financial reporting purposes. With the share price at $20 on the vesting date, the deductible amount is $200,000 (10,000 \times $20), and the tax benefit is $70,000 ($200,000 \times .35).

718-20-55-75 At vesting the journal entries would be as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax expense</td>
<td>$24,500</td>
</tr>
<tr>
<td>Deferred tax asset</td>
<td>$24,500</td>
</tr>
<tr>
<td>Current taxes payable</td>
<td>$ 70,000</td>
</tr>
<tr>
<td>Current tax expense</td>
<td>$ 70,000</td>
</tr>
</tbody>
</table>

To write off deferred tax asset related to deductible share award at vesting ($70,000 \times .35 = $24,500).

To adjust current tax expense and current taxes payable to recognize the current tax benefit from deductible compensation cost upon vesting of share award.

>> Example 9: Share Award Granted by a Nonpublic Entity That Uses the Calculated Value Method

[Note: Paragraph 718-20-55-76 is amended and paragraphs 718-20-55-76A through 55-76B are added in Issue 4. They are shown here for context.]

718-20-55-76 This Example illustrates the guidance in paragraph 718-10-30-20 paragraphs 718-10-30-19A through 30-20.

718-20-55-76A This Example (see paragraphs 718-20-55-77 through 55-83) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, an entity should substitute the historical volatility of an appropriate industry sector index for expected volatility in accordance with paragraph 718-10-
30-20 when measuring the grant-date fair value of nonemployee awards with similar facts and circumstances (that is, an entity has determined that it is not practicable for it to estimate the expected volatility of its share price), as illustrated in paragraphs 718-20-55-77 through 55-80. Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

718-20-55-76B Compensation cost attribution for awards to nonemployees may be the same as or different from that which is illustrated in paragraph 718-20-55-81 for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

718-20-55-77 On January 1, 20X6, Entity W, a small nonpublic entity that develops, manufactures, and distributes medical equipment, grants 100 share options to each of its 100 employees. The share price at the grant date is $7. The options are granted at-the-money, cliff vest at the end of 3 years, and have a 10-year contractual term. Entity W estimates the expected term of the share options granted as 5 years and the risk-free rate as 3.75 percent. For simplicity, this Example assumes that no forfeitures occur during the vesting period and that no dividends are expected to be paid in the future, and this Example does not reflect the accounting for income tax consequences of the awards.

718-20-55-78 Entity W does not maintain an internal market for its shares, which are rarely traded privately. It has not issued any new equity or convertible debt instruments for several years and has been unable to identify any similar entities that are public. Entity W has determined that it is not practicable for it to estimate the expected volatility of its share price and, therefore, it is not possible for it to reasonably estimate the grant-date fair value of the share options. Accordingly, Entity W is required to apply the provisions of paragraph 718-10-30-20 in accounting for the share options under the calculated value method.

718-20-55-79 Entity W operates exclusively in the medical equipment industry. It visits the Dow Jones Indexes website and, using the Industry Classification Benchmark, reviews the various industry sector components of the Dow Jones U.S. Total Market Index. It identifies the medical equipment subsector, within the health care equipment and services sector, as the most appropriate industry sector in relation to its operations. It reviews the current components of the medical equipment index and notes that, based on the most recent assessment of its share price and its issued share capital, in terms of size it would rank among entities in the index with a small market capitalization (or small-cap entities). Entity W selects the small-cap version of the medical equipment index as an appropriate industry sector index because it considers that index to be representative of its size and the industry sector in which it operates. Entity W obtains the historical daily closing
total return values of the selected index for the five years immediately before January 1, 20X6, from the Dow Jones Indexes website. It calculates the annualized historical volatility of those values to be 24 percent, based on 252 trading days per year.

**718-20-55-80** Entity W uses the inputs that it has determined above in a Black-Scholes-Merton option-pricing formula, which produces a value of $2.05 per share option. This results in total compensation cost of $20,500 (10,000 × $2.05) to be accounted for over the requisite service period of 3 years.

**718-20-55-81** For each of the 3 years ending December 31, 20X6, 20X7, and 20X8, Entity W will recognize compensation cost of $6,833 ($20,500 ÷ 3). The journal entry for each year is as follows.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>$6,833</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$6,833</td>
</tr>
</tbody>
</table>

To recognize compensation cost.

**718-20-55-82** The share option award granted by a nonpublic entity that used the calculated value method is as follows.

**Example 10: Share Award with a Clawback Feature**

This Example illustrates the guidance in paragraph 718-20-35-2.
This Example (see paragraphs 718-20-55-85 through 55-86) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, the accounting for a contingent feature (such as a clawback) of an award that might cause a grantee to return to the entity either equity instruments earned or realized gains from the sale of the equity instruments earned is equally applicable to nonemployee awards with the same feature as the awards in this Example (that is, the clawback feature). Therefore, the guidance in this Example also serves as implementation guidance for similar nonemployee awards.

Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

On January 1, 20X5, Entity T grants its chief executive officer an award of 100,000 shares of stock that vest upon the completion of 5 years of service. The market price of Entity T’s stock is $30 per share on that date. The grant-date fair value of the award is $3,000,000 (100,000 × $30). The shares become freely transferable upon vesting; however, the award provisions specify that, in the event of the employee’s termination and subsequent employment by a direct competitor (as defined by the award) within three years after vesting, the shares or their cash equivalent on the date of employment by the direct competitor must be returned to Entity T for no consideration (a clawback feature). The chief executive officer completes five years of service and vests in the award. Approximately two years after vesting in the share award, the chief executive officer terminates employment and is hired as an employee of a direct competitor. Paragraph 718-10-55-8 states that contingent features requiring an employee to transfer equity shares earned or realized gains from the sale of equity instruments earned as a result of share-based payment arrangements to the issuing entity for consideration that is less than fair value on the date of transfer (including no consideration) are not considered in estimating the fair value of an equity instrument on the date it is granted. Those features are accounted for if and when the contingent event occurs by recognizing the consideration received in the corresponding balance sheet account and a credit in the income statement equal to the lesser of the recognized compensation cost of the share-based payment arrangement that contains the contingent feature ($3,000,000) and the fair value of the consideration received. This guidance does not apply to cancellations of awards of equity instruments as discussed in paragraphs 718-20-35-7 through 35-9. The former chief executive officer returns 100,000 shares of Entity T’s common
stock with a total market value of $4,500,000 as a result of the award’s provisions. The following journal entry accounts for that event.

<table>
<thead>
<tr>
<th>Treasury stock</th>
<th>$4,500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Other income</td>
<td>$3,000,000</td>
</tr>
</tbody>
</table>

To recognize the receipt of consideration as a result of the clawback feature.

718-20-55-86 If instead of delivering shares to Entity T, the former chief executive officer had paid cash equal to the total market value of 100,000 shares of Entity T’s common stock, the following journal entry would have been recorded.

<table>
<thead>
<tr>
<th>Cash</th>
<th>$4,500,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$1,500,000</td>
</tr>
<tr>
<td>Other income</td>
<td>$3,000,000</td>
</tr>
</tbody>
</table>

To recognize the receipt of consideration as a result of the clawback feature.

> > Example 11: Certain Noncompete Agreements and Requisite Service for Employee Awards

718-20-55-87 Paragraphs 718-10-25-3 through 25-4 require that the accounting for all share-based payment transactions with employees or others 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. Some share-based compensation arrangements with employees may contain noncompete provisions. Those noncompete provisions may be in-substance service conditions because of their nature. Determining whether a noncompete provision or another type of provision represents an in-substance service condition is a matter of judgment based on relevant facts and circumstances. This Example illustrates a situation in which a noncompete provision represents an in-substance service condition.

718-20-55-88 Entity K is a professional services firm in which retention of qualified employees is important in sustaining its operations. Entity K’s industry expertise and relationship networks are inextricably linked to its employees; if its employees terminate their employment relationship and work for a competitor, the entity’s operations may be adversely impacted.

718-20-55-89 As part of its compensation structure, Entity K grants 100,000 restricted share units to an employee on January 1, 20X6. The fair value of the restricted share units represents approximately four times the expected future annual total compensation of the employee. The restricted share units are fully vested as of the date of grant, and retention of the restricted share units is not contingent on future service to Entity K. However, the units are transferred to the employee based on a 4-year delayed-transfer schedule (25,000 restricted share units to be transferred beginning on December 31, 20X6, and on December 31 in
each of the 3 succeeding years) if and only if specified noncompete conditions are satisfied. The restricted share units are convertible into unrestricted shares any time after transfer.

718-20-55-90 The noncompete provisions require that no work in any capacity may be performed for a competitor (which would include any new competitor formed by the employee). Those noncompete provisions lapse with respect to the restricted share units as they are transferred. If the noncompete provisions are not satisfied, the employee loses all rights to any restricted share units not yet transferred. Additionally, the noncompete provisions stipulate that Entity K may seek other available legal remedies, including damages from the employee. Entity K has determined that the noncompete is legally enforceable and has legally enforced similar arrangements in the past.

718-20-55-91 The nature of the noncompete provision (being the corollary condition of active employment), the provision’s legal enforceability, the employer’s intent to enforce and past practice of enforcement, the delayed-transfer schedule mirroring the lapse of noncompete provisions, the magnitude of the award’s fair value in relation to the employee’s expected future annual total compensation, and the severity of the provision limiting the employee’s ability to work in the industry in any capacity are facts that provide a preponderance of evidence suggesting that the arrangement is designed to compensate the employee for future service in spite of the employee’s ability to terminate the employment relationship during the service period and retain the award (assuming satisfaction of the noncompete provision). Consequently, Entity K would recognize compensation cost related to the restricted share units over the four-year substantive service period.

718-20-55-92 Example 10 (see paragraph 718-20-55-84) provides an illustration of another noncompete agreement. That Example and this one are similar in that both noncompete agreements are not contingent upon employment termination (that is, both agreements may activate and lapse during a period of active employment after the vesting date). A key difference between the two Examples is that the award recipient in that Example must provide five years of service to vest in the award (as opposed to vesting immediately). Another key difference is that the award recipient in that Example receives the shares upon vesting and may sell them immediately without restriction as opposed to the restricted share units, which are transferred according to the delayed-transfer schedule. In that Example, the noncompete provision is not deemed to be an in-substance service condition. In making a determination about whether a noncompete provision may represent an in-substance service condition, the provision’s legal enforceability, the entity’s intent to enforce the provision and its past practice of enforcement, the employee’s rights to the instruments such as the right to sell them, the severity of the provision, the fair value of the award, and the existence or absence of an explicit employee service condition are all factors that shall be considered. Because noncompete provisions can be structured differently, one or more of those factors (such as the entity’s intent to enforce the provision) may be more important than others in
making that determination. For example, if Entity K did not intend to enforce the provision, then the noncompete provision would not represent an in-substance service condition.

> > Example 12: Modifications and Settlements

718-20-55-93 The following Cases illustrate the accounting for modifications of the terms of an award (see paragraphs 718-20-35-3 through 35-4) and are based on Example 1, Case A (see paragraph 718-20-55-10), in which Entity T granted its employees 900,000 share options with an exercise price of $30 on January 1, 20X5:

a. Modification of vested share options (Case A)  
b. Share settlement of vested share options (Case B)  
c. Modification of nonvested share options (Case C)  
d. Cash settlement of nonvested share options (Case D).

718-20-55-93A Cases A through D (see paragraphs 718-20-55-94 through 55-102) describe employee awards. Specifically, each case is an extension of Case A in Example 1. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, the methodology for determining the additional compensation cost that an entity should recognize upon modification or settlement in paragraphs 718-20-55-94 through 55-102 is equally applicable to nonemployee awards with the same features as the awards in Cases A through D (that is, awards with a specified period of time for vesting). Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

718-20-55-93B All aspects of Case A (see paragraph 718-20-55-94) and Case B (see paragraph 718-20-55-97) that illustrate a modification and share settlement of vested share options, respectively, including the immediate recognition of any additional compensation cost, should be the same for both employee awards and nonemployee awards.

718-20-55-93C The compensation cost attribution for awards to nonemployees may be the same or different for employee awards in Case C (see paragraph 718-20-55-98), which illustrates the modification of a nonvested share option. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C.

718-20-55-93D All aspects of Case D (see paragraph 718-20-55-102), which illustrates a cash settlement of a nonvested share option, including the immediate recognition of any additional compensation cost, should be the same for both employee awards and nonemployee awards. That is because the cash settlement of a nonvested share option effectively vests the share option.
Case A: Modification of Vested Share Options

On January 1, 20X9, after the share options have vested, the market price of Entity T stock has declined to $20 per share, and Entity T decides to reduce the exercise price of the outstanding share options to $20. In effect, Entity T issues new share options with an exercise price of $20 and a contractual term equal to the remaining contractual term of the original January 1, 20X5, share options, which is 6 years, in exchange for the original vested share options. Entity T incurs additional compensation cost for the excess of the fair value of the modified share options issued over the fair value of the original share options at the date of the exchange, measured as shown in the following paragraph. A nonpublic entity using the calculated value would compare the calculated value of the original award immediately before the modification with the calculated value of the modified award unless an entity has ceased to use the calculated value, in which case it would follow the guidance in paragraph 718-20-35-3(a) through (b) (calculating the effect of the modification based on the fair value). The modified share options are immediately vested, and the additional compensation cost is recognized in the period the modification occurs.

The January 1, 20X9, fair value of the modified award is $7.14. To determine the amount of additional compensation cost arising from the modification, the fair value of the original vested share options assumed to be repurchased is computed immediately before the modification. The resulting fair value at January 1, 20X9, of the original share options is $3.67 per share option, based on their remaining contractual term of 6 years, suboptimal exercise factor of 2, $20 current share price, $30 exercise price, risk-free interest rates of 1.5 percent to 3.4 percent, expected volatility of 35 percent to 50 percent and a 1.0 percent expected dividend yield. The additional compensation cost stemming from the modification is $3.47 per share option, determined as follows.

| Fair value of modified share option at January 1, 20X9 | $7.14 |
| Less: Fair value of original share option at January 1, 20X9 | 3.67 |
| Additional compensation cost to be recognized | $3.47 |

Compensation cost already recognized during the vesting period of the original award is $10,981,157 for 747,526 vested share options (see paragraphs 718-20-55-14 through 55-17). For simplicity, it is assumed that no share options were exercised before the modification. Previously recognized compensation cost is not adjusted. Additional compensation cost of $2,593,915 (747,526 vested share options × $3.47) is recognized on January 1, 20X9, because the modified share options are fully vested; any income tax effects from the additional compensation cost are recognized accordingly.

Case B: Share Settlement of Vested Share Options

Rather than modify the option terms, Entity T offers to settle the original January 1, 20X5, share options for fully vested equity shares at January 1,
20X9. The fair value of each share option is estimated the same way as shown in Case A, resulting in a fair value of $3.67 per share option. Entity T recognizes the settlement as the repurchase of an outstanding equity instrument, and no additional compensation cost is recognized at the date of settlement unless the payment in fully vested equity shares exceeds $3.67 per share option. Previously recognized compensation cost for the fair value of the original share options is not adjusted.

> > > Case C: Modification of Nonvested Share Options

718-20-55-98 On January 1, 20X6, 1 year into the 3-year vesting period, the market price of Entity T stock has declined to $20 per share, and Entity T decides to reduce the exercise price of the share options to $20. The three-year cliff-vesting requirement is not changed. In effect, in exchange for the original nonvested share options, Entity T grants new share options with an exercise price of $20 and a contractual term equal to the 9-year remaining contractual term of the original share options granted on January 1, 20X5. Entity T incurs additional compensation cost for the excess of the fair value of the modified share options issued over the fair value of the original share options at the date of the exchange determined in the manner described in paragraphs 718-20-55-95 through 55-96. Entity T adds that additional compensation cost to the remaining unrecognized compensation cost for the original share options at the date of modification and recognizes the total amount ratably over the remaining two years of the three-year vesting period. Because the original vesting provision is not changed, the modification has an explicit service period of two years, which represents the requisite service period as well. Thus, incremental compensation cost resulting from the modification would be recognized ratably over the remaining two years rather than in some other pattern.

718-20-55-99 The January 1, 20X6, fair value of the modified award is $8.59 per share option, based on its contractual term of 9 years, suboptimal exercise factor of 2, $20 current share price, $20 exercise price, risk-free interest rates of 1.5 percent to 4.0 percent, expected volatilities of 35 percent to 55 percent, and a 1.0 percent expected dividend yield. The fair value of the original award immediately before the modification is $5.36 per share option, based on its remaining contractual term of 9 years, suboptimal exercise factor of 2, $20 current share price, $30 exercise price, risk-free interest rates of 1.5 percent to 4.0 percent, expected volatilities of 35 percent to 55 percent, and a 1.0 percent expected dividend yield. Thus, the additional compensation cost stemming from the modification is $3.23 per share option, determined as follows.

<table>
<thead>
<tr>
<th>Description</th>
<th>Fair Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of modified share option at January 1, 20X6</td>
<td>$8.59</td>
</tr>
<tr>
<td>Less: Fair value of original share option at January 1, 20X6</td>
<td>5.36</td>
</tr>
<tr>
<td>Incremental value of modified share option at January 1, 20X6</td>
<td><strong>$3.23</strong></td>
</tr>
</tbody>
</table>

718-20-55-100 On January 1, 20X6, the remaining balance of unrecognized compensation cost for the original share options is $9.79 per share option. Using
a value of $14.69 for the original option as noted in paragraph 718-20-55-9 results in recognition of $4.90 ($14.69 ÷ 3) per year. The unrecognized balance at January 1, 20X6, is $9.79 ($14.69 – $4.90) per option. The total compensation cost for each modified share option that is expected to vest is $13.02, determined as follows.

| Incremental Value of Modified Share Option | $ 3.23 |
| Unrecognized Compensation Cost for Original Share Option | $ 9.79 |
| Total Compensation Cost to be Recognized | $13.02 |

718-20-55-101 That amount is recognized during 20X6 and 20X7, the two remaining years of the requisite service period.

