FASB’s project Employee Share-Based Payment Accounting Improvements: Background, Post-implementation Review (PIR) Report by Financial Accounting Foundation (FAF) and Current status of the project

Background

The objective of the project is to reduce cost and complexity and improve the accounting for share-based payment awards issued to employees for public and private companies.

The FASB staff began performing broad-based pre-agenda outreach at the direction of the Private Company Council (PCC) in 2013 to identify what issues, if any, private companies encounter when applying the share-based payment guidance. Following the results of that outreach, in spring of 2014, the PCC asked the FASB staff to perform more targeted pre-agenda research related to a few alternatives for measuring share-based payment awards.

In August 2014, the FAF issued its PIR Report on Statement 123(R), Share-Based Payment. The PIR team concluded that Statement 123(R) achieved its expected benefits because (a) it resolved the issues that led to its issuance and (b) it generally provides users with useful information. The report also noted that it is more costly (difficult) for private entities to apply as compared with public business entities. Higher costs were attributed to both the complexity of the awards granted, which are often highly structured and contain multiple features, and the lack of internal expertise to comply with the requirements. The PIR Report is described in the next section below.

The FASB’s response letter to the PIR Report stated that the input from the PIR Report was consistent with the input the FASB previously received from stakeholders through outreach performed for the Simplification Initiative and pre-agenda research for the PCC.

At the Board meeting on October 8, 2014, the Board formally added a project to its agenda to improve the accounting for employee share-based payment awards.

PIR by FAF on Statement 123(R), Share-Based Payment

This is a summary of the PIR Report and not a full report.

PIR objectives and procedures

The three primary objectives of the PIR were to:

1) determine whether a standard is accomplishing its stated purpose;

2) evaluate its implementation and continuing compliance costs and related benefits; and

3) provide feedback to improve the standard-setting process.

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1 This Appendix was prepared on the basis of information available in the FASB’s public website: http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=1176164543600
For this PIR, the FAF’s primary means of gathering information that was used in forming its conclusions were from the following:

- Holding discussions with a diverse group of FASB stakeholders (practitioners, preparers, regulators, and users), many of whom are considered subject-matter experts on share-based payment accounting. – the “PIR resource group”, with 32 members in total, including 14 users of financial statements.

- Reviewing feedback received by the FASB in 2013 from its outreach with non-public entity stakeholders. – the “FASB non-public resource group”, with 16 members in total, including 5 users of financial statements.

The FAF did not use any surveys in the PIR research. Its research observations were indications of stakeholders’ views and do not constitute statistically valid inferences. It came to its conclusions using its judgement, considering all the input received, and striving to be objective and balanced.

PIR objective 1: Did Statement 123(R) accomplish its stated purpose?

It was agreed by members of the resource groups that the requirement in Statement 123(R) to recognise share-based payment arrangements in earnings increased the decision-usefulness of information about share-based payment arrangements in the financial statements.

User members of the PIR resource group said that information about share-based payment transactions is useful for many types of analyses, particularly the following:

- understanding current share-based payment awards and structures;
- analysing the incentive compensation structure for management and employees, including the nature and types of plans provided;
- analysing performance (primarily earnings) projections;
- forecasting an entity’s cash flows;
- estimating the impact of share-based payment arrangements on total shareholder returns, including potential dilutive effects;
- understanding the impact of share-based payment arrangements on an entity’s overall cost structure, including the magnitude of share-based payment arrangements in relation to total compensation cost; and
- assessing historical stock-buyback plans.

In terms of whether Statement 123(R) was operational, the FAF concluded that: “both public and non-public entities have difficulties understanding and/or applying certain areas of Statement 123(R). We conclude that for public entities, Statement 123(R) is generally understandable, can be applied as intended, and results in reliable information. However, our research indicates that Statement 123(R) is often more difficult for non-public entities to understand and to apply as intended. The complexity of the financial instruments used by non-public entities for employee SBC [Share-Based Compensation] awards along with the lack of internal expertise to account for SBC transactions were said to be driving the
difficulties associated with applying Statement 123(R). Consequently, non-public entities typically require the assistance of external experts to ensure compliance with Statement 123(R).”

The research by the FAF indicated that the following areas were difficult to understand and / or to apply for either public or non-public entities, or both (as noted below):

- liability versus equity classification (public and non-public entities);
- estimating expected forfeitures (non-public entities); and
- measuring share-based payment arrangements (non-public entities).

Please note that the list above is not exclusive, because the staff have tried to focus on the areas that were relevant for IFRS reporters.

With respect to changes in financial reporting and operating practices, the FAF concluded that – while the changes made to financial reporting and operating practices as a result of Statement 123(R) could be considered significant (eg entities introduced different compensation plans) – they were consistent with the FASB’s original expectations.

Furthermore, the research did not identify any significant unanticipated consequences resulting from the application of Statement 123(R).

PIR objective 2: Statement 123(R)’s costs and benefits

On the basis of its research, the FAF concluded that the costs incurred for the implementation of Statement 123(R) were generally consistent with what the FASB and its stakeholders had anticipated. It also concluded that the ongoing costs incurred by public entities to comply with Statement 123(R) were not significant. However, the costs associated with implementing Statement 123(R) were relatively more significant for non-public entities. Specific areas for which non-public entities incurred significant costs were:

- measuring share-based payment arrangements;
- estimating expected forfeitures; and
- determining whether an arrangement should be classified as equity or a liability.

The FAF concluded that, overall, Statement 123(R) achieved its expected benefits as it increased the decision-usefulness of information in financial statements about share-based payment arrangements.

PIR objective 3: Standard-setting process improvements

As a result of its PIR of Statement 123(R), the FAF did not have any formal recommendations about the standard-setting process.
Current status of the project

The FASB issued final improvements to Employee Share-Based Payment Accounting on 30 March 2016.

The FASB’s key improvements are:

Accounting for Forfeitures

The FASB decided to modify the requirement to estimate the number of awards that will ultimately vest when determining the amount of compensation cost to recognize over the vesting period. The FASB decided to allow an entity an accounting policy election either to estimate the number of forfeitures (awards that will not vest because employees do not provide the necessary service to earn the awards) or to recognize forfeitures as they occur.

Practical Expedients for Private Companies:

Expected Term

The improvements allow private entities to use the simplified method to estimate the expected term for (1) awards with only service conditions and (2) awards with performance conditions when it is probable that the performance conditions (or both performance and service conditions) will be met. If it is not probable that an award’s performance conditions will be met, nonpublic entities applying the practical expedient would use the award’s contractual term as the estimate for the expected term.

Intrinsic Value

As a practical expedient for private companies, the FASB provided private companies with a one-time election to switch from measuring liability-classified awards at fair value to measuring liability-classified awards at intrinsic value.

Pre-Agenda Research

In addition, the FASB decided to perform additional research regarding disclosures within Topic 718 Compensation – Stock Compensation as part of the Disclosure Framework project.

This list of FASB’s amendments is not exclusive; a full list of FASB amendments can be found at: