FASB ASU 2016-09: Amendments to ASC 718

This summary is intended only for a high level overview. It is not intended to be accounting or tax advice. SOS recommends its clients consult their qualified accounting and tax advisors before taking action in order to understand the impact new accounting guidance will have on their company's stock based compensation accounting, tax, financial reporting and equity systems/databases.

Background

On March 30, 2016, the Financial Accounting Standards Board (FASB) issued its long-awaited simplification guidance on ASC 718, *Compensation- Stock Compensation*. The guidance in Accounting Standards Update (ASU) 2016-09 is intended to change or simplify certain aspects in accounting for share-based payments to employees. The new guidance does not address or impact the accounting for share-based payments to nonemployees, so ASC 505-50, *Equity Awards to Nonemployees*, still governs.

So what are the amendments in ASU 2016-09?

1. **Accounting for Income Taxes.** All income tax effects will be recorded in the income statement when awards are vested/settled. Excess Tax Benefits/Deficiencies will no longer be recorded in APIC (i.e. APIC Windfall/Shortfall Pools).

    a. **Earnings Per Share.** Assumed proceeds from excess tax benefits will no longer be a component in calculating buy back shares using the treasury stock method.
    b. **Cash Flow Presentation.** Excess tax benefits can be presented as an operating activity only. They will no longer be presented as a financing activity.

2. **Statutory Tax Withholding.** Employers can now withhold the maximum amount of taxes in the employee's applicable jurisdiction (net share settlement or withhold to cover methods) and still qualify for the exception to liability classification.

    a. **Cash Flow Presentation.** Cash paid to a tax authority when shares are withheld can be listed as a financing activity.

3. **Accounting for Forfeitures**. Companies will now be able to elect as an accounting policy whether to account for forfeitures by a) continuing to estimate forfeitures under the previous ASC 718 guidance OR b) recognize forfeitures when they occur. This accounting policy election must be disclosed and it applies to awards with service-based conditions only. For performance conditions, management must continue to perform a probability assessment. This will impact the disclosure of options that are "expected to vest."

4. **Nonpublic entity practical expedient to calculating expected term**. In short, nonpublic companies without sufficient historical history are permitted to use the U.S. Securities and Exchange Commission's (SEC) "Simplified Method" (SAB No. 110/107), which calculates expected term as the midpoint between the vesting period and the contractual term of the option. This same expedient is afforded to new publicly traded companies. If a performance condition exists, companies should assess at the grant date the probability that the performance criteria will be met and either use the SEC's Simplified Method or use the contractual term.

5. **Nonpublic entity practical expedient to using intrinsic value**. For nonpublic entities that measure liability-classified awards at fair value, they can elect a one-time change in accounting principle to measure those awards at intrinsic value.

When will this impact your company?

The new guidance is effective for public business entities for fiscal years beginning after December 15, 2016, and interim periods within those years. For all other entities, it is effective for fiscal years beginning after December 15, 2017, and interim periods within fiscal years beginning after December 15, 2018. Early adoption is permitted, but all of the guidance must be adopted in the same period. Companies cannot pick and choose which amendments to adopt "a la carte". It's all or nothing. Also, keep in mind that various transition requirements will apply to these amendments, some can be applied prospectively and others retrospectively. Include your auditors on these key decisions.

What should be done now?

As mentioned previously, SOS recommends its clients consult their qualified accounting and tax advisors before taking action. Additionally, other resources listed below may aid the company in understanding and applying the new changes.

1. Read ASU 2016-09 and understand its impact.
2. If your company has a Form 10-K, Form 10-Q or equivalent private company report due soon, don't forget the footnote disclosure on the impact of recently issued or adopted accounting pronouncements.
3. Determine when your company plans to adopt the ASU 2016-09 guidance and the transition methods.
4. Identify gaps in processes and equity tracking databases.
    a. Decide on the forfeiture rate policy election.
    b. Draft or revise the company's policy on withholding shares for taxes.
    c. Identify the tax jurisdictions of participants with equity and note the statutory tax requirements. Ensure systems, processes and adequate controls are in place to monitor the appropriate tax rates.
    d. Reach out to your 3rd party providers to see what impact ASU 2016-09 will have on their equity systems.
5. Consider looking back at the impact the excess tax benefits/deficiencies would have had if they were always recognized in the income statement.
6. Forecast the impact of the volatility to the income statement for the current year and future years.
7. Keep management informed and consult with your qualified accounting and tax advisors. No one likes surprises.

Other resources:

FASB ASU 2016-09

Link to the official FASB ASU

National Association of Stock Plan Professionals (NASPP) ASC 718 summary on the new amendments

Our friends at NASPP have been following these accounting developments closely via the NASPP Blog (see entries on/after 4/7/16, 3/30/16, 2/9/16, 1/19/16, 1/12/16, 1/5/16, 12/8/15, 12/1/15, 11/10/15, 8/18/15, 6/16/15, 6/9/15, 2/10/15, 11/4/14 and 10/28/14). In addition, a NASPP Webcast: ASC 718 in Motion: The FASB's Amendments was held on ***Tuesday, May 10, 2016*** that provided a panel discussion with a focus on practical implementation, including key decisions companies need to make.

Big 4 Accounting Firms' ASC 718 summaries on the new amendments*

EY- To the Point No. 2016-15
Deloitte- Heads Up Volume 23, Issue 13
PwC- In brief No. US2016-12
KPMG- Defining Issues No. 16-11

Questions or comments? Please email us at xtra@sos-team.com

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