> > > Case D: Cash Settlement of Nonvested Share Options

718-20-55-102 Rather than modify the share option terms, Entity T offers on January 1, 20X6, to settle the original January 1, 20X5, grant of share options for cash. Because the share price decreased from $30 at the grant date to $20 at the date of settlement, the fair value of each share option is $5.36, the same as in Case C. If Entity T pays $5.36 per share option, it would recognize that cash settlement as the repurchase of an outstanding equity instrument and no incremental compensation cost would be recognized. However, the cash settlement of the share options effectively vests them. Therefore, the remaining unrecognized compensation cost of $9.79 per share option would be recognized at the date of settlement.

> > Example 14: Modifications of Awards with Performance and Service Vesting Conditions

718-20-55-107 Paragraphs 718-10-55-60 through 55-63 note that awards may vest based on service conditions, performance conditions, or a combination of the two. Modifications of market conditions that affect exercisability or the ability to retain the award are not addressed by this Example. A modification of vesting conditions is accounted for based on the principles in paragraph 718-20-35-3; that is, total recognized compensation cost for an equity award that is modified 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. If awards are expected to vest under the original vesting conditions at the date of the modification, an entity shall recognize compensation cost if either of the following criteria is met:

a. The awards ultimately vest under the modified vesting conditions
b. The awards ultimately would have vested under the original vesting conditions.

718-20-55-108 In contrast, if at the date of modification awards are not expected to vest under the original vesting conditions, an entity should recognize compensation cost only if the awards vest under the modified vesting conditions.
Said differently, if the entity believes that the original performance or service vesting condition is not probable of achievement at the date of the modification, the cumulative compensation cost related to the modified award, assuming vesting occurs under the modified performance or service vesting condition, is the modified award’s fair value at the date of the modification. The following Cases illustrate the application of those requirements:

a. Type I probable to probable modification (Case A)
b. Type II probable to improbable modification (Case B)
c. Type III improbable to probable modification (Case C)
d. Type IV improbable to improbable modification (Case D).

718-20-55-109 Cases A through D are all based on the same scenario: Entity T grants 1,000 share options to each of 10 employees in the sales department. The share options have the same terms and conditions as those described in Example 1 (see paragraph 718-20-55-4), except that the share options specify that vesting is conditional upon selling 150,000 units of product A (the original sales target) over the 3-year explicit service period. The grant-date fair value of each option is $14.69 (see paragraph 718-20-55-9). For simplicity, this Example assumes that no forfeitures will occur from employee termination; forfeitures will only occur if the sales target is not achieved. Example 15 (see paragraph 718-20-55-120) provides an additional illustration of a Type III modification.

718-20-55-109A Cases A through D (see paragraphs 718-20-55-111 through 55-119) describe employee awards because the Cases use the terms and conditions of the employee awards presented as part of Example 1 of this Subtopic (see paragraph 718-20-55-4). However, the principles about determining the cumulative amount of compensation cost that an entity should recognize because of a modification to an employee award provided in Cases A through D are the same for nonemployee awards that are modified. Consequently, the guidance in paragraphs 718-20-55-111 through 55-119 should be applied to determine the cumulative amount of compensation cost that an entity should recognize because of a modification to a nonemployee award.

718-20-55-109B Any additional compensation cost should be recognized by applying the guidance in paragraph 718-10-25-2C. That is, an asset or expense must be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the share-based payment awards. Additionally, valuation amounts used in the Cases could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

718-20-55-110 Cases A through D assume that the options are out-of-the-money when modified; however, that fact is not determinative in the illustrations (that is, options could be in- or out-of-the-money).
Case A: Type I Probable to Probable Modification

Based on historical sales patterns and expectations related to the future, management of Entity T believes at the grant date that it is probable that the sales target will be achieved. On January 1, 20X7, 102,000 units of Product A have been sold. During December 20X6, one of Entity T’s competitors declared bankruptcy after a fire destroyed a factory and warehouse containing the competitor’s inventory. To push the salespeople to take advantage of that situation, the award is modified on January 1, 20X7, to raise the sales target to 154,000 units of Product A (the modified sales target). Notwithstanding the nature of the modification’s probability of occurrence, the objective of this Case is to demonstrate the accounting for a Type I modification. Additionally, as of January 1, 20X7, the options are out-of-the-money because of a general stock market decline. No other terms or conditions of the original award are modified, and management of Entity T continues to believe that it is probable that the modified sales target will be achieved. Immediately before the modification, total compensation cost expected to be recognized over the 3-year vesting period is $146,900 or $14.69 multiplied by the number of share options expected to vest (10,000). Because no other terms or conditions of the award were modified, the modification does not affect the per-share-option fair value (assumed to be $8 in this Case at the date of the modification). Moreover, because the modification does not affect the number of share options expected to vest, no incremental compensation cost is associated with the modification.

This paragraph illustrates the cumulative compensation cost Entity T should recognize for the modified award based on three potential outcomes:

a. Outcome 1—achievement of the modified sales target. In Outcome 1, all 10,000 share options vest because the salespeople sold at least 154,000 units of Product A. In that outcome, Entity T would recognize cumulative compensation cost of $146,900.

b. Outcome 2—achievement of the original sales target. In Outcome 2, no share options vest because the salespeople sold more than 150,000 units of Product A but less than 154,000 units (the modified sales target is not achieved). In that outcome, Entity T would recognize cumulative compensation cost of $146,900 because the share options would have vested under the original terms and conditions of the award.

c. Outcome 3—failure to achieve either sales target. In Outcome 3, no share options vest because the modified sales target is not achieved; additionally, no share options would have vested under the original terms and conditions of the award. In that case, Entity T would recognize cumulative compensation cost of $0.

Case B: Type II Probable to Improbable Modification

It is generally believed that Type II modifications will be rare; therefore, this illustration has been provided for the sake of completeness. Based
on historical sales patterns and expectations related to the future, management of Entity T believes that at the grant date, it is probable that the sales target (150,000 units of product A) will be achieved. At January 1, 20X7, 102,000 units of product A have been sold and the options are out-of-the-money because of a general stock market decline. Entity T’s management implements a cash bonus program based on achieving an annual sales target for 20X7. The options are neither cancelled nor settled as a result of the cash bonus program. The cash bonus program would be accounted for using the same accounting as for other cash bonus arrangements. Concurrently, the sales target for the option awards is revised to 170,000 units of Product A. No other terms or conditions of the original award are modified. Management believes that the modified sales target is not probable of achievement; however, they continue to believe that the original sales target is probable of achievement. Immediately before the modification, total compensation cost expected to be recognized over the 3-year vesting period is $146,900 or $14.69 multiplied by the number of share options expected to vest (10,000). Because no other terms or conditions of the award were modified, the modification does not affect the per-share-option fair value (assumed in this Case to be $8 at the modification date). Moreover, because the modification does not affect the number of share options expected to vest under the original vesting provisions, Entity T would determine incremental compensation cost in the following manner.

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value of modified share option</td>
<td>$8</td>
</tr>
<tr>
<td>Share options expected to vest under original sales target</td>
<td>10,000</td>
</tr>
<tr>
<td>Fair value of modified award</td>
<td>$80,000</td>
</tr>
<tr>
<td>Fair value of original share option</td>
<td>$8</td>
</tr>
<tr>
<td>Share options expected to vest under original sales target</td>
<td>10,000</td>
</tr>
<tr>
<td>Fair value of original award</td>
<td>$80,000</td>
</tr>
<tr>
<td>Incremental compensation cost of modification</td>
<td>$0</td>
</tr>
</tbody>
</table>

718-20-55-114 In determining the fair value of the modified award for this type of modification, an entity shall use the greater of the options expected to vest under the modified vesting condition or the options that previously had been expected to vest under the original vesting condition.

718-20-55-115 This paragraph illustrates the cumulative compensation cost Entity T should recognize for the modified award based on three potential outcomes:

a. **Outcome 1**—achievement of the modified sales target. In Outcome 1, all 10,000 share options vest because the salespeople sold at least 170,000 units of Product A. In that outcome, Entity T would recognize cumulative compensation cost of $146,900.

b. **Outcome 2**—achievement of the original sales target. In Outcome 2, no share options vest because the salespeople sold more than 150,000 units of Product A but less than 170,000 units (the modified sales target is not achieved). In that outcome, Entity T would recognize cumulative
compensation cost of $146,900 because the share options would have vested under the original terms and conditions of the award.

c. Outcome 3—failure to achieve either sales target. In Outcome 3, no share options vest because the modified sales target is not achieved; additionally, no share options would have vested under the original terms and conditions of the award. In that case, Entity T would recognize cumulative compensation cost of $0.

Case C: Type III Improbable to Probable Modification

Based on historical sales patterns and expectations related to the future, management of Entity T believes at the grant date that none of the options will vest because it is not probable that the sales target will be achieved. On January 1, 20X7, 80,000 units of Product A have been sold. To further motivate the salespeople, the sales target (150,000 units of Product A) is lowered to 120,000 units of Product A (the modified sales target). No other terms or conditions of the original award are modified. Management believes that the modified sales target is probable of achievement. Immediately before the modification, total compensation cost expected to be recognized over the 3-year vesting period is $0 or $14.69 multiplied by the number of share options expected to vest (zero). Because no other terms or conditions of the award were modified, the modification does not affect the per-share-option fair value (assumed in this Case to be $8 at the modification date). Since the modification affects the number of share options expected to vest under the original vesting provisions, Entity T will determine incremental compensation cost in the following manner.

| Fair value of modified share option | $ 8 |
| Share options expected to vest under modified sales target | 10,000 |
| Fair value of modified award | $80,000 |
| Fair value of original share option | $ 8 |
| Share options expected to vest under original sales target | - |
| Fair value of original award | - |
| Incremental compensation cost of modification | $80,000 |

This paragraph illustrates the cumulative compensation cost Entity T should recognize for the modified award based on three potential outcomes:

a. Outcome 1—achievement of the modified sales target. In Outcome 1, all 10,000 share options vest because the salespeople sold at least 120,000 units of Product A. In that outcome, Entity T would recognize cumulative compensation cost of $80,000.

b. Outcome 2—achievement of the original sales target and the modified sales target. In Outcome 2, Entity T would recognize cumulative compensation cost of $80,000 because in a Type III modification the original vesting condition is generally not relevant (that is, the modified award generally vests at a lower threshold of service or performance).
c. Outcome 3—failure to achieve either sales target. In Outcome 3, no share options vest because the modified sales target is not achieved; in that case, Entity T would recognize cumulative compensation cost of $0.

> > > Case D: Type IV Improbable to Improbable Modification

718-20-55-118 Based on historical sales patterns and expectations related to the future, management of Entity T believes that at the grant date it is not probable that the sales target will be achieved. On January 1, 20X7, 80,000 units of Product A have been sold. To further motivate the salespeople, the sales target is lowered to 130,000 units of Product A (the modified sales target). No other terms or conditions of the original award are modified. Entity T lost a major customer for Product A in December 20X6; hence, management continues to believe that the modified sales target is not probable of achievement. Immediately before the modification, total compensation cost expected to be recognized over the 3-year vesting period is $0 or $14.69 multiplied by the number of share options expected to vest (zero). Because no other terms or conditions of the award were modified, the modification does not affect the per-share-option fair value (assumed in this Case to be $8 at the modification date). Furthermore, the modification does not affect the number of share options expected to vest; hence, there is no incremental compensation cost associated with the modification.

718-20-55-119 This paragraph illustrates the cumulative compensation cost Entity T should recognize for the modified award based on three potential outcomes:

a. Outcome 1—achievement of the modified sales target. In Outcome 1, all 10,000 share options vest because the salespeople sold at least 130,000 units of Product A. In that outcome, Entity T would recognize cumulative compensation cost of $80,000 (10,000 × $8).

b. Outcome 2—achievement of the original sales target and the modified sales target. In Outcome 2, Entity T would recognize cumulative compensation cost of $80,000 because in a Type IV modification the original vesting condition is generally not relevant (that is, the modified award generally vests at a lower threshold of service or performance).

c. Outcome 3—failure to achieve either sales target. In Outcome 3, no share options vest because the modified sales target is not achieved; in that case, Entity T would recognize cumulative compensation cost of $0.

> > Example 15: Illustration of a Type III Improbable to Probable Modification

718-20-55-120 This Example illustrates the guidance in paragraph 718-20-35-3.

718-20-55-120A This Example (see paragraph 718-20-55-121) describes employee awards. However, the principle provided in paragraph 718-20-55-121 is the same for nonemployee awards that are modified. Consequently, that guidance should be applied to determine the cumulative amount of compensation cost, if
any, that an entity should recognize because of a modification to a nonemployee award.

718-20-55-120B Any additional compensation cost should be recognized by applying the guidance in paragraph 718-10-25-2C. That is, an asset or expense must be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the share-based payment awards. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

718-20-55-121 On January 1, 20X7, Entity Z issues 1,000 at-the-money options with a 4-year explicit service condition to each of 50 employees that work in Plant J. On December 12, 20X7, Entity Z decides to close Plant J and notifies the 50 Plant J employees that their employment relationship will be terminated effective June 30, 20X8. On June 30, 20X8, Entity Z accelerates vesting of all options. The grant-date fair value of each option is $20 on January 1, 20X7, and $10 on June 30, 20X8, the modification date. At the date Entity Z decides to close Plant J and terminate the employees, the service condition of the original award is not expected to be satisfied because the employees cannot render the requisite service. Because Entity Z's accounting policy is to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3, any compensation cost recognized before December 12, 20X7, for the original award would be reversed. At the date of the modification, the fair value of the original award, which is $0 ($10 × 0 options expected to vest under the original terms of the award), is subtracted from the fair value of the modified award $500,000 ($10 × 50,000 options expected to vest under the modified award). The total recognized compensation cost of $500,000 will be less than the fair value of the award at the grant date ($1 million) because at the date of the modification, the original vesting conditions were not expected to be satisfied. If Entity Z’s accounting policy was to account for forfeitures when they occur in accordance with paragraph 718-10-35-3, then compensation cost recognized before December 12, 20X7, would not be reversed until the award is forfeited. However, Entity Z would be required to assess at the date of the modification whether the performance or service conditions of the original award are expected to be satisfied.

>> Example 16: Modifications Regarding an Award’s Classification

718-20-55-122 A modification may affect the classification of an award (for example, change the award from an equity instrument to a liability instrument). If an entity modifies an award in that manner, the Compensation—Stock Compensation Topic requires that the entity account for that modification in accordance with paragraph 718-20-35-3. The following Cases illustrate modifications regarding an award’s classification:
a. Equity to liability modification (share-settled share options to cash-settled share options) (Case A)
b. Equity to equity modification (share options to shares) (Case B)
c. Liability to equity modification (cash-settled to share-settled stock appreciation rights) (Case C)
d. Liability to liability modification (cash-settled to cash-settled stock appreciation rights) (Case D)
e. Equity to liability modification (share options to fixed cash payment) (Case E).

718-20-55-122A Cases A through E (see paragraphs 718-20-55-123 through 55-144) describe employee awards. Specifically, Case A (see paragraph 718-20-55-123), Case B (see paragraph 718-20-55-134), and Case E (see paragraph 718-20-55-144) are extensions of Case A in Example 1 of this Subtopic (see paragraph 718-20-55-10), and Cases C and D (see paragraphs 718-20-55-135 and 718-20-55-139, respectively) are extensions of Example 1 in Subtopic 718-30 on awards classified as liabilities (see paragraph 718-30-55-1). However, the principles of determining the additional compensation cost that an entity should recognize upon modification (if any) and the guidance for reclassification of awards from equity to liabilities or vice versa are the same for nonemployee awards with the same features as the awards in Cases A through E (that is, awards with a specified period of time for vesting). Consequently, the guidance provided in Cases A through E should be applied to determine the cumulative amount of compensation cost that an entity should recognize because of a modification (if any) to a nonemployee award. An entity should consider its specific facts and circumstances for the nonemployee awards it has issued when calculating any additional compensation cost resulting from a modification to the awards. For example, the pattern of recognition of previously recognized compensation cost (that is, compensation cost recognized before the modification) may have been different from that which is illustrated in Cases A through E because of the requirements of paragraph 718-10-25-2C.

718-20-55-122B Any additional compensation cost resulting from a modification of a nonemployee award should be recognized in accordance with paragraph 718-10-25-2C. That is, an asset or expense must be recognized (or previous recognition reversed) in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services rather than if the grantor had paid with or used the equity instruments. Additionally, valuation amounts used in the cases could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based transactions.

718-20-55-122C Cases A through E should serve as guidance for any reclassification entries required because of a modification of a nonemployee award from equity to liability or vice versa.
Case A: Equity to Liability Modification (Share-Settled Share Options to Cash-Settled Share Options)

Entity T grants the same share options described in Example 1, Case A (see paragraph 718-20-55-10). As in Example 1, Case A, Entity T has an accounting policy to estimate the number of forfeitures expected to occur in accordance with paragraph 718-10-35-3. The number of options for which the requisite service is expected to be rendered is estimated at the grant date to be 821,406 (900,000 × 0.97^3). For simplicity, this Case assumes that estimated forfeitures equal actual forfeitures. Thus, as shown in the table in paragraph 718-20-55-130, the fair value of the award at January 1, 20X5, is $12,066,454 (821,406 × $14.69), and the compensation cost to be recognized during each year of the 3-year vesting period is $4,022,151 ($12,066,454 ÷ 3). The journal entries for 20X5 are the same as those in paragraph 718-20-55-12.

On January 1, 20X6, Entity T modifies the share options granted to allow the employee the choice of share settlement or net cash settlement; the options no longer qualify as equity because the holder can require Entity T to settle the options by delivering cash. Because the modification affects no other terms or conditions of the options, the fair value (assumed to be $7 per share option) of the modified award equals the fair value of the original award immediately before its terms are modified on the date of modification; the modification also does not change the number of share options for which the requisite service is expected to be rendered. On the modification date, Entity T recognizes a liability equal to the portion of the award attributed to past service multiplied by the modified award’s fair value. To the extent that the liability equals or is less than the amount recognized in equity for the original award, the offsetting debit is a charge to equity. To the extent that the liability exceeds the amount recognized in equity for the original award, the excess is recognized as compensation cost. In this Case, at the modification date, one-third of the award is attributed to past service (one year of service rendered/three-year requisite service period). The modified award’s fair value is $5,749,842 (821,406 × $7), and the liability to be recognized at the modification date is $1,916,614 ($5,749,842 ÷ 3). The related journal entry follows.

| Additional paid-in capital | $1,916,614 |
| Share-based compensation liability | $1,916,614 |

To recognize the share-based compensation liability.

No entry would be made to the deferred tax accounts at the modification date. The amount of remaining additional paid-in capital attributable to compensation cost recognized in 20X5 is $2,105,537 ($4,022,151 – $1,916,614).

Paragraph 718-20-35-3(b) specifies that 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 service or performance conditions of the original award are not expected to be satisfied. In
accordance with that principle, Entity T would ultimately recognize cumulative compensation cost equal to the greater of the following:

a. The grant-date fair value of the original equity award
b. The fair value of the modified liability award when it is settled.

718-20-55-127 To the extent that the recognized fair value of the modified liability award is less than the recognized compensation cost associated with the grant-date fair value of the original equity award, changes in that liability award’s fair value through its settlement do not affect the amount of compensation cost recognized. To the extent that the fair value of the modified liability award exceeds the recognized compensation cost associated with the grant-date fair value of the original equity award, changes in the liability award’s fair value are recognized as compensation cost.

718-20-55-128 At December 31, 20X6, the fair value of the modified award is assumed to be $25 per share option; hence, the modified award’s fair value is $20,535,150 (821,406 × $25), and the corresponding liability at that date is $13,690,100 ($20,535,150 × 2/3) because two-thirds of the requisite service period has been rendered. The increase in the fair value of the liability award is $11,773,486 ($13,690,100 – $1,916,614). Before any adjustments for 20X6, the amount of remaining additional paid-in capital attributable to compensation cost recognized in 20X5 is $2,105,537 ($4,022,151 – $1,916,614). The cumulative compensation cost at December 31, 20X6, associated with the grant-date fair value of the original equity award is $8,044,302 ($4,022,151 × 2). Entity T would record the following journal entries for 20X6.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation cost</td>
<td>$9,667,949</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>$2,105,537</td>
</tr>
<tr>
<td>Share-based compensation liability</td>
<td>$11,773,486</td>
</tr>
</tbody>
</table>

To increase the share-based compensation liability to $13,690,100 and recognize compensation cost of $9,667,949 ($13,690,100 – $4,022,151).

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax asset</td>
<td>$3,383,782</td>
</tr>
<tr>
<td>Deferred tax benefit</td>
<td>$3,383,782</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for additional compensation cost ($9,667,949 × .35 = $3,383,782).

718-20-55-129 At December 31, 20X7, the fair value is assumed to be $10 per share option; hence, the modified award’s fair value is $8,214,060 (821,406 × $10), and the corresponding liability for the fully vested award at that date is $8,214,060. The decrease in the fair value of the liability award is $5,476,040 ($8,214,060 – $13,690,100). The cumulative compensation cost as of December 31, 20X7, associated with the grant-date fair value of the original equity award is $12,066,454 (see paragraph 718-20-55-123). Entity T would record the following journal entries for 20X7.

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax asset</td>
<td>$3,383,782</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for additional compensation cost ($9,667,949 × .35 = $3,383,782).
To recognize a share-based compensation liability of $8,214,060, a reduction of compensation cost of $1,623,646 ($13,690,100 – $12,066,454), and additional paid-in capital of $3,852,394 ($12,066,454 – $8,214,060).

Deferred tax expense $568,276
Deferred tax asset $568,276

To reduce the deferred tax asset for the reduction in compensation cost ($1,623,646 × .35 = $568,276).

718-20-55-130 The modified liability award is as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Value of Award</th>
<th>Pretax Cost for Year</th>
<th>Cumulative Pretax Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X5</td>
<td>$12,066,454 (821,406 × $14.69)</td>
<td>$4,022,151 ($12,066,454 ÷ 3)</td>
<td>$4,022,151</td>
</tr>
<tr>
<td>20X6</td>
<td>$20,535,150 (821,406 × $25.00)</td>
<td>$9,667,949 (($20,535,150 × ½) – $4,022,151)</td>
<td>$13,690,100</td>
</tr>
<tr>
<td>20X7</td>
<td>$12,066,454 (821,406 × $14.69)</td>
<td>$12,066,454 ($12,066,454 – $13,690,100)</td>
<td>$12,066,454</td>
</tr>
</tbody>
</table>

718-20-55-131 For simplicity, this Case assumes that all share option holders elected to be paid in cash on the same day, that the liability award’s fair value is $10 per option, and that Entity T has already recognized its income tax expense for the year without regard to the effects of the settlement of the award. In other words, current tax expense and current taxes payable were recognized based on income and deductions before consideration of additional deductions from settlement of the award.

718-20-55-132 The $8,214,060 in cash paid to the employees on the date of settlement is deductible for tax purposes. In the period of settlement, tax return deductions that are less than compensation cost recognized result in a charge to income tax expense. The tax benefit is $2,874,921 ($8,214,060 × .35). Because tax return deductions are less than compensation cost recognized, the entity must write off the deferred tax assets recognized in excess of the tax benefit from the exercise of employee stock options to income tax expense in the income statement. The journal entries to reflect settlement of the share options are as follows.

<table>
<thead>
<tr>
<th>Share-based compensation liability</th>
<th>$8,214,060</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash ($10 × 821,406)</td>
<td>$8,214,060</td>
</tr>
</tbody>
</table>

To recognize the cash paid to settle share options.

Deferred tax expense $4,223,259
Deferred tax asset $4,223,259
To write off deferred tax asset related to compensation cost ($12,066,454 × .35 = $4,223,259).

<table>
<thead>
<tr>
<th>Current taxes payable</th>
<th>Current tax expense</th>
</tr>
</thead>
<tbody>
<tr>
<td>$2,874,921</td>
<td>$2,874,921</td>
</tr>
</tbody>
</table>

To adjust current tax expense and current taxes payable for the tax benefit from deductible compensation cost upon settlement of share options.

718-20-55-133 If instead of requesting cash, employees had held their share options and those options had expired worthless, the share-based compensation liability account would have been eliminated over time with a corresponding increase to additional paid-in capital. Previously recognized compensation cost would not be reversed. Similar to the adjustment for the actual tax deduction described in paragraph 718-20-55-132, all of the deferred tax asset of $4,223,259 would be charged to income tax expense when the share options expire.

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

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

>> Case C: Liability to Equity Modification (Cash-Settled to Share-Settled Stock Appreciation Rights)

718-20-55-135 This Case is based on the facts given in Example 1 (see paragraph 718-30-55-1). Entity T grants cash-settled stock appreciation rights to its employees. The fair value of the award on January 1, 20X5, is $12,066,454 (821,406 × $14.69) (see paragraph 718-30-55-2).
On December 31, 20X5, the assumed fair value is $10 per stock appreciation right; hence, the fair value of the award at that date is $8,214,060 (821,406 × $10). The share-based compensation liability at December 31, 20X5, is $2,738,020 ($8,214,060 ÷ 3), which reflects the portion of the award related to the requisite service provided in 20X5 (1 year of the 3-year requisite service period). For convenience, this Case assumes that journal entries to account for the award are performed at year-end. The journal entries for 20X5 are as follows.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>Share-based compensation liability</th>
<th>$2,738,020</th>
</tr>
</thead>
</table>

To recognize compensation cost.

<table>
<thead>
<tr>
<th>Deferred tax asset</th>
<th>Deferral tax benefit</th>
<th>$958,307</th>
</tr>
</thead>
</table>

To recognize the deferred tax asset for the temporary difference related to compensation cost ($2,738,020 × .35 = $958,307).

On January 1, 20X6, Entity T modifies the stock appreciation rights by replacing the cash-settlement feature with a net share settlement feature, which converts the award from a liability award to an equity award because Entity T no longer has an obligation to transfer cash to settle the arrangement. Entity T would compare the fair value of the instrument immediately before the modification to the fair value of the modified award and recognize any incremental compensation cost. Because the modification affects no other terms or conditions, the fair value, assumed to be $10 per stock appreciation right, is unchanged by the modification and, therefore, no incremental compensation cost is recognized. The modified award’s total fair value is $8,214,060. The modified award would be accounted for as an equity award from the date of modification with a fair value of $10 per share. Therefore, at the modification date, the entity would reclassify the liability of $2,738,020 recognized on December 31, 20X5, as additional paid-in capital. The related journal entry is as follows.

<table>
<thead>
<tr>
<th>Share-based compensation liability</th>
<th>$2,738,020</th>
</tr>
</thead>
<tbody>
<tr>
<td>Additional paid-in capital</td>
<td>$2,738,020</td>
</tr>
</tbody>
</table>

To reclassify the award as equity.

Entity T will account for the modified awards as equity going forward following the pattern given in Example 1, Case A (see paragraph 718-20-55-1), recognizing $2,738,020 of compensation cost in each of 20X6 and 20X7, for a cumulative total of $8,214,060.
This Case is based on the facts given in Example 1 (see paragraph 718-30-55-1). Entity T grants stock appreciation rights to its employees. The fair value of the award on January 1, 20X5, is $12,066,454 ($821,406 × $14.69).

On December 31, 20X5, the fair value of each stock appreciation right is assumed to be $5; therefore, the fair value of the award is $4,107,030 ($821,406 × $5). The share-based compensation liability at December 31, 20X5, is $1,369,010 ($4,107,030 ÷ 3), which reflects the portion of the award related to the requisite service provided in 20X5 (1 year of the 3-year requisite service period). For convenience, this Case assumes that journal entries to account for the award are performed at year-end. The journal entries to recognize compensation cost for 20X5 are as follows.

| Compensation cost | $1,369,010 |
| Share-based compensation liability | $1,369,010 |

To recognize compensation cost.

Deferred tax asset | $479,154  
Deferred tax benefit | $479,154

To recognize the deferred tax asset for the temporary difference related to compensation cost ($1,369,010 × .35 = $479,154).

On January 1, 20X6, Entity T reprices the stock appreciation rights, giving each holder the right to receive an amount in cash equal to the increase in value of 1 share of Entity T stock over $10. The modification affects no other terms or conditions of the stock appreciation rights and does not change the number of stock appreciation rights expected to vest. The fair value of each stock appreciation right based on its modified terms is $12. The incremental compensation cost is calculated per the method in Example 12 (see paragraph 718-20-55-93).

Fair value of modified stock appreciation right award (821,406 × $12) | $9,856,872  
Less: Fair value of original stock appreciation right (821,406 × $5) | 4,107,030  
Incremental value of modified stock appreciation right | 5,749,842  
Divide by three to reflect earned portion of the award | 1,916,614

Compensation cost to be recognized

Entity T also could determine the incremental value of the modified stock appreciation right award by multiplying the fair value of the modified stock appreciation right award by the portion of the award that is earned and subtracting the cumulative recognized compensation cost [($9,856,872 ÷ 3) – $1,369,010 = $1,916,614]. As a result, Entity T would record the following journal entries at the date of the modification.

| Compensation cost | $1,916,614  
| Share-based compensation liability | $1,916,614
To recognize incremental compensation cost.

<table>
<thead>
<tr>
<th>Deferred tax asset</th>
<th>$670,815</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax benefit</td>
<td>$670,815</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for the temporary difference related to additional compensation cost ($1,916,614 × .35 = $670,815).

718-20-55-143 Entity T would continue to remeasure the liability award at each reporting date until the award’s settlement.

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

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

Amendments to Subtopic 718-30

28. Amend paragraph 718-30-05-1, with a link to transition paragraph 718-10-65-11, as follows:

Compensation—Stock Compensation—Awards Classified as Liabilities

Overview and Background

718-30-05-1 Share-based payment awards to employees may be classified as either equity or liabilities. This Subtopic addresses instruments classified as liabilities. It is closely intertwined with Subtopic 718-10, which contains guidance applicable to instruments classified as either equity or liabilities issued in share-based payment transactions. It may also be necessary in some cases to refer to the guidance contained in Subtopic 718-20.

29. Amend paragraphs 718-30-15-2, 718-30-30-1, and 718-30-35-1 through 35-3, with a link to transition paragraph 718-10-65-11, as follows:

Scope and Scope Exceptions

> Transactions

718-30-15-2 The guidance in this Subtopic applies to share-based payment awards with employees that are classified as liabilities by the employer-grantor (see paragraphs 718-10-25-6 through 25-1925-19A for a description of what is classified as liability).

Initial Measurement

> Measurement Objective and Measurement Date

> > Public Entity

718-30-30-1 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 718-10-30-6. However, the measurement date for liability instruments is the date of settlement.

Nonpublic Entity

[Note: Paragraphs 718-30-30-2 through 30-2A are amended in Issue 3. They are shown here for context.]

718-30-30-2 A nonpublic entity shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements (for employee and nonemployee awards) at fair value or to measure all such liabilities at intrinsic value. Consistent with the guidance in paragraph 718-10-30-20, a nonpublic 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 (see Examples 8 through 9 [paragraphs 718-20-55-71 through 55-83]).

718-30-30-2A A nonpublic entity shall make the accounting policy election in paragraph 718-30-30-2 to change its measurement of all liability-classified employee awards from fair value to intrinsic value upon adoption of the amendments in Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting in accordance with the transition provisions in paragraph 718-10-65-10. Those transition provisions do not require a nonpublic entity to evaluate whether the change in accounting policy is preferable under Topic 250 on accounting changes and error corrections.

Editor's Note: Paragraph 718-30-30-2A will be deleted after the effective date for Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.

Subsequent Measurement

Measurement

718-30-35-1 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.

718-30-35-2 Changes in the fair value (or intrinsic value for a nonpublic entity that elects that method) of a liability incurred under a share-based payment arrangement that occur during the employee's requisite service period or the
nonemployee’s vesting 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 for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award at that date. Changes in the fair value (or intrinsic value) of a liability that occur after the end of the employee’s requisite service period or the nonemployee’s vesting period are compensation cost 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 Subtopic is an adjustment of compensation cost in the period of settlement. Example 1 (see paragraph 718-30-55-1) provides an illustration of accounting for a liability award from the grant date through its settlement.

> > Public Entity

718-30-35-3 A public entity shall measure a liability award under a share-based payment arrangement based on the award’s fair value remeasured at each reporting date until the date of settlement. 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 for an employee award or the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award at the reporting date) in the fair value of the instrument for each reporting period. Example 1 (see paragraph 718-30-55-1) provides an illustration of accounting for an instrument classified as a liability using the fair-value-based method.

30. Add paragraphs 718-30-55-1A through 55-1B and 718-30-55-12A through 55-12B, with a link to transition paragraph 718-10-65-11, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Cash-Settled Stock Appreciation Right

718-30-55-1 This Example illustrates the guidance in paragraphs 718-30-35-2 through 35-4 and 718-740-25-2 through 25-4.

718-30-55-1A This Example (see paragraphs 718-30-55-2 through 55-11) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, the concepts about valuation and forfeiture estimation and remeasurement of awards, exercise, and expiration in paragraphs 718-30-55-2
through 55-11 are equally applicable to nonemployee awards with the same features as the awards in this Example (that is, awards with a specified period of time for vesting classified as liabilities). Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

718-30-55-1B Compensation cost attribution for awards to nonemployees may be the same or different for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

718-30-55-2 Entity T, a public entity, grants share appreciation rights with the same terms and conditions as those described in Example 1 (see paragraph 718-20-55-4). As in Example 1, Case A, Entity T makes an accounting policy election in accordance with paragraph 718-10-35-3 to estimate the number of forfeitures expected to occur and includes that estimate in its initial accrual of compensation costs. Each stock appreciation right entitles the holder to receive an amount in cash equal to the increase in value of 1 share of Entity T stock over $30. Entity T determines the grant-date fair value of each stock appreciation right in the same manner as a share option and uses the same assumptions and option-pricing model used to estimate the fair value of the share options in that Example; consequently, the grant-date fair value of each stock appreciation right is $14.69 (see paragraphs 718-20-55-7 through 55-9). The awards cliff-vest at the end of three years of service (an explicit and requisite service period of three years). The number of stock appreciation rights for which the requisite service is expected to be rendered is estimated at the grant date to be 821,406 (900,000 × .973). Thus, the fair value of the award as of January 1, 20X5, is $12,066,454 (821,406 × $14.69). For simplicity, this Example assumes that estimated forfeitures equal actual forfeitures.

718-30-55-3 Paragraph 718-30-35-4 permits a nonpublic entity to measure share-based payment liabilities at either fair value (or, in some cases, calculated value) or intrinsic value. If a nonpublic entity elects to measure those liabilities at fair value, the accounting demonstrated in this Example would be applicable. Paragraph 718-30-35-3 requires that share-based compensation liabilities be recognized at fair value or a portion thereof (depending on the percentage of requisite service rendered at the reporting date) and be remeasured at each reporting date through the date of settlement; consequently, compensation cost recognized during each year of the three-year vesting period (as well as during each year thereafter through the date of settlement) will vary based on changes in the award’s fair value. As of December 31, 20X5, the assumed fair value is $10 per stock appreciation right; hence, the fair value of the award is $8,214,060 (821,406 × $10). The share-based compensation liability as of December 31,
20X5, is $2,738,020 ($8,214,060 ÷ 3) to account for the portion of the award related to the service rendered in 20X5 (1 year of the 3-year requisite service period). For convenience, this Example assumes that journal entries to account for the award are performed at year-end. The journal entries for 20X5 are as follows.

**Compensation cost**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share-based compensation liability</td>
<td>$2,738,020</td>
</tr>
</tbody>
</table>

To recognize compensation cost.

**Deferred tax asset**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax benefit</td>
<td>$958,307</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for the temporary difference related to compensation cost ($2,738,020 × .35 = $958,307).

**718-30-55-4** As of December 31, 20X6, the fair value is assumed to be $25 per stock appreciation right; hence, the award’s fair value is $20,535,150 (821,406 × $25), and the corresponding liability at that date is $13,690,100 ($20,535,150 × 2/3) because service has been provided for 2 years of the 3-year requisite service period. Compensation cost recognized for the award in 20X6 is $10,952,080 ($13,690,100 – $2,738,020). Entity T recognizes the following journal entries for 20X6.

**Compensation cost**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share-based compensation liability</td>
<td>$10,952,080</td>
</tr>
</tbody>
</table>

To recognize a share-based compensation liability of $13,690,100 and associated compensation cost.

**Deferred tax asset**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deferred tax benefit</td>
<td>$3,833,228</td>
</tr>
</tbody>
</table>

To recognize the deferred tax asset for additional compensation cost ($10,952,080 × .35 = $3,833,228).

**718-30-55-5** As of December 31, 20X7, the fair value is assumed to be $20 per stock appreciation right; hence, the award’s fair value is $16,428,120 (821,406 × $20), and the corresponding liability at that date is $16,428,120 ($16,428,120 × 1) because the award is fully vested. Compensation cost recognized for the liability award in 20X7 is $2,738,020 ($16,428,120 – $13,690,100). Entity T recognizes the following journal entries for 20X7.

**Compensation cost**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share-based compensation liability</td>
<td>$2,738,020</td>
</tr>
</tbody>
</table>

To recognize a share-based compensation liability of $16,428,120 and associated compensation cost.
To recognize the deferred tax asset for additional compensation cost ($2,738,020 × .35 = $958,307).

**718-30-55-6** The share-based liability award is as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Value of Award at Year-End</th>
<th>Pretax Cost for Year</th>
<th>Cumulative Pretax Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X5</td>
<td>$8,214,060 (821,406 × $10)</td>
<td>$2,738,020 ($8,214,060 ÷ 3)</td>
<td>$2,738,020</td>
</tr>
<tr>
<td>20X6</td>
<td>$20,535,150 (821,406 × $25)</td>
<td>$10,952,080 ($20,535,150 × 5%) – $2,738,020</td>
<td>$13,690,100</td>
</tr>
<tr>
<td>20X7</td>
<td>$16,428,120 (821,406 × $20)</td>
<td>$2,738,020 ($16,428,120 – 513,690,100)</td>
<td>$16,428,120</td>
</tr>
</tbody>
</table>

**718-30-55-7** For simplicity, this Example assumes that all of the stock appreciation rights are exercised on the same day, that the liability award’s fair value is $20 per stock appreciation right, and that Entity T has already recognized its income tax expense for the year without regard to the effects of the exercise of the employee stock appreciation rights. In other words, current tax expense and current taxes payable were recognized based on taxable income and deductions before consideration of additional deductions from exercise of the stock appreciation rights. The amount credited to cash for the exercise of the stock appreciation rights is equal to the share-based compensation liability of $16,428,120.

**718-30-55-8** At exercise the journal entry is as follows.

| Share-based compensation liability | $16,428,120 |
| Cash (821,406 × $20)              | $16,428,120 |

To recognize the cash payment to employees from stock appreciation right exercise.

**718-30-55-9** The cash paid to the employees on the date of exercise is deductible for tax purposes. The tax benefit is $5,749,842 ($16,428,120 × .35).

**718-30-55-10** At exercise the journal entry is as follows.

| Deferred tax expense | $5,749,842 |
| Deferred tax asset   | $5,749,842 |

To write off the deferred tax asset related to the stock appreciation rights.

| Current taxes payable | $5,749,842 |
| Current tax expense   | $5,749,842 |

To adjust current tax expense and current taxes payable to recognize the current tax benefit from deductible compensation cost.

**718-30-55-11** If the stock appreciation rights had expired worthless, the share-based compensation liability account and deferred tax asset account would have been adjusted to zero through the income statement as the award’s fair value decreased.
Example 2: Award Granted by a Nonpublic Entity That Elects the Intrinsic Value Method

718-30-55-12 This Example illustrates the guidance in paragraphs 718-30-35-4 and 718-740-25-2 through 25-4.

718-30-55-12A This Example (see paragraphs 718-30-55-13 through 55-20) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, a nonpublic entity can make the accounting policy election in paragraph 718-30-30-2 to change its measurement of all liability-classified nonemployee awards from fair value to intrinsic value and remeasure those awards each reporting period as illustrated in this Example. Therefore, the guidance in this Example may serve as implementation guidance for similar liability-classified nonemployee awards.

718-30-55-12B Compensation cost attribution for awards to nonemployees may be the same or different for liability-classified employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

718-30-55-13 On January 1, 20X6, Entity W, a nonpublic entity that has chosen the accounting policy of using the intrinsic value method of accounting for share-based payments that are classified as liabilities in accordance with paragraphs 718-30-30-2 and 718-30-35-4, grants 100 cash-settled stock appreciation rights with a 5-year life to each of its 100 employees. Each stock appreciation right entitles the holder to receive an amount in cash equal to the increase in value of 1 share of Entity W's stock over $7. The awards cliff-vest at the end of three years of service (an explicit and requisite service period of three years). For simplicity, the Example assumes that no forfeitures occur during the vesting period and does not reflect the accounting for income tax consequences of the awards.

718-30-55-14 Because of Entity W's accounting policy decision to use intrinsic value, all of its share-based payments that are classified as liabilities are recognized at intrinsic value (or a portion thereof, depending on the percentage of requisite service that has been rendered) at each reporting date through the date of settlement; consequently, the compensation cost recognized in each year of the three-year requisite service period will vary based on changes in the liability award's intrinsic value. As of December 31, 20X6, Entity W stock is valued at $10 per share; hence, the intrinsic value is $3 per stock appreciation right ($10 – $7), and the intrinsic value of the award is $30,000 (10,000 × $3). The compensation cost to be recognized for 20X6 is $10,000 ($30,000 ÷ 3), which corresponds to the service provided in 20X6 (1 year of the 3-year service period). For convenience,
this Example assumes that journal entries to account for the award are performed at year-end. The journal entry for 20X6 is as follows.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>$10,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share-based compensation liability</td>
<td>$10,000</td>
</tr>
</tbody>
</table>

To recognize compensation cost.

718-30-55-15 As of December 31, 20X7, Entity W stock is valued at $8 per share; hence, the intrinsic value is $1 per stock appreciation right ($8 – $7), and the intrinsic value of the award is $10,000 (10,000 × $1). The decrease in the intrinsic value of the award is $20,000 ($10,000 – $30,000). Because services for 2 years of the 3-year service period have been rendered, Entity W must recognize cumulative compensation cost for two-thirds of the intrinsic value of the award, or $6,667 ($10,000 × 2/3); however, Entity W recognized compensation cost of $10,000 in 20X5. Thus, Entity W must recognize an entry in 20X7 to reduce cumulative compensation cost to $6,667.

<table>
<thead>
<tr>
<th>Share-based compensation liability</th>
<th>$3,333</th>
</tr>
</thead>
<tbody>
<tr>
<td>Compensation cost</td>
<td>$3,333</td>
</tr>
</tbody>
</table>

To adjust cumulative compensation cost ($6,667 – $10,000).

718-30-55-16 As of December 31, 20X8, Entity W stock is valued at $15 per share; hence, the intrinsic value is $8 per stock appreciation right ($15 – $7), and the intrinsic value of the award is $80,000 (10,000 × $8). The cumulative compensation cost recognized as of December 31, 20X8, is $80,000 because the award is fully vested. The journal entry for 20X8 is as follows.

<table>
<thead>
<tr>
<th>Compensation cost</th>
<th>$73,333</th>
</tr>
</thead>
<tbody>
<tr>
<td>Share-based compensation liability</td>
<td>$73,333</td>
</tr>
</tbody>
</table>

To recognize compensation cost ($80,000 – $6,667).

718-30-55-17 The share-based liability award at intrinsic value is as follows.

<table>
<thead>
<tr>
<th>Year</th>
<th>Total Value of Award at Year-End</th>
<th>Pretax Cost for Year</th>
<th>Cumulative Pretax Cost</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X6</td>
<td>$30,000 (10,000 × $3)</td>
<td>$10,000 ($30,000 ÷ 3)</td>
<td>$10,000</td>
</tr>
<tr>
<td>20X7</td>
<td>$10,000 (10,000 × $1)</td>
<td>$(3,333) [(10,000 × 1/3) – $10,000]</td>
<td>$6,667</td>
</tr>
<tr>
<td>20X8</td>
<td>$80,000 (10,000 × $8)</td>
<td>$73,333 ($80,000 – $6,667)</td>
<td>$80,000</td>
</tr>
</tbody>
</table>

718-30-55-18 For simplicity, this Example assumes that all of the stock appreciation rights are settled on the day that they vest, December 31, 20X8, when the share price is $15 and the intrinsic value is $8 per share. The cash paid to settle the stock appreciation rights is equal to the share-based compensation liability of $80,000.

718-30-55-19 At exercise the journal entry is as follows.
To recognize the cash payment to employees for settlement of stock appreciation rights.

718-30-55-20 If the stock appreciation rights had not been settled, Entity W would continue to remeasure those remaining awards at intrinsic value at each reporting date through the date they are exercised or otherwise settled.

Amendments to Subtopic 718-50

31. Amend paragraph 718-50-30-1, with a link to transition paragraph 718-10-65-11, as follows:

Compensation—Stock Compensation—Employee Share Purchase Plans

Initial Measurement

718-50-30-1 Paragraph 718-10-30-6 states that the objective of 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 providing goods or rendering services. Estimating the fair value of equity instruments at the grant date, which are issued in exchange for employee services, also applies to the fair value measurements associated with grants under a compensatory employee share purchase plan and is the basis for the approach described in Example 1, Case A (see paragraph 718-50-55-10).

Amendments to Subtopic 718-740

32. Amend paragraphs 718-740-15-2, 718-740-25-1, and 718-740-45-8 and its related heading, with a link to transition paragraph 718-10-65-11, as follows:

Compensation—Stock Compensation—Income Taxes

Scope and Scope Exceptions

> Transactions
718-740-15-2 The guidance in this Subtopic applies to share-based payment transactions with both employees and nonemployees.

**Recognition**

> Determination of Temporary Differences

718-740-25-1 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 718-10-25-7 through 25-1925-19A. Incremental guidance is also provided for issues related to employee stock ownership plans.

**Other Presentation Matters**

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

718-740-45-8 An income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employeesgrantees for any of the following equity classified awards shall be recognized as income tax expense or benefit in the income statement:

- Nonvested equity shares
- Nonvested equity share units
- Outstanding equity share options.

**Amendments to Subtopic 805-30**

33. Amend paragraphs 805-30-30-7, 805-30-30-9 and its related heading, 805-30-30-11 through 30-13, and 805-30-35-3, with a link to transition paragraph 718-10-65-11, as follows:

**Business Combinations—Goodwill or Gain from Bargain Purchase, Including Consideration Transferred**

**Initial Measurement**

> Consideration Transferred

805-30-30-7 The consideration transferred in a business combination shall be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer, the liabilities incurred by the acquirer to former owners of the acquiree, and the equity interests issued by the acquirer. (However, any portion of the acquirer’s share-based payment awards exchanged for awards held by the acquiree’s employeesgrantees that is included in consideration transferred in the business combination shall be measured in
accordance with paragraph 805-20-30-21 rather than at fair value.) Examples of potential forms of consideration include the following:

a. Cash 
b. Other assets 
c. A business or a subsidiary of the acquirer 
d. Contingent consideration (see paragraphs 805-30-25-5 through 25-7) 
e. Common or preferred equity instruments 
f. Options 
g. Warrants 
h. Member interests of mutual entities.

> > Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Acquiree’s EmployeesGrantees

805-30-30-9 An acquirer may exchange its share-based payment awards for awards held by employeesgrantees of the acquiree. This Topic refers to such awards as replacement awards. Exchanges of share options or other share-based payment awards in conjunction with a business combination are modifications of share-based payment awards in accordance with Topic 718. If the acquirer is obligated to replace the acquiree awards, either all or a portion of the fair-value-based measure of the acquirer’s replacement awards shall be included in measuring the consideration transferred in the business combination. The acquirer is obligated to replace the acquiree awards if the acquiree or its employeesgrantees have the ability to enforce replacement. For example, for purposes of applying this requirement, the acquirer is obligated to replace the acquiree’s awards if replacement is required by any of the following:

a. The terms of the acquisition agreement 
b. The terms of the acquiree’s awards 
c. Applicable laws or regulations.

805-30-30-10 In situations in which acquiree awards would expire as a consequence of a business combination and the acquirer replaces those awards even though it is not obligated to do so, all of the fair-value-based measure of the replacement awards shall be recognized as compensation cost in the postcombination financial statements. That is, none of the fair-value-based measure of those awards shall be included in measuring the consideration transferred in the business combination.

805-30-30-11 To determine the portion of a replacement award that is part of the consideration transferred for the acquiree, the acquirer shall measure both the replacement awards granted by the acquirer and the acquiree awards as of the acquisition date in accordance with Topic 718. The portion of the fair-value-based measure of the replacement award that is part of the consideration transferred in exchange for the acquiree equals the portion of the acquiree award that is attributable to precombination vestingservice.
805-30-30-12 The acquirer shall attribute a portion of a replacement award to postcombination vesting service if it requires postcombination vesting service, regardless of whether employees grantees had rendered all of the service or delivered all of the goods required in exchange for their acquiree awards before the acquisition date. The portion of a nonvested replacement award attributable to postcombination vesting service equals the total fair-value-based measure of the replacement award less the amount attributed to precombination vesting service. Therefore, the acquirer shall attribute any excess of the fair-value-based measure of the replacement award over the fair value of the acquiree award to postcombination vesting service.

805-30-30-13 Paragraphs 805-30-55-6 through 55-13, 805-740-25-10 through 25-11, 805-740-45-5 through 45-6, and Example 2 (see paragraph 805-30-55-17) provide additional guidance and illustrations on distinguishing between the portion of a replacement award that is attributable to precombination vesting service, which the acquirer includes in the consideration transferred in the business combination, and the portion that is attributed to postcombination vesting service, which the acquirer recognizes as compensation cost in its postcombination financial statements.

Subsequent Measurement

> Replacement Share-Based Payment Awards

805-30-35-3 Topic 718 provides guidance on subsequent measurement and accounting for the portion of replacement share-based payment awards issued by an acquirer that is attributable to employees’ future goods or services.

34. Amend paragraphs 805-30-55-7 through 55-13 and their related heading and 805-30-55-17 through 55-24 and their related headings and add paragraphs 805-30-55-9A and 805-30-55-25 through 55-35 and their related headings, with a link to transition paragraph 718-10-65-11, as follows:

Implementation Guidance and Illustrations

> Implementation Guidance

> > Acquirer Share-Based Payment Awards Exchanged for Awards Held by the Employees Grantees of the Acquiree

805-30-55-6 If the acquirer is obligated to replace the acquiree’s share-based payment awards, paragraph 805-30-30-9 requires the acquirer to include either all or a portion of the fair-value-based measure of the replacement awards in the consideration transferred in the business combination. Paragraphs 805-30-55-7 through 55-13, 805-740-25-10 through 25-11, 805-740-45-5 through 45-6, and Example 2 (see paragraph 805-30-55-17) provide additional guidance on and illustrate how to determine the portion of an award to include in consideration
transferred in a business combination and the portion to recognize as compensation cost in the acquiree’s postcombination financial statements.

805-30-55-7 To determine the portion of a replacement award that is part of the consideration exchanged for the acquiree and the portion that is compensation for postcombination vesting service, the acquirer first measures both the replacement awards and the acquiree awards as of the acquisition date in accordance with the requirements of Topic 718. In most situations, those requirements result in use of the fair-value-based measurement method, but that Topic permits use of the calculated value method or the intrinsic value method in specified circumstances. This discussion focuses on the fair-value-based method, but the guidance in paragraphs 805-30-30-9 through 30-13 and the additional guidance cited in the preceding paragraph also apply in situations in which Topic 718 permits use of either the calculated value method or the intrinsic value method for both the acquiree awards and the replacement awards.

805-30-55-8 The portion of the employee replacement award attributable to precombination vesting service is the fair-value-based measure of the acquiree award multiplied by the ratio of the precombination employee’s service period to the greater of the total service period or the original service period of the acquiree award. (Example 2, Cases C and D [see paragraphs 805-30-55-21 through 55-24] illustrate that calculation.) The total service period is the sum of the following amounts:

a. The part of the employee’s requisite service period for the acquiree award that was completed before the acquisition date
b. The postcombination employee’s requisite service period, if any, for the replacement award.

805-30-55-9 The employee’s requisite service period includes explicit, implicit, and derived service periods during which employees are required to provide service in exchange for the award (consistent with the requirements of Topic 718).

805-30-55-9A The portion of a nonemployee replacement award attributable to precombination vesting is based on the fair-value-based measure of the acquiree award multiplied by the percentage that would have been recognized had the grantor paid cash for the goods or services instead of paying with a nonemployee award. For this calculation, the percentage that would have been recognized is the lower of:

a. The percentage that would have been recognized calculated on the basis of the original vesting requirements of the nonemployee award
b. The percentage that would have been recognized calculated on the basis of the effective vesting requirements. Effective vesting requirements are equal to the services or goods provided before the acquisition date plus any additional postcombination services or goods required by the replacement award.
The portion of a nonvested replacement award (for employee and nonemployee) attributable to postcombination vesting service, and therefore recognized as compensation cost in the postcombination financial statements, equals the total fair-value-based measure of the replacement award less the amount attributed to precombination vesting service. Therefore, the acquirer attributes any excess of the fair-value-based measure of the replacement award over the fair value of the acquiree award to postcombination vesting service and recognizes that excess as compensation cost in the postcombination financial statements.

Regardless of the accounting policy elected in accordance with paragraph 718-10-35-1D or 718-10-35-3, the portion of a nonvested replacement award included in consideration transferred shall reflect the acquirer’s estimate of the number of replacement awards for which the requisite service is expected to be rendered or the goods are expected to be delivered (that is, an acquirer that has elected an accounting policy to recognize forfeitures as they occur in accordance with paragraph 718-10-35-1D or 718-10-35-3 should estimate the number of replacement awards for which the requisite service is expected to be rendered or the goods are expected to be delivered when determining the portion of a nonvested replacement award included in consideration transferred). For example, if the fair-value-based measure of the portion of a replacement award attributed to precombination vesting service is $100 and the acquirer expects that the requisite service will be rendered for only 95 percent of the instruments awarded, the amount included in consideration transferred in the business combination is $95. Changes in the number of replacement awards for which the requisite service is expected to be rendered or the goods are expected to be delivered are reflected in compensation cost for the periods in which the changes or forfeitures occur—not as adjustments to the consideration transferred in the business combination. If an acquirer’s accounting policy is to account for forfeitures as they occur, the amount excluded from consideration transferred (because the requisite service is not expected to be rendered or the goods are not expected to be delivered) should be attributed to the postcombination vesting service and recognized in compensation cost over the employee’s requisite service period or the nonemployee’s vesting period. Recognition of compensation cost for nonemployees should consider the recognition guidance provided in paragraph 718-10-25-2C. That is, recognition of the fair value of the nonemployee share-based payment award should be recognized in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the share-based payment awards.

Similarly, the effects of other events, such as modifications or the ultimate outcome of awards with performance conditions, that occur after the acquisition date are accounted for in accordance with Topic 718 in determining compensation cost for the period in which an event occurs. If the replacement award for an employee award has a graded vesting schedule, the acquirer shall
recognize the related compensation cost in accordance with its policy election for other awards with graded vesting in accordance with paragraph 718-10-35-8.

805-30-55-13 The same requirements for determining the portions of a replacement award attributable to precombination and postcombination vestingservice apply regardless of whether a replacement award is classified as a liability or an equity instrument in accordance with the provisions of paragraphs 718-10-25-6 through 25-4925-19A. All changes in the fair-value-based measure of awards classified as liabilities after the acquisition date and the related income tax effects are recognized in the acquirer’s postcombination financial statements in the period(s) in which the changes occur.

> Illustrations

> > Example 2: Acquirer Replacement of Employee Awards

805-30-55-17 The following Cases illustrate the guidance referred to in paragraph 805-30-55-6 for replacement awards that the acquirer was obligated to issue. The Cases assume that all awards are classified as equity and that the awards have only an explicit service period. As discussed in paragraphs 805-30-55-8 through 55-9, the acquirer also must take any implicit or derived employee’s service periods into account in determining the employee’s requisite service period for a replacement award. In these Cases, the acquiring entity is referred to as Acquirer and the acquiree is referred to as Target:

a. Awards that require no postcombination vestingservice that are exchanged for acquiree awards for which employees:
   1. Have rendered the required service as of the acquisition date (Case A)
   2. Have not rendered all of the required service as of the acquisition date (Case D).

b. Awards that require postcombination vestingservice that are exchanged for acquiree awards for which employees:
   1. Have rendered the required service as of the acquisition date (Case B)
   2. Have not rendered all of the required service as of the acquisition date (Case C).

> > > Case A: No Required Postcombination VestingService, All Requisite Service for Acquiree Awards Rendered as of Acquisition Date

805-30-55-18 Acquirer issues replacement awards of $110 (fair-value-based measure) at the acquisition date for Target awards of $100 (fair-value-based measure) at the acquisition date. No postcombination vestingservice are required for the replacement awards, and Target’s employees had rendered all of the required service for the acquiree awards as of the acquisition date.

805-30-55-19 The amount attributable to precombination vestingservice is the fair-value-based measure of Target’s awards ($100) at the acquisition date; that
amount is included in the consideration transferred in the business combination. The amount attributable to postcombination vesting service is $10, which is the difference between the total value of the replacement awards ($110) and the portion attributable to precombination vesting service ($100). Because no postcombination vesting service is required for the replacement awards, Acquirer immediately recognizes $10 as compensation cost in its postcombination financial statements.

> > > Case B: Postcombination Vesting Service Required, All Requisite Service for Acquiree Awards Rendered as of Acquisition Date

805-30-55-20 Acquirer exchanges replacement awards that require one year of postcombination vesting service for share-based payment awards of Target for which employees had completed the requisite service period before the business combination. The fair-value-based measure of both awards is $100 at the acquisition date. When originally granted, Target's awards had a requisite service period of four years. As of the acquisition date, the Target employees holding unexercised awards had rendered a total of seven years of service since the grant date. Even though Target employees had already rendered all of the requisite service, Acquirer attributes a portion of the replacement award to postcombination compensation cost in accordance with paragraphs 805-30-30-12 through 30-13 because the replacement awards require one year of postcombination vesting service. The total service period is five years—the requisite service period for the original acquiree award completed before the acquisition date (four years) plus the requisite service period for the replacement award (one year). The portion attributable to precombination vesting service equals the fair-value-based measure of the acquiree award ($100) multiplied by the ratio of the precombination vesting service period (4 years) to the total service period (5 years). Thus, $80 ($100 × 4 ÷ 5 years) is attributed to the precombination vesting service period and therefore included in the consideration transferred in the business combination. The remaining $20 is attributed to the postcombination vesting service period and therefore is recognized as compensation cost in Acquirer's postcombination financial statements in accordance with Topic 718.

> > > Case C: Postcombination Vesting Service Required, All Requisite Service for Acquiree Awards Not Rendered as of Acquisition Date

805-30-55-21 Acquirer exchanges replacement awards that require one year of postcombination vesting service for share-based payment awards of Target for which employees had not yet rendered all of the required services as of the acquisition date. The fair-value-based measure of both awards is $100 at the acquisition date. When originally granted, the awards of Target had a requisite service period of four years. As of the acquisition date, the Target employees had rendered two years' service, and they would have been required to render two additional years of service after the acquisition date for their awards to vest. Accordingly, only a portion of Target's awards is attributable to precombination vesting service.
The replacement awards require only one year of postcombination vesting service. Because employees have already rendered two years of service, the total requisite service period is three years. The portion attributable to precombination vesting services equals the fair-value-based measure of the acquiree award ($100) multiplied by the ratio of the precombination vesting service period (2 years) to the greater of the total service period (3 years) or the original service period of Target’s award (4 years). Thus, $50 ($100 × 2 ÷ 4 years) is attributable to precombination vesting service and therefore included in the consideration transferred for the acquiree. The remaining $50 is attributable to postcombination vesting service and therefore recognized as compensation cost in Acquirer’s postcombination financial statements in accordance with Topic 718.

> > > Case D: No Required Postcombination Vesting Service, All Requisite Service for Acquiree Awards Not Rendered as of Acquisition Date

Assume the same facts as in Case C, except that Acquirer exchanges replacement awards that require no postcombination vesting service for share-based payment awards of Target for which employees had not yet rendered all of the requisite service as of the acquisition date. The terms of the replaced Target awards did not eliminate any remaining requisite service period upon a change in control. (If the Target awards had included a provision that eliminated any remaining requisite service period upon a change in control, the guidance in Case A would apply.) The fair-value-based measure of both awards is $100. Because employees have already rendered two years of service and the replacement awards do not require any postcombination vesting service, the total service period is two years.

The portion of the fair-value-based measure of the replacement awards attributable to precombination vesting services equals the fair-value-based measure of the acquiree award ($100) multiplied by the ratio of the precombination vesting service period (2 years) to the greater of the total service period (2 years) or the original service period of Target’s award (4 years). Thus, $50 ($100 × 2 ÷ 4 years) is attributable to precombination vesting service and therefore included in the consideration transferred for the acquiree. The remaining $50 is attributable to postcombination vesting service. Because no postcombination vesting service is required to vest in the replacement award, Acquirer recognizes the entire $50 immediately as compensation cost in the postcombination financial statements.

> > Example 3: Acquirer Replacement of Nonemployee Awards

The following Cases illustrate the guidance referred to in paragraph 805-30-55-6 for replacement awards that the acquirer was obligated to issue and the attribution guidance for a nonemployee replacement award to precombination and postcombination vesting referenced in paragraph 805-30-55-9A.

In these Cases, the acquiring entity is referred to as Acquirer and the acquiree is referred to as Target.
a. Awards that require no postcombination vesting that are exchanged for acquiree awards for which grantees:
   1. Have met the vesting condition as of the acquisition date (Case A)
   2. Have not met the vesting condition as of the acquisition date (Case D).

b. Awards that require postcombination vesting that are exchanged for acquiree awards for which grantees:
   1. Have met the vesting condition as of the acquisition date (Case B)
   2. Have not met the vesting condition as of the acquisition date (Case C).

805-30-55-27 The Cases assume the following:

a. All awards are classified as equity.
b. The only vesting condition included in the awards, if any, involves the delivery of engines.
c. Target and Acquirer typically pay cash as each engine is delivered to their suppliers.

> > > Case A: No Required Postcombination Vesting and the Vesting Condition for Acquiree Awards Has Been Met as of Acquisition Date

805-30-55-28 Acquirer issues replacement awards of $110 (fair-value-based measure) at the acquisition date for Target awards of $100 (fair-value-based measure) at the acquisition date. No postcombination vesting is required for the replacement awards, and Target’s grantee has delivered all the engines necessary for the acquiree awards as of the acquisition date.

805-30-55-29 The amount attributable to precombination vesting is the fair-value-based measure of Target’s awards ($100) at the acquisition date; that amount is included in the consideration transferred in the business combination. The amount attributable to postcombination vesting is $10, which is the difference between the total value of the replacement awards ($110) and the portion attributable to precombination vesting ($100). Because no postcombination vesting is required for the replacement awards, Acquirer immediately recognizes $10 as compensation cost in its postcombination financial statements.

> > > Case B: Postcombination Vesting Required and the Vesting Condition for Acquiree Awards Has Been Met as of Acquisition Date

805-30-55-30 Acquirer exchanges replacement awards that require the delivery of another 10 engines postcombination for share-based payment awards of Target for which the grantee had met the necessary vesting condition to deliver 40 engines before the business combination. The fair-value-based measure of both awards is $100 at the acquisition date. Even though the grantee already had met the vesting condition for the acquiree’s award, Acquirer attributes a portion of the replacement award to postcombination compensation cost in accordance with
paragraphs 805-30-30-12 through 30-13 because the replacement awards require the delivery of an additional 10 engines.

805-30-55-31 The portion attributable to precombination vesting equals the fair-value-based measure of the acquiree award ($100) multiplied by the percentage that would have been recognized for the award. The percentage that would have been recognized is the lower of the calculation on the basis of the original vesting requirements and the percentage that would have been recognized on the basis of the effective vesting requirements as described in paragraph 805-30-55-9A. The percentage that would have been recognized on the basis of the original vesting requirements equals 100 percent, which is calculated as 40 engines delivered divided by 40 engines required to be delivered. The percentage that would have been recognized on the basis of the effective vesting requirements equals 80 percent, which is calculated as 40 engines delivered divided by 50 engines (the sum of 40 engines delivered plus 10 engines required postcombination). Thus, $80 ($100 \times 80\%) is attributed to the precombination vesting period and therefore is included in the consideration transferred in the business combination. The remaining $20 is attributed to the postcombination vesting period and therefore is recognized as compensation cost in Acquirer’s postcombination financial statements in accordance with Topic 718.

> > > Case C: Postcombination Vesting Required and the Vesting Condition for Acquiree Awards Has Not Been Met as of Acquisition Date

805-30-55-32 Acquirer exchanges replacement awards that require the delivery of 10 engines postcombination for share-based payment awards of Target for which the grantee had not met the necessary vesting condition to deliver 40 engines before the business combination. The fair-value-based measure of both awards is $100 at the acquisition date. As of the acquisition date, Target grantee has delivered 20 engines, and Target grantee would have been required to deliver an additional 20 engines after the acquisition date for its awards to vest. Accordingly, only a portion of Target’s awards is attributable to precombination vesting.

805-30-55-33 The portion attributable to precombination vesting equals the fair-value-based measure of the acquiree award ($100) multiplied by the percentage that would have been recognized on the award. The percentage that would have been recognized is the lower of the percentage that would have been recognized on the basis of the original vesting requirements and the percentage that would have been recognized on the basis of the effective vesting requirements as described in paragraph 805-30-55-9A. The percentage that would have been recognized on the basis of the original vesting requirements equals 50 percent, which is calculated as 20 engines delivered divided by 40 engines required to be delivered. The percentage that would have been recognized on the basis of the effective vesting requirements equals 66.67 percent, which is calculated as 20 engines delivered divided by 30 engines (the sum of 20 engines delivered plus 10 engines required postcombination). Thus, $50 ($100 \times 50\%) is attributed to precombination vesting and therefore is included in the consideration transferred...
in the business combination. The remaining $50 is attributed to the postcombination vesting and therefore is recognized as compensation cost in Acquirer’s postcombination financial statements in accordance with Topic 718.

Case D: No Postcombination Vesting Required and the Vesting Condition for Acquiree Awards Has Not Been Met as of Acquisition Date

Assume the same facts as in Case C, except that Acquirer exchanges replacement awards that require no postcombination vesting for share-based payment awards of Target for which the grantee had not met the necessary vesting condition to deliver 40 engines before the business combination. The terms of the replaced Target awards did not eliminate the vesting condition upon a change in control. (If the Target awards had included a provision that eliminated the vesting condition upon a change in control, the guidance in Case A [see paragraph 805-30-55-28] would apply.) The fair-value-based measure of both awards is $100.

The portion attributable to precombination vesting equals the fair-value-based measure of the acquiree award ($100) multiplied by the percentage that would have been recognized on the award. The percentage that would have been recognized is the lower of the percentage that would have been recognized on the basis of the original vesting requirements and the percentage that would have been recognized on the basis of the effective vesting requirements as described in paragraph 805-30-55-9A. The percentage that would have been recognized on the basis of the original vesting requirements equals 50 percent, which is calculated as 20 engines delivered divided by 40 engines required to be delivered. The percentage that would have been recognized on the basis of the effective vesting requirements equals 100 percent, which is calculated as 20 engines delivered divided by 20 engines (the sum of 20 engines delivered plus zero engines required postcombination). Thus, $50 ($100 × 50%) is attributed to the precombination vesting and is therefore included in the consideration transferred in the business combination. The remaining $50 is attributed to the postcombination vesting. Because no postcombination vesting is required to vest in the replacement award, Acquirer recognizes the entire $50 immediately as compensation cost in the postcombination financial statements.

Amendments to Subtopic 805-740

35. Amend paragraphs 805-740-25-10 through 25-11, with a link to transition paragraph 718-10-65-11, as follows:

Business Combinations—Income Taxes
Recognition
>
Replacement Awards Classified as Equity
Paragraph 805-30-30-9 identifies the types of awards that are referred to as replacement awards in the Business Combinations Topic. For a replacement award classified as equity that ordinarily would result in postcombination tax deductions under current tax law, an acquirer shall recognize a deferred tax asset for the deductible temporary difference that relates to the portion of the fair-value-based measure attributed to a precombination employee service exchange of goods or services and therefore included in consideration transferred in the business combination.

Paragraph 805-40-25-11 For a replacement award classified as equity that ordinarily would not result in tax deductions under current tax law, an acquirer shall recognize no deferred tax asset for the portion of the fair-value-based measure attributed to precombination vesting service and thus included in consideration transferred in the business combination. A future event, such as an employee's disqualifying disposition of shares under a tax law, may 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.

Amendments to Subtopic 815-10

36. Amend paragraph 815-10-15-74, with a link to transition paragraph 718-10-65-11, as follows:

Derivatives and Hedging—Overall
Scope and Scope Exceptions

> Instruments

>> Instruments Not within Scope

>>> Certain Contracts Involving an Entity’s Own Equity

Paragraph 815-10-15-74 Notwithstanding the conditions of paragraphs 815-10-15-13 through 15-139, the reporting entity shall not consider the following contracts to be derivative instruments for purposes of this Subtopic:

a. Contracts issued or held by that reporting entity that are both:
   1. Indexed to its own stock
   2. Classified in stockholders’ equity in its statement of financial position.

b. Contracts issued by the entity that are subject to Topic 718 or Subtopic 505-50. If any such contract ceases to be subject to Topic 718 or Subtopic 505-50 in accordance with paragraphs 718-10-35-9 through 35-14, the terms of that contract shall then be analyzed to determine whether the contract is subject to this Subtopic. An award that ceases to be subject to Topic 718 or Subtopic 505-50 in accordance with those paragraphs shall be analyzed to determine whether it is subject to this Subtopic.

c. Any of the following contracts:
1. A contract between an acquirer and a seller to enter into a business combination
2. A contract to enter into an acquisition by a not-for-profit entity
3. A contract between one or more NFPs to enter into a merger of not-for-profit entities.
d. Forward contracts that require settlement by the reporting entity’s delivery of cash in exchange for the acquisition of a fixed number of its equity shares (forward purchase contracts for the reporting entity’s shares that require physical settlement) that are accounted for under paragraphs 480-10-30-3 through 30-5, 480-10-35-3, and 480-10-45-3.

37. Amend paragraphs 815-10-45-10 and its related heading, 815-10-55-43, and 815-10-55-46 through 55-48 and their related heading, add paragraph 815-10-55-48A, and supersede paragraphs 815-10-55-49 through 55-53 and their related heading, with a link to transition paragraph 718-10-65-11, as follows:

Other Presentation Matters

> Income Statement Classification

> > Options Granted to Employees and Nonemployees

815-10-45-10 Subsequent changes in the fair value of an option that was granted to an employee grantee and is subject to or became subject to this Subtopic shall be included in the determination of net income. (See paragraphs 815-10-55-49, 815-10-55-48A, and 815-10-55-54 through 55-55 for discussion of such an option.) Changes in fair value of the option award before vesting shall be characterized as compensation expense in the grantor’s employer’s income statement. Changes in fair value of the option award after vesting may be reflected elsewhere in the grantor’s employer’s income statement.

Implementation Guidance and Illustrations

> Implementation Guidance

> > Scope Application to Certain Contracts

815-10-55-43 This guidance illustrates the application of Section 815-10-15 in the following situations:

a. Contract with payment provision  
b. Credit derivatives  
c. Equity options issued to employees and nonemployees  
d. Subparagraph superseded by Accounting Standards Update No. 2018-07 Equity instruments (including options) issued to nonemployees  
e. Repurchase agreements and wash sales  
f. Short sales (sales of borrowed securities)  
g. Take-or-pay contracts.

> > > Equity Options Issued to Employees and Nonemployees
Some entities issue stock options to their employees in which the underlying shares are stock of an unrelated entity. Consider the following example:

a. Entity A awards an option to an employee.

b. The terms of the option award provide that, if the employee continues to provide services for three years, the employee may exercise the option and purchase one share of common stock of Entity B, a publicly traded entity, for $10 from Entity A.

c. Entity B is unrelated to Entity A and, therefore, is not a subsidiary or accounted for by the equity method.

The option award in this example is not within the scope of Topic 718 because the underlying stock is not an equity instrument of the employer-grantor.

The option award is not subject to Topic 718. Rather, the option award in the above example in paragraph 815-10-55-46 meets the definition of a derivative instrument in this Subtopic and, therefore, should be accounted for by the employer as a derivative instrument under this Subtopic. After vesting, the option award would continue to be accounted for as a derivative instrument under this Subtopic.

Paragraphs 718-10-35-9 through 35-14 contain the concept that equity instruments that are granted in share-based payment transactions may initially be subject to that Subtopic, but after certain events or circumstances, those equity instruments may cease being subject to that Subtopic. The terms of an award that ceases to be subject to Topic 718 in accordance with paragraphs 718-10-35-9 through 35-14 should be analyzed to determine whether the award is subject to this Subtopic. [Content moved from paragraph 815-10-55-50]

Equity Instruments (Including Options) Issued to Nonemployees

Issuer's Accounting

Paragraph superseded by Accounting Standards Update No. 2018-07. For the issuer, equity instruments (including stock options) that are granted to nonemployees as compensation for goods and services in share-based payment transactions are subject to this Subtopic once performance has occurred (as discussed in Subtopic 505-50) and provided that the scope exception in paragraph 815-10-15-74(a) does not apply. From the perspective of the issuer, equity instruments (including stock options) granted to a nonemployee for goods and services in share-based payment transactions are not included in the scope of this Subtopic if performance has not yet occurred. Any equity instrument granted in a share-based payment transaction subject to Subtopic 505-50 for the reporting entity is not considered to be a derivative instrument subject to this Subtopic by that entity during the period that the equity instrument is subject to Subtopic 505-50.
Paragraph superseded by Accounting Standards Update No. 2018-07. Paragraphs 718-10-35-9 through 35-14 contain the concept that equity instruments that are granted in share-based payment transactions may initially be subject to that Subtopic, but after certain events or circumstances, those equity instruments may cease being subject to that Subtopic. The terms of an award that ceases to be subject to Topic 718 in accordance with paragraphs 718-10-35-9 through 35-14 should be analyzed to determine whether the award is subject to this Subtopic. [Content moved to paragraph 815-10-55-48A]

Paragraph superseded by Accounting Standards Update No. 2018-07. Subtopic 505-50 provides guidance for accounting by the issuer for certain share-based compensation arrangements granted to nonemployees for goods and services, including guidance regarding counterparty performance commitments and conditions in share-based payment transactions.

Paragraph superseded by Accounting Standards Update No. 2018-07. Pursuant to paragraph 815-40-15-3(c), the guidance in Subtopic 815-40 applies to contracts issued to acquire goods or services from nonemployees when performance has occurred.

Paragraph superseded by Accounting Standards Update No. 2018-07. Thus, an equity instrument (including a stock option) granted to a nonemployee for goods and services in a share-based payment transaction would typically cease being subject to Subtopic 505-50 after performance has occurred. At that point, the scope exception in paragraph 815-10-15-74(b) would no longer apply. The issuer would then need to determine whether that equity instrument meets the definition of a derivative instrument and is within the scope of this Subtopic by analyzing the terms of the instrument. The scope exception in paragraph 815-10-15-74(a) may apply.

Amendments to Subtopic 815-40


Derivatives and Hedging—Contracts in Entity’s Own Equity

Scope and Scope Exceptions

> Instruments

815-40-15-3 The guidance in this Subtopic does not apply to any of the following:

a. Either the derivative instrument component or the financial instrument if the derivative instrument component is embedded in and not detachable from the financial instrument
b. Contracts that are issued to compensate employees or grantees in a **share-based payment arrangement**

c. Subparagraph superseded by Accounting Standards Update No. 2018-07. Contracts that are issued to acquire goods or services from nonemployees when performance has not yet occurred.

d. A written put option and a purchased call option embedded in the shares of a noncontrolling interest of a consolidated subsidiary if the arrangement is accounted for as a financing under the guidance beginning in paragraph 480-10-55-53.

e. Financial instruments that are within the scope of Topic 480 (see paragraph 815-40-15-12).

> Evaluating Whether an Instrument Is Considered Indexed to an Entity’s Own Stock

**815-40-15-5A** The guidance in this paragraph through paragraph 815-40-15-8 does not apply to share-based payment awards within the scope of Topic 718 for purposes of determining whether instruments are classified as liability awards or equity awards under that Topic. Equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options are not within the scope of Topic 718 themselves. Consequently, the guidance in this paragraph through paragraph 815-40-15-8 applies to such market-based employee share-based payment stock option valuation instruments for purposes of making the determinations described in the preceding paragraph 815-40-15-5.

**Implementation Guidance and Illustrations**

> Implementation Guidance

> > Scope Application

**815-40-55-1** Both of the following are within the scope of this Subtopic includes based on the criteria in paragraph 815-40-15-2: Security price guarantees or other financial instruments indexed to, or otherwise based on, the price of the entity’s stock that are issued in connection with a purchase-business combination and that are accounted for as contingent consideration.

a. Subparagraph superseded by Accounting Standards Update No. 2018-07. Security price guarantees or other financial instruments indexed to, or otherwise based on, the price of the entity’s stock that are issued in connection with a purchase-business combination and that are accounted for as contingent consideration.

b. Subparagraph superseded by Accounting Standards Update No. 2018-07. Contracts issued to acquire goods or services from nonemployees when performance has occurred.

> Illustrations
Example 21: Variability Involving Securities Issued to Establish a Market-Based Measure of Employee Stock Option Value

This Example illustrates the application of the guidance beginning in paragraph 815-40-15-5A. Entity A issues a security to investors for purposes of establishing a market-based measure of the grant-date fair value of a grant of employee stock options issued in a share-based payment transaction. Under the terms of that market-based employee stock option valuation instrument, Entity A is obligated to make variable quarterly payments to the investors that are a function of the net intrinsic value received by a pool of Entity A’s employees each period. The market-based employee stock option valuation instrument has a 10-year term, consistent with the contractual term of the underlying employee stock options. The market-based employee stock option valuation instrument is not considered indexed to Entity A’s own stock based on the following evaluation:

a. Step 1. The analysis of the exercise contingency (or contingencies) depends on the particular terms and features of the instrument. However, as indicated in Step 2 below, a market-based employee stock option valuation instrument would not be considered indexed to the entity’s own stock.

b. Step 2. The settlement amount will not equal the difference between the fair value of a fixed number of the entity’s equity shares and a fixed strike price. The instrument provides for variable quarterly payments to investors that are based on actual employee stock option exercises for the period. Because a variable that affects the instrument’s settlement amount is employee stock option exercise behavior, which is not an input to the fair value of a fixed-for-fixed option or forward contract on equity shares, the instrument is not considered indexed to the entity’s own stock.

Amendments to Subtopic 820-10

39. Amend paragraph 820-10-15-2 and its related pending content, with a link to transition paragraph 718-10-65-11, as follows:

Fair Value Measurement—Overall

Scope and Scope Exceptions

Other Considerations

Topics and Subtopics Not within Scope

820-10-15-2 The Fair Value Measurement Topic does not apply as follows:
a. To accounting principles that address share-based payment transactions (this includes Subtopic 505-50 and all Subtopics in Topic 718 except for 718-40, which is within the scope of Topic 820)
b. To Sections, Subtopics, or Topics that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including both of the following:
   1. Sections, Subtopics, or Topics that permit measurements that are determined on the basis of, or otherwise use, standalone selling price
   2. Topic 330.
c. To accounting principles that address fair value measurements for purposes of lease classification or measurement in accordance with Topic 840. This scope exception does not apply to assets acquired and liabilities assumed in a business combination or an acquisition by a not-for-profit entity that are required to be measured at fair value in accordance with Topic 805, regardless of whether those assets and liabilities are related to leases.
d. To the recognition and measurement of revenue from contracts with customers in accordance with Topic 606
e. To the recognition and measurement of gains and losses upon the derecognition of nonfinancial assets in accordance with Subtopic 610-20.

Pending Content:

Transition Date: (P) December 16, 2018; (N) December 16, 2019 I Transition Guidance: 842-10-65-1

820-10-15-2 The Fair Value Measurement Topic does not apply as follows:

a. To accounting principles that address share-based payment transactions (this includes Subtopic 505-50 and all Subtopics in Topic 718 except for 718-40, which is within the scope of Topic 820)
b. To Sections, Subtopics, or Topics that require or permit measurements that are similar to fair value but that are not intended to measure fair value, including both of the following:
   1. Sections, Subtopics, or Topics that permit measurements that are determined on the basis of, or otherwise use, standalone selling price
   2. Topic 330.
c. Subparagraph superseded by Accounting Standards Update No. 2016-02.
d. To the recognition and measurement of revenue from contracts with customers in accordance with Topic 606
e. To the recognition and measurement of gains and losses upon the
derecognition of nonfinancial assets in accordance with Subtopic 610-20.

Amendments to Subtopic 845-10

40. Amend paragraph 845-10-15-4(c), with a link to transition paragraph 718-10-65-11, as follows:

Nonmonetary Transactions—Overall
Scope and Scope Exceptions

> Transactions

845-10-15-4 The guidance in the Nonmonetary Transactions Topic does not apply to the following transactions:

c. Acquisition of nonmonetary assets goods or services on issuance of the capital stock of an entity under Subtopics 718-10 and 505-50

Transition and Open Effective Date Information

41. Add paragraph 718-10-65-11 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting

718-10-65-11 The following represents the transition and effective date information related to Accounting Standards Update No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting:

a. The pending content that links to this paragraph shall be effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years.

b. The pending content that links to this paragraph shall be effective for all other entities for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

c. Early adoption, including adoption in an interim period, of the pending content that links to this paragraph is permitted for:

1. Public business entities for which financial statements have not yet been issued, but no earlier than the adoption of the pending content that links to paragraph 606-10-65-1

2. All other entities for which financial statements have not yet been made available for issuance, but no earlier than the adoption of the pending content that links to paragraph 606-10-65-1.
If an entity early adopts the pending content that links to this paragraph in an interim period, any adjustments shall be reflected as of the beginning of the fiscal year that includes that interim period.

d. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-12 through 65-14.

e. An entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the pending content that links to this paragraph is adopted. For purposes of determining the cumulative-effect adjustment, an entity shall:

1. Assess only liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established

2. Remeasure awards as defined in (e)(1) at fair value as of the adoption date rather than grant-date fair value

3. Not remeasure assets that are completed. For example, finished goods inventory or equipment that has begun amortization would not be remeasured upon transition.

f. In the first interim period and fiscal year of adoption, an entity shall disclose both of the following:

1. The nature of and reason for the change in accounting principle

2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 2: Aligning Postvesting Classification Requirements

42. Under current GAAP, Subtopic 505-50 requires an entity to initially assess classification of nonemployee share-based payment awards in accordance with Topic 718. However, Subtopic 505-50 requires an entity to reassess the classification of the award under other GAAP (for example, Topic 815 on derivatives and hedging) after the nonemployee share-based payment awards are vested (that is, earned) and no further performance is required. This requirement in Subtopic 505-50 is different from the requirements of Topic 718. Topic 718 states that an entity generally continues to apply the classification provisions of that Topic (that is, the initial classification assessment) to employee awards and does not reassess classification as long as the employee earned the award for employee services and the award is not modified after the holder ceases to be an employee. Because of the difference in the guidance, some nonemployee share-based payment awards initially classified as equity likely have been reclassified to liabilities upon vesting. The amendments to paragraphs 718-10-35-9 through 35-11 and the addition of transition paragraph 718-10-65-12 reflect the Board’s decision to eliminate the subsequent classification differences for employee and
nonemployee awards. It is likely that the classification of some nonemployee awards would not have changed after the awards vested if the changes had been in place at the time those awards did vest. Consequently, application of that change could revert some liability-classified nonemployee awards to equity classification upon adoption.

Amendments to Subtopic 718-10

43. Amend paragraphs 718-10-35-9 through 35-11 and 718-10-35-14 and add paragraph 718-10-35-9A, with a link to transition paragraph 718-10-65-12, as follows:

Compensation—Stock Compensation—Overall

Subsequent Measurement

> Awards May Become Subject to Other Guidance

718-10-35-9 Paragraphs 718-10-35-9 through 35-14 are intended to apply to those instruments issued in share-based payment transactions with employees and nonemployees accounted for under this Topic, 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.

718-10-35-9A A convertible instrument award granted to a nonemployee in exchange 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. Once vested, a convertible instrument award that is equity in form, or debt in form, that can be converted into equity instruments of the grantor, shall follow recognition and measurement through reference to other applicable generally accepted accounting principles (GAAP), including Subtopic 470-20 on debt with conversion and other options.

718-10-35-10 A freestanding financial instrument issued to an employee in exchange for goods past or future employee services received (or to be received) that is subject to initial recognition and measurement guidance within this Topic shall continue to be subject to the recognition and measurement provisions of this Topic throughout the life of the instrument, unless its terms are modified when the holder after a nonemployee vests in the award and is no longer providing goods or services, or a grantee 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.

718-10-35-11 Other modifications of that instrument that take place when the holder after a nonemployee vests in the award and is no longer providing goods or services, or a grantee is no longer an employee shall be subject to the modification guidance in paragraph 718-10-35-14. Following modification, recognition and measurement of the instrument shall be determined through reference to other applicable GAAP.

718-10-35-12 Once the classification of an instrument is determined, the recognition and measurement provisions of this Topic shall be applied until the instrument ceases to be subject to the requirements discussed in paragraph 718-10-35-10. Topic 480 or other applicable GAAP, such as Topic 815, applies to a freestanding financial instrument that was issued under a share-based payment arrangement but that is no longer subject to this Topic. This guidance is not intended to suggest that all freestanding financial instruments shall be accounted for as liabilities pursuant to Topic 480, but rather that freestanding financial instruments issued in share-based payment transactions may become subject to that Topic or other applicable GAAP depending on their substantive characteristics and when certain criteria are met.

718-10-35-13 Paragraph superseded by Accounting Standards Update No. 2016-09.

718-10-35-14 An entity may modify (including cancel and replace) or settle a fully vested, freestanding financial instrument after it becomes subject to Topic 480 or other applicable GAAP. Such a modification or settlement shall be accounted for under the provisions of this Topic unless it applies equally to all financial instruments of the same class regardless of whether the holder of the financial instrument is (or was) an employee (or an employee’s beneficiary). Following the modification, the instrument continues to be accounted for under that Topic or other applicable GAAP. 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 or vendor relationship depending on the terms of the modification or settlement. Thus, such a modification or settlement may be subject to the requirements of this Topic. See paragraph 718-10-35-10 for a discussion of changes to awards made solely to reflect an equity restructuring.
The following represents the transition and effective date information related to Accounting Standards Update No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting:

a. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-11 and 718-10-65-13 through 65-14.

b. An entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the pending content that links to this paragraph is adopted. Upon adoption, an entity shall reevaluate the classification of nonemployee awards initially classified as equity before completion of performance and subsequently reclassified to liabilities upon completion of performance because of other guidance (for example, Topic 815 on derivatives and hedging).

c. For purposes of determining the cumulative-effect adjustment, an entity shall assess unsettled liability-classified awards that were previously classified as equity awards as of the adoption date. If a liability-classified award would have remained equity classified because of the application of the pending content that links to this paragraph, the guidance on the modification of an award from liability classification to equity classification in paragraphs 718-20-55-135 through 55-138 shall be applied.

d. In the first interim period and fiscal year of adoption, an entity shall disclose both of the following:
   1. The nature of and reason for the change in accounting principle
   2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 3: Intrinsic Value

45. The amendments reflect the Board’s decision to allow a nonpublic entity (which is defined in Topic 718 as an entity whose equity securities generally do not trade in a public market) to make an accounting policy election as of the effective date to change the measurement of all liability-classified nonemployee awards
from fair value to intrinsic value without evaluating whether intrinsic value is preferable to fair value.

Amendments to Subtopic 718-30

46. Amend paragraph 718-30-30-2, with a link to transition paragraph 718-10-65-13, as follows:

Compensation—Stock Compensation—Awards Classified as Liabilities

Initial Measurement

> Measurement Objective and Measurement Date

> > Nonpublic Entity

718-30-30-2 A nonpublic entity shall make a policy decision of whether to measure all of its liabilities incurred under share-based payment arrangements (for employee and nonemployee awards) at fair value or to measure all such liabilities at intrinsic value. Consistent with the guidance in paragraph 718-10-30-20, a nonpublic 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 (see Examples 8 through 9 [paragraphs 718-20-55-71 through 55-83]).

47. Amend paragraph 718-30-30-2A, with no additional link to a transition paragraph, as follows:

718-30-30-2A A nonpublic entity shall make the accounting policy election in paragraph 718-30-30-2 to change its measurement of all liability-classified employee awards from fair value to intrinsic value upon adoption of the amendments in Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting in accordance with the transition provisions in paragraph 718-10-65-10. Those transition provisions do A nonpublic entity is not required to evaluate whether the change in accounting policy is preferable under Topic 250 on accounting changes and error corrections.

Editor’s Note: Paragraph 718-30-30-2A will be deleted after the effective date for Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting.
Paragraph superseded by Accounting Standards Update No. 2016-09.

Transition and Open Effective Date Information

48. Add paragraph 718-10-65-13 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting

**718-10-65-13** The following represents the transition and effective date information related to Accounting Standards Update No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting:

a. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-11 through 65-12 and 718-10-65-14.

b. If a nonpublic entity has already made an accounting policy election to measure employee liability-classified awards at intrinsic value according to paragraph 718-30-30-2, then the nonpublic entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which the pending content that links to this paragraph is adopted by adjusting the carrying amount of nonemployee liability-classified awards that have not been settled by the adoption date to intrinsic value.

c. In the first interim and fiscal year of adoption, an entity shall disclose both of the following:
   1. The nature of and reason for the change in accounting principle
   2. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the period of adoption.

Issue 4: Calculated Value

49. The amendments to Subtopics 718-10 and 718-20 and the addition of transition paragraph 718-10-65-14 reflect the Board’s decision to require a nonpublic entity (which is defined in Topic 718 as an entity whose equity securities generally do not trade in a public market) to account for its equity share options and similar instruments on the basis of a value calculated using the historical volatility of a specific industry sector index instead of the expected volatility of the entity’s share price when it is not practicable to estimate the expected volatility of its share price.
Amendments to Subtopic 718-10

50. Add paragraph 718-10-30-19A and its related heading, with a link to transition paragraph 718-10-65-14, as follows:

**Compensation—Stock Compensation—Overall**

**Initial Measurement**

> **Nonpublic Entity—Calculated Value for Nonemployee Awards**

**718-10-30-19A** Similar to employee equity share options and similar instruments, a nonpublic entity may not be able to reasonably estimate the fair value of nonemployee awards because it is not practicable for the nonpublic entity to estimate the expected volatility of its share price. In that situation, the nonpublic entity shall account for nonemployee equity share options and similar instruments on the basis of a value calculated using the historical volatility of an appropriate industry sector index instead of the expected volatility of the nonpublic entity’s share price (the calculated value) in accordance with paragraph 718-10-30-20. A nonpublic entity’s use of calculated value shall be consistent between employee share-based payment transactions and nonemployee share-based payment transactions.

> **Nonpublic Entity—Calculated Value**

**718-10-30-20** A nonpublic 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 Topic, provisions that apply to accounting for share options and similar instruments at fair value also apply to calculated value. Paragraphs 718-10-55-51 through 55-58 and Example 9 (see paragraph 718-20-55-76) provide additional guidance on applying the calculated value method to equity share options and similar instruments granted by a nonpublic entity.

Amendments to Subtopic 718-20

51. Amend paragraph 718-20-55-76 and add paragraphs 718-20-55-76A through 55-76B, with a link to transition paragraph 718-10-65-14, as follows:
Compensation—Stock Compensation—Awards Classified as Equity

Implementation Guidance and Illustrations

> Illustrations

> > Example 9: Share Award Granted by a Nonpublic Entity That Uses the Calculated Value Method

718-20-55-76 This Example illustrates the guidance in paragraphs 718-10-30-19A through 30-20.

718-20-55-76A This Example (see paragraphs 718-20-55-77 through 55-83) describes employee awards. However, the principles on how to account for the various aspects of employee awards, except for the compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Consequently, an entity should substitute the historical volatility of an appropriate industry sector index for expected volatility in accordance with paragraph 718-10-30-20 when measuring the grant-date fair value of nonemployee awards with similar facts and circumstances (that is, an entity has determined that it is not practicable for it to estimate the expected volatility of its share price) as illustrated in paragraphs 718-20-55-77 through 55-80. Therefore, the guidance in those paragraphs may serve as implementation guidance for similar nonemployee awards.

718-20-55-76B Compensation cost attribution for awards to nonemployees may be the same as or different from that which is illustrated in paragraph 718-20-55-81 for employee awards. That is because an entity is required to recognize compensation cost for nonemployee awards in the same manner as if the entity had paid cash in accordance with paragraph 718-10-25-2C. Additionally, valuation amounts used in this Example could be different because an entity may elect to use the contractual term as the expected term of share options and similar instruments when valuing nonemployee share-based payment transactions.

Transition and Open Effective Date Information

52. Add paragraph 718-10-65-14 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting

718-10-65-14 The following represents the transition and effective date information related to Accounting Standards Update No. 2018-07, Compensation—Stock
Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting:

a. An entity shall apply the pending content that links to this paragraph in the same period in which it applies the pending content that links to paragraphs 718-10-65-11 through 65-13.

b. A nonpublic entity shall apply the pending content that links to this paragraph prospectively to all awards that are measured at fair value after the adoption date.

Amendments to Status Sections

53. Amend paragraph 230-10-00-1, by adding the following item to the table, as follows:

230-10-00-1 The following table identifies the changes made to this Subtopic.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
<th>Accounting Standards Update</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>230-10-45-15</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
</tr>
</tbody>
</table>

54. Amend paragraph 260-10-00-1, by adding the following items to the table, as follows:

260-10-00-1 The following table identifies the changes made to this Subtopic.

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<tr>
<th>Paragraph</th>
<th>Action</th>
<th>Accounting Standards Update</th>
<th>Date</th>
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<tbody>
<tr>
<td>Option</td>
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<td>06/20/2018</td>
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<tr>
<td>Share-Based Payment Arrangements</td>
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<td>06/20/2018</td>
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<tr>
<td>260-10-45-22</td>
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<td>2018-07</td>
<td>06/20/2018</td>
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<td>260-10-45-28</td>
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<td>260-10-45-28A</td>
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<td>06/20/2018</td>
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<td>260-10-45-29 through 45-30</td>
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<tr>
<td>260-10-45-32</td>
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<td>06/20/2018</td>
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<td>260-10-45-45</td>
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<td>260-10-55-33</td>
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<td>260-10-55-69</td>
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<td>06/20/2018</td>
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55. Amend paragraph 323-10-00-1, by adding the following items to the table, as follows:

### 323-10-00-1

The following table identifies the changes made to this Subtopic.

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<th>Date</th>
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<td>323-10-30-3</td>
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<td>323-10-55-19 through 55-26</td>
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56. Amend paragraph 440-10-00-1, by adding the following item to the table, as follows:

### 440-10-00-1

The following table identifies the changes made to this Subtopic.

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<td>440-10-60-4</td>
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57. Amend paragraph 470-20-00-1, by adding the following item to the table, as follows:

### 470-20-00-1

The following table identifies the changes made to this Subtopic.

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<tr>
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58. Amend paragraph 480-10-00-1, by adding the following item to the table, as follows:

### 480-10-00-1

The following table identifies the changes made to this Subtopic.

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<tr>
<th>Paragraph</th>
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</table>
59. Amend paragraph 505-10-00-1, by adding the following items to the table, as follows:

505-10-00-1 The following table identifies the changes made to this Subtopic.

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<th>Paragraph</th>
<th>Action</th>
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<tr>
<td>505-10-25-3</td>
<td>Amended</td>
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</table>

60. Amend paragraph 505-50-00-1, by adding the following items to the table, as follows:

505-50-00-1 The following table identifies the changes made to this Subtopic.

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<th>Action</th>
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<td>06/20/2018</td>
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<td>Customer (1st def.)</td>
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<td>06/20/2018</td>
</tr>
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<td>Employee (2nd def.)</td>
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<td>06/20/2018</td>
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<td>Fair Value (1st def.)</td>
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<td>06/20/2018</td>
</tr>
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<td>Issued, Issuance, or Issuing of an Equity Instrument</td>
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<td>06/20/2018</td>
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<td>Market Condition</td>
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<td>06/20/2018</td>
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<td>Reload Feature and Reload Option</td>
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<td>2018-07</td>
<td>06/20/2018</td>
</tr>
<tr>
<td>Share-Based Payment Transactions</td>
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### Table: Accounting Standards Update Date

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<td>06/20/2018</td>
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<td>505-50-15-1 through 15-3</td>
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<td>06/20/2018</td>
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<tr>
<td>505-50-25-1 through 25-4</td>
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</table>

61. Amend paragraph 606-10-00-1, by adding the following item to the table, as follows:

**606-10-00-1** The following table identifies the changes made to this Subtopic.

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<th>Paragraph</th>
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</tbody>
</table>

62. Amend paragraph 705-20-00-1, by adding the following item to the table, as follows:

**705-20-00-1** The following table identifies the changes made to this Subtopic.
63. Amend paragraph 718-10-00-1, by adding the following items to the table, as follows:

**718-10-00-1** The following table identifies the changes made to this Subtopic.

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<th>Paragraph</th>
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<td>Contract</td>
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<tr>
<td>Customer (1st def.)</td>
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<td>06/20/2018</td>
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<td>through 25-16</td>
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64. Amend paragraph 718-20-00-1, by adding the following items to the table, as follows:

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65. Amend paragraph 718-30-00-1, by adding the following items to the table, as follows:

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66. Amend paragraph 718-50-00-1, by adding the following items to the table, as follows:

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67. Amend paragraph 718-740-00-1, by adding the following items to the table, as follows:

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68. Amend paragraph 805-30-00-1, by adding the following items to the table, as follows:

**805-30-00-1** The following table identifies the changes made to this Subtopic.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
<th>Accounting Standards Update</th>
<th>Date</th>
</tr>
</thead>
<tbody>
<tr>
<td>805-30-30-7</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
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<td>805-30-30-9</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
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<td>through 30-13</td>
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<tr>
<td>805-30-35-3</td>
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<td>through 55-13</td>
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<tr>
<td>805-30-55-9A</td>
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<td>06/20/2018</td>
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<tr>
<td>805-30-55-17</td>
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<tr>
<td>805-30-55-25</td>
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<td>06/20/2018</td>
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<td>through 55-35</td>
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</table>

69. Amend paragraph 805-740-00-1, by adding the following items to the table, as follows:

**805-740-00-1** The following table identifies the changes made to this Subtopic.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
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<tr>
<td>805-740-25-10</td>
<td>Amended</td>
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<td>06/20/2018</td>
</tr>
<tr>
<td>805-740-25-11</td>
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</table>

70. Amend paragraph 815-10-00-1, by adding the following items to the table, as follows:

**815-10-00-1** The following table identifies the changes made to this Subtopic.
<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
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<tr>
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<td>2018-07</td>
<td>06/20/2018</td>
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<tr>
<td>815-10-45-10</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
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<tr>
<td>815-10-55-43</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
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<tr>
<td>815-10-55-46 through 55-48</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
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<tr>
<td>815-10-55-48A</td>
<td>Added</td>
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</tr>
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<td>815-10-55-49 through 55-53</td>
<td>Superseded</td>
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<td>06/20/2018</td>
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</table>

71. Amend paragraph 815-40-00-1, by adding the following items to the table, as follows:

**815-40-00-1** The following table identifies the changes made to this Subtopic.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
<th>Accounting Standards Update</th>
<th>Date</th>
</tr>
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<tbody>
<tr>
<td>Share-Based Payment Arrangement</td>
<td>Added</td>
<td>2018-07</td>
<td>06/20/2018</td>
</tr>
<tr>
<td>815-40-15-3</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
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<tr>
<td>815-40-15-5A</td>
<td>Amended</td>
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<td>06/20/2018</td>
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<tr>
<td>815-40-55-1</td>
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<td>06/20/2018</td>
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<tr>
<td>815-40-55-48</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
</tr>
</tbody>
</table>

72. Amend paragraph 820-10-00-1, by adding the following item to the table, as follows:

**820-10-00-1** The following table identifies the changes made to this Subtopic.

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
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<th>Date</th>
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<tr>
<td>820-10-15-2</td>
<td>Amended</td>
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<td>06/20/2018</td>
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</table>

73. Amend paragraph 845-10-00-1, by adding the following item to the table, as follows:

**845-10-00-1** The following table identifies the changes made to this Subtopic.
<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Action</th>
<th>Accounting Standards Update</th>
<th>Date</th>
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<tr>
<td>845-10-15-4</td>
<td>Amended</td>
<td>2018-07</td>
<td>06/20/2018</td>
</tr>
</tbody>
</table>

The amendments in this Update were adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, Chairman
James L. Kroeker, Vice Chairman
Christine A. Botosan
Marsha L. Hunt
Harold L. Monk, Jr.
R. Harold Schroeder
Marc A. Siegel
Background Information and Basis for Conclusions

Introduction and Background Information

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

BC2. The Board is issuing this Update as part of its initiative to reduce cost and complexity in accounting standards (Simplification Initiative). The objective of the Simplification Initiative is to identify, evaluate, and improve areas of GAAP for which cost and complexity can be reduced while maintaining or improving the usefulness of the information provided to users of financial statements. Some of the areas apply only to nonpublic entities. A nonpublic entity is generally defined in Topic 718 as an entity whose equity securities do not trade in a public market.

BC3. This project is broader than many of the other projects that have been completed as part of the Board’s Simplification Initiative because it results in a substantive change for entities that grant share-based payment awards to nonemployees. However, it is not the Board’s intent that the amendments in this Update will result in changes in practice for share-based payment awards granted to employees. By more closely aligning the accounting requirements for economically similar share-based payment transactions with nonemployees to those with employees, the Board expects that this project will meet the objective of the Simplification Initiative because it both:

   a. Improves the consistency of information reported to users of financial statements
   b. Reduces the cost and complexity of accounting for share-based payment transactions with nonemployees because it eliminates an entity’s need for a separate process for granting and tracking awards to nonemployees that are economically similar to those granted to employees.

BC4. The accounting for nonemployee share-based payments was identified as an area for improvement through (a) outreach for the Simplification Initiative, (b) ongoing dialogue with the Private Company Council about making improvements to the accounting for share-based payments, and (c) the August 2014 Post-Implementation Review Report on Statement 123(R).
BC5. This project follows another Board project on improvements to accounting for share-based payment awards to employees in Topic 718. That project, which was completed with the issuance of the amendments in the March 2016 Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, included a number of improvements to the accounting for employee awards for both public entities and nonpublic entities. Many of the improvements made in that project apply to awards to nonemployees under the amendments in this Update.

BC6. The FASB issued a proposed Update, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, on March 7, 2017, with comments due on June 5, 2017. The Board received 24 comment letters on the proposed Update. In addition to evaluating feedback from those letters, the staff obtained feedback through stakeholder outreach. The Board considered the feedback from those stakeholders (as discussed below) during its redeliberations of the issues addressed by the proposed Update. Stakeholders also provided other potential improvements that could be made to the share-based payment model (for both employee awards and nonemployee awards), but the Board did not redeliberate those points because they were beyond the scope of this Update.

Basis for Conclusions
Benefits and Costs

BC7. The Board anticipates that entities will not incur significant transition costs as a result of applying the amendments in this Update and that in the long term the amendments will lead to a reduction in cost. The Board is issuing this Update as part of its Simplification Initiative. This project is expected to reduce the cost and complexity of accounting for share-based payment transactions with nonemployees. Aligning the accounting requirements for employee and nonemployee share-based payment transactions eliminates an entity’s need for a separate process for granting and tracking awards to nonemployees that are economically similar to those granted to employees. Moreover, this change is expected to benefit users of financial statements because they will be able to analyze all share-based payment transactions together and not have to differentiate between awards granted to employees and those granted to nonemployees.

BC8. While entities may incur costs when transitioning from one accounting methodology to another, the Board decided that the expected benefits of the amendments in this Update justify the expected costs. Additionally, entities that do not engage in nonemployee share-based payment transactions or do not have nonemployee awards outstanding will not incur any additional costs because of
the amendments, but they will benefit from the change if a decision is made to grant share-based payments to nonemployees in the future.

Expanding the Scope of Topic 718

BC9. The amendments in this Update expand the scope of Topic 718 to include all share-based payment transactions for acquiring goods and services from nonemployees. An entity should apply the requirements of Topic 718 to nonemployee share-based payment transactions with the exception of (a) specific guidance related to the attribution of compensation cost (that is, the period of time over which share-based payment awards vest and the pattern of cost recognition over that period), (b) the required use of expected term as an input to the valuation of nonemployee share options and similar instruments granted in share-based payment transactions, and (c) postvesting classification guidance on convertible instruments issued to a nonemployee. Consequently, Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees, is superseded, and GAAP no longer has separate accounting approaches for share-based payment transactions with nonemployees and employees. The amendments stipulate that share-based payments to nonemployees within the scope of Topic 718 are transactions for goods or services used or consumed in a grantor’s own operations and do not include transactions that provide financing to the issuer.

BC10. The Board decided against providing further clarification of the current guidance related to the attribution of compensation cost. Feedback from outreach efforts indicated that this area did not pose a significant concern or create a significant amount of confusion. Therefore, the Board did not want to change practice in this area by attempting to prescribe the vesting period and cost recognition pattern for what could be any number of possibilities that are reasonably determined today. Moreover, the Board questioned why it would be necessary to develop specific cost attribution guidance when there is an absence of this type of specific guidance for costs paid in cash. The Board decided that stakeholders currently are applying judgment to make these determinations for nonemployee share-based payment transactions and that they should continue to apply judgment under the amendments in this Update. The Board retained the definition of an employee to distinguish between those share-based payments for which the specific attribution guidance in Topic 718 is applicable and those share-based payments for which it is not.

BC11. Although it has not provided specific attribution guidance for nonemployee share-based payment transactions, the Board notes that in many instances the decisions about attribution of costs for nonemployee share-based payment transactions should be the same as or similar to those for employee share-based payment transactions because often the same or similar awards are granted to both employees and nonemployees for the same or similar work performed. For example, nonemployee awards may be structured in such a way that the vesting period for nonemployee awards may not be explicitly stated as part of the
arrangement. However, there may be one or more performance conditions that must be satisfied to earn the award. In those instances, the Board expects that the terms of the share-based payment arrangement should provide enough information to allow the grantor to determine the probability of meeting the performance conditions such that an implicit period can be determined in much the same way an employer currently determines these periods for employee awards. Additionally, the amendments in this Update do not link the decisions about attribution method to the valuation method used for nonemployee awards. For example, differences in attribution of costs from period to period between employee and nonemployee share-based payment transactions do not preclude a grantor from concluding that an appropriate valuation model could be used to estimate the fair value of an entire award with a graded vesting schedule even though the period-to-period recognition of cost may not be straight line.

BC12. Under current GAAP, the accounting requirements for aspects of nonemployee share-based payment transactions are significantly different from the requirements for employee share-based payment transactions in Topic 718. The original basis for the differences in accounting requirements between employee share-based payment transactions and nonemployee share-based payment transactions was the view that there is a fundamental difference between the relationship that employees and nonemployees have with the entity granting the awards. Specifically, there was a presumption that employees are more economically dependent on the entity granting the share-based payment awards than are nonemployees. Therefore, the view was that employees are more likely to complete the required service than nonemployees. That is, a nonemployee may have multiple opportunities for other compensation and may choose not to complete the required service if the fair value of the share-based payment award declines after the grant date. Consequently, the Emerging Issues Task Force (EITF) previously concluded in EITF Issue No. 96-3, “Accounting for Equity Instruments That Are Issued for Consideration Other Than Employee Services under FASB Statement No. 123” (superseded), that the measurement date for equity classified awards granted to employees (that is, grant date) was not appropriate for awards granted to nonemployees because it was assumed that a nonemployee’s level of effort was directly related to the value of the award.

BC13. The Board observed that stakeholders generally did not agree with the assertion that there is a fundamental difference between the relationship that employees and nonemployees have with the entity granting the awards. Stakeholders stated that the notion of economic dependency of employees may be overstated. That is, the underlying basis for the argument that nonemployees have multiple opportunities for other compensation, which, in turn, creates an ongoing value assessment of share-based awards affecting performance, is equally applicable to employees. Specifically, stakeholders noted that most employment arrangements are at will in most jurisdictions, which suggests that the employee’s relationship with the employer is similar to that of a nonemployee. In addition, stakeholders noted that many employees and nonemployees that receive
share-based compensation from an entity also receive cash compensation from the same entity. Consequently, stakeholders stated that having a separate model for nonemployee share-based payment transactions is unwarranted.

BC14. The Board agreed with stakeholders that awards granted to nonemployees are economically similar to those with employees despite the fact they may be granted for different items (for example, goods) and that, therefore, a separate model for nonemployee share-based payment transactions is not warranted. In concluding that share-based payment transactions with nonemployees are economically similar to transactions with employees, the Board observed that:

a. In many instances, the entity is paying for services from nonemployees that also are provided by employees with the only difference being that the nonemployee does not meet the technical definition of an employee in Topic 718.

b. In many instances, the terms and conditions of share-based payment awards granted to nonemployees are the same as those granted to employees.

c. The employee-employer relationship observed during previous standard-setting efforts is likely overstated because most employment is at will and today’s workforce often changes jobs.

d. Additional outreach conducted revealed that participants were generally unaware of instances of nonemployees deciding not to fulfill obligations, which suggests that there is not a high correlation between changes in share-based payment award value and changes in the nonemployee’s decisions to perform under a contract.

BC15. Although the Board decided that awards granted to nonemployees are economically similar, it initially decided to maintain different accounting for one aspect of valuation. Topic 718 requires that the grantor of an employee award determine the expected term of an option or similar instrument to use as an input to an option-pricing model when valuing the employee award. This is because employee share options generally differ from transferable share options in that employees cannot sell (or hedge) their share options—they can only exercise them. Because of this, employees generally exercise their options before the end of the options’ contractual term. To reflect the effect of those restrictions on employee options relative to transferable options, Topic 718 requires that the fair value of an employee share option or similar instrument be based on its expected term. In contrast, during its initial outreach, the Board was informed that nonemployee options typically do not have the same restrictions on transfer after vesting. Moreover, because of this difference, entities do not track nonemployee postvesting behavior, which makes the calculation of expected term inoperable for some entities. Additionally, if entities could perform the calculation, it is likely the expected term would be close to, if not the same as, the contractual term. Consequently, the Board initially decided that because of the differences in conditions between nonemployee awards and employee awards, and in the interest of simplification, it would require entities to use the contractual term of
nonemployee options and similar instruments as the input to the option-pricing model in the amendments in the proposed Update.

BC16. The Board received feedback from respondents on the proposed Update that employee awards and nonemployee awards are commonly issued with similar transfer restrictions. In such instances, the contractual term for awards that contain restrictions would result in a higher value for the awards than the amount that would have been recorded for comparable employee awards. As such, the Board amended its initial decision to require the use of contractual term. The Board decided that on an award-by-award basis an entity may elect to use the contractual term as the expected term when estimating the fair value of a nonemployee award to satisfy the measurement objective in paragraph 718-10-30-6. Otherwise, an entity must apply the existing guidance in Topic 718 in estimating the expected term of a nonemployee award, which may result in a term less than the contractual term of the award.

BC17. The Board considered how to align the separate accounting models for share-based payment transactions. That is, the Board considered superseding Subtopic 505-50 and including nonemployee share-based payment transactions within the scope of Topic 718 or, alternatively, superseding Topic 718 and including employee share-based payment transactions within the scope of Subtopic 505-50. The Board decided that it was more appropriate to supersede Subtopic 505-50 and include awards to nonemployees within the scope of Topic 718 because:

a. Subtopic 505-50 lacks guidance for fundamental aspects of the accounting, which has led to diversity in practice.

b. The FASB’s outreach, in connection with its project on improvements to the accounting for share-based payment awards, and the Post-Implementation Review Report on Statement 123(R) indicated that stakeholders stated that the employee model provides investors with useful information and is operable for preparers and auditors.

c. The majority of share-based payment transactions are with employees, and, therefore, the implementation costs of including nonemployee share-based payment transactions within the scope of Topic 718 should be less than the implementation costs of the other approach.

BC18. Once the Board decided to supersede Subtopic 505-50, it considered an alternative that would have distinguished between a nonemployee share-based payment transaction for services and a nonemployee share-based payment transaction for goods. An alternative that makes that distinction would have expanded the scope of Topic 718 to include nonemployee share-based payment transactions for services or services similar to those provided by employees, while maintaining the separate model in Subtopic 505-50 for nonemployee share-based payment transactions for goods. That alternative would have more closely aligned Topic 718 with IFRS 2, *Share-based Payment*. IFRS 2 addresses share-based payments issued to (a) employees and others providing similar services as
employees and (b) other parties. However, the Board had concerns about the complexity of such an alternative because determining whether the nature of a transaction is for goods or services can be difficult in some circumstances. Moreover, some transactions involve both goods and services as part of a single contract and, therefore, stakeholders likely would have requested that the Board provide guidance to address those contracts. One alternative would have required bifurcation of the contract into two units of account—the goods and the services—so that the share-based payment model for each type of promise could be applied. Another alternative would have required the grantor to determine whether the predominant promise is either goods or services. The Board concluded that those alternatives would have (1) added cost and complexity to applying the guidance while not improving the usefulness of the information and (2) created a risk of accounting for similar awards in significantly different ways. In addition, stakeholders informed the Board that a majority of share-based payment transactions with nonemployees involve what most consider to be services. Consequently, the Board decided that adding potentially significant complexity to the accounting was not worthwhile to address what is currently a narrow population of transactions.

BC19. Finally, the Board considered a limited-scope alternative that would have required an entity to determine whether the resolution of a performance condition was probable for specific nonemployee share-based payment transactions. The guidance in Subtopic 505-50 requires that in situations in which the quantity or any of the terms of the equity instrument are dependent on the achievement of performance conditions that result in a range of aggregate fair values for the equity instruments, the grantor should utilize the lowest aggregate fair value within that range for recognition purposes. The concept of lowest aggregate fair value does not consider the probability of resolving a particular performance condition and, therefore, a remote chance of nonperformance can result in a lowest aggregate fair value of $0 resulting in the delay of the recognition of compensation cost until performance completion. Participants in the FASB’s outreach indicated that the concept is widely considered to be counterintuitive because it is inconsistent with the principle for attribution of compensation cost in Subtopic 505-50 for nonemployee share-based payment transactions. That is, for those situations in which the lowest aggregate fair value would suggest $0, many stakeholders stated that if an entity was paying cash, it would likely recognize an expense on the basis of whether the outflow was probable. Consequently, the requirement is not applied consistently in practice. Ultimately, the Board rejected the alternative because of its limited-scope nature. The Board concluded that the alternative would not have sufficiently addressed the issues raised by stakeholders and that the overall problem could be resolved through application of the employee share-based payment transaction model in Topic 718.
Aligning Postvesting Classification Requirements

BC20. The amendments in this Update align the postvesting classification requirements for employee and nonemployee share-based payment awards. Specifically, an entity generally should continue to apply the classification provisions of Topic 718 (that is, the initial classification assessment) to nonemployee share-based payment awards and not reassess classification so long as the award is not modified after the nonemployee vests in the award and is no longer providing goods or services. Under current GAAP, an entity is required to initially assess classification of nonemployee share-based payment awards. However, a reassessment of classification under other Topics (for example, Topic 815 on derivatives and hedging) is required once nonemployee share-based payment awards are vested (that is, earned) and no further performance is required.

BC21. The Board concluded that employee share-based payment awards and nonemployee share-based payment awards are economically similar. Consequently, the Board concluded there should be no substantive difference in classification guidance. However, to address potential structuring concerns, the Board decided to make it clear that the guidance in Topic 718 applies to instruments granted for goods or services used or consumed in a grantor’s own operations and does not apply to instruments granted essentially to provide financing to the issuer. That is, the intent of the scope language is to ensure that instruments accounted for under Topic 718 are instruments issued for goods or services used or consumed in a grantor’s own operations and that transactions are not entered into to circumvent accounting classification.

Convertible Instruments

BC22. Notwithstanding the conclusion explained in paragraph BC21, the amendments in this Update require that an entity apply other applicable GAAP (including Subtopic 470-20, Debt—Debt with Conversion and Other Options) to account for a convertible instrument award when it becomes fully vested. For the purposes of applying beneficial conversion feature guidance, this Update amends Subtopic 470-20 to require that an entity use the fair value determined in accordance with Topic 718 as of the date that a convertible instrument award becomes fully vested. Under existing GAAP, convertible instrument awards also require a reassessment under other Topics when the award vests as described in paragraph BC20. Existing GAAP also requires an entity to use the fair value as of the measurement date in accordance with Subtopic 505-50, which is generally when the convertible instrument award vests.

BC23. The Board received feedback indicating that convertible instruments granted in exchange for goods or services (convertible instrument awards) rarely occur in practice. As such, the Board decided to preserve the current accounting
result for convertible instrument awards rather than delay the issuance of this Update by having to deliberate the accounting for convertible instrument awards. The Board also noted that its current project on distinguishing liabilities from equity (including convertible debt) is better suited to address concerns, if any, with the current accounting model for convertible instrument awards.

**Intrinsic Value**

BC24. The amendments in this Update require that a nonpublic entity change its measurement of all liability-classified nonemployee share-based payment awards from fair value to intrinsic value if the nonpublic entity has already made an accounting policy election to measure employee liability-classified awards at intrinsic value as permitted by paragraph 718-30-30-2.

BC25. Under current GAAP, a nonpublic entity is required to make a policy election to either measure all liability-classified employee awards at fair value or measure all such awards at intrinsic value. Subtopic 505-50 or current guidance for nonemployee share-based payment awards does not address this particular accounting policy election. The Board concluded that employee share-based payment awards and nonemployee share-based payment awards are economically similar and, therefore, there should be no substantive difference in measurement guidance. Consequently, the Board notes that the accounting policy election must apply equally to both employee awards and nonemployee awards.

**Calculated Value**

BC26. The amendments in this Update require that a nonpublic entity account for its equity share options and similar instruments issued to nonemployees on the basis of a value calculated using the historical volatility of an appropriate industry sector index when it is not practicable for the nonpublic entity to estimate the expected volatility of its share price. This is different from current practice, which requires the use of the expected volatility of the entity’s share price because the guidance for nonemployee share-based payment awards does not address this particular aspect of measurement.

BC27. Under current GAAP, a nonpublic entity is required to account for its equity share options and similar instruments issued to employees on the basis of a value calculated using the historical volatility of an appropriate industry sector index when it is not practicable to estimate the expected volatility of its share price. The Board concluded that share-based payment awards granted to nonemployees and employees are economically similar and that, therefore, there should be no substantive difference in measurement guidance. Consequently, the Board notes the use of calculated value, when appropriate, to be equally applicable to both employee awards and nonemployee awards.
Disclosure

BC28. The Board considered whether to add specific disclosures for nonemployee share-based payment transactions. Under current GAAP, entities are required to disclose separately information related to share-based payment transactions to the extent that the disclosures are important to understanding the effects of those transactions on the financial statements. While there is no specific provision for entities to disclose separately arrangements made with nonemployees, that is only true to the extent that the differences in the characteristics of the awards do not make separate disclosure important to understanding the entity’s use of share-based payment compensation. However, in the event entities find this information to be important, they should disclose separately the related transactions in accordance with current guidance. Consequently, the Board decided not to add separate disclosures specific to share-based payment transactions for nonemployees because the Board notes that this is already provided for under the current requirements. That is, an entity should consider whether providing separate information about the nonemployee share-based payment transactions is required under paragraph 718-10-50-2(g).

Comparison with International Financial Reporting Standards (IFRS Standards)

BC29. IFRS 2 addresses share-based payments issued to (a) employees and others providing similar services as employees and (b) other parties. For transactions with other parties, the share-based payment is measured at the fair value of the goods or services unless that fair value is not reliably measurable, in which case the fair value of the award is used. The fair value is measured at the date the entity obtains the goods or the counterparty renders the service. For the remaining amendments in this Update, generally, IFRS Standards neither have comparable guidance nor explicitly permit practical expedients.

Transition and Effective Date

BC30. The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, but no earlier than an entity’s adoption date of Topic 606. The amendments should be applied on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption. The Board concluded that the benefits of determining the cumulative-effect adjustment between additional paid-in capital and retained earnings for settled awards does not justify
the costs. Accordingly, the Board decided that the transition guidance should be applied to only liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established.

BC31. A nonpublic entity must apply the guidance on calculated value in this Update prospectively to all awards that are measured at fair value after the effective date. With a prospective adoption, a nonpublic entity would not incur the cost to determine a cumulative-effect adjustment to the previous estimate for the value of an option or similar instrument using a practical expedient that the Board decided should result in a reasonable estimate that is not significantly different from fair value.

BC32. The Board considered retrospective application for all the amendments in this Update but concluded that retrospective application requires an entity to incur potentially significant costs because of the complexity of the application. If an entity applied the amendments retrospectively, it would have to assess all instruments ever granted and determine the effect to the financial statements for all periods presented. Complexity notwithstanding, in the Board's view, this is not appropriate because the analysis would likely result in a reclassification between equity accounts for the majority of instruments, which would not improve the usefulness of the information provided to users of financial statements. Consequently, a retrospective application appeared contrary to the objectives of the Simplification Initiative.

BC33. The Board considered whether to require all unsettled awards to be measured at grant date fair value upon adoption of the amendments in this Update. Most respondents to the proposed Update stated that it would be difficult or impossible for some entities to determine the grant date fair value of nonemployee awards. Because Subtopic 505-50 generally requires awards to be remeasured at fair value each reporting period, most entities do not value awards at the grant date but rather at the first reporting period. Moreover, many nonemployee awards contain performance conditions that require the award to be measured at the lowest aggregate fair value, which can be $0 until performance is complete. Consequently, measuring the fair value of many nonemployee awards can occur several quarters beyond the grant date. This time lag in measurement is particularly acute for nonpublic entities in which nonemployee awards can be more prevalent. The Board recognized the cost and complexity of requiring grant date fair value measurement of all unsettled awards upon adoption. The Board therefore decided to require that awards be measured at adoption date fair value as a substitute for grant date fair value. The Board decided that requiring entities to value liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established at adoption-date fair value will not add complexity because Subtopic 505-50 and other applicable guidance (such as Topic 815) already require remeasurement of awards at fair value at the end of each reporting period.
BC34. The Board decided that entities should not remeasure assets that are completed. For example, finished goods inventory or equipment that has begun amortization would not be remeasured upon transition. The Board agreed with feedback indicating that the expected costs of remeasuring assets that include nonemployee share-based costs upon adoption would not justify the expected benefits. However, the Board concluded that the transition guidance in this Update requires assets under construction or in progress to be remeasured. In the Board’s view, the remeasurement of assets under construction or in progress does not increase cost or complexity in accounting for nonemployee share-based payment awards because current GAAP already requires such a remeasurement. In fact, the amendments in this Update remove the requirement of remeasuring unvested equity-classified nonemployee awards after the adoption date because most equity-classified nonemployee awards are remeasured until performance is complete under Subtopic 505-50.
Amendments to the XBRL Taxonomy

The amendments to the *FASB Accounting Standards Codification®* in this Accounting Standards Update require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Those improvements, which will be incorporated into the proposed 2019 Taxonomy, are available through Taxonomy Improvements provided at [www.fasb.org](http://www.fasb.org), and finalized as part of the annual release process.