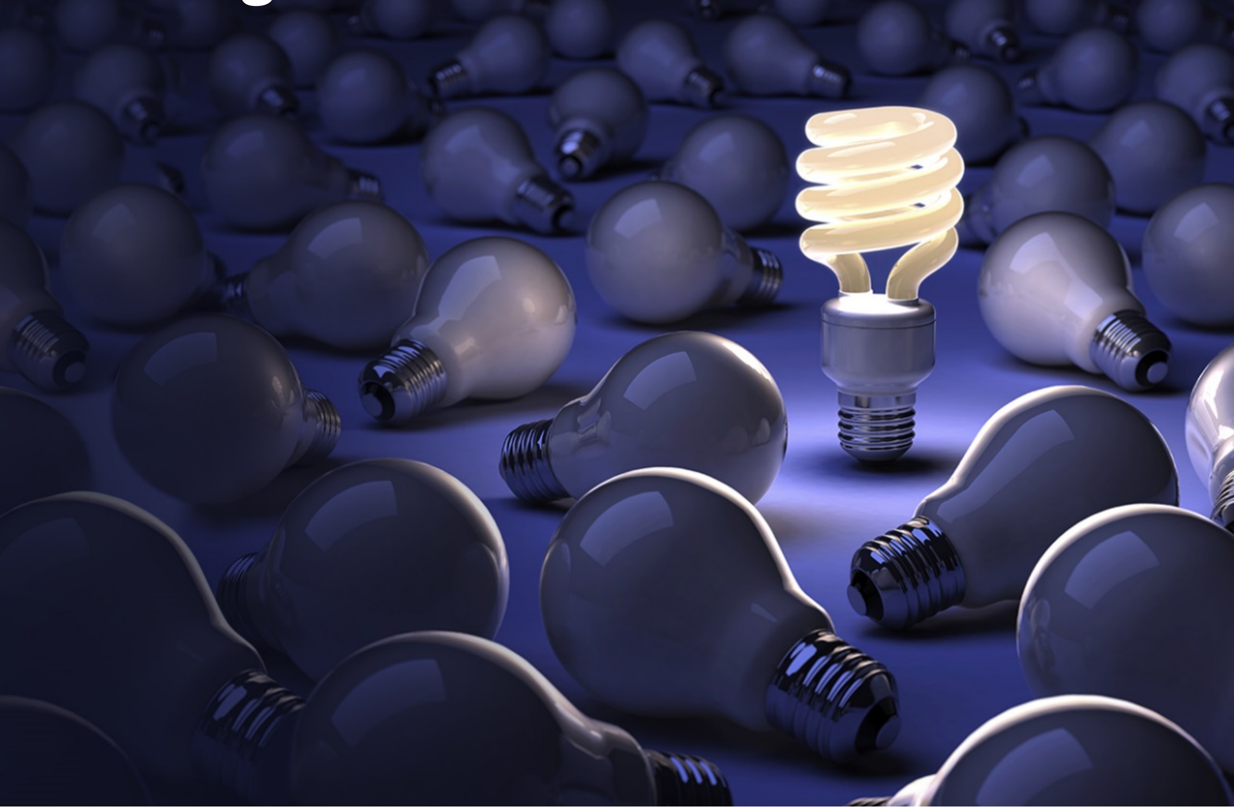
KPMG

# Accounting Update - ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*



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# Summary

## Intent is to improve and simplify

- Excess tax benefits and deficiencies
- Forfeitures
- Withholding tax
- Practical expedient for non-publics

**Net income, EPS, Statement of Cash Flows, and Balance Sheet classifications are affected**

# Excess tax benefits and deficiencies

| What's changing? | Observations |
| --- | --- |
| ■ Excess tax benefits and deficiencies recognized in earnings<br>➢ No more APIC pools<br>➢ Discrete items of the reporting period (i.e., not anticipated when determining effective tax rate)<br>■ No delay in recognition of excess tax benefits<br>■ Fully diluted EPS (treasury stock method) will exclude future estimated excess tax benefits from assumed proceeds | ■ No tracking APIC pools<br>■ Earnings volatility<br>■ Valuation allowances may negate impact<br>■ Difficult judgments full vs. partial valuation allowance |

| | |
| --- | --- |
| **Transition** | • **Tax benefits and deficiencies and EPS – Prospective**<br>• **Prior unrecognized benefits – Cumulative catch to opening retained earnings in year of adoption** |

# Cash flow classification of excess tax benefits

## What's changing?

- No longer be separated from other income tax cash flows and presented in financing activities
- Will be presented as operating activities

## Observations

- Will result in increase in operating cash flows
- Eliminates need to separately identify gross tax benefits

**Transition – Prospective or retrospective transition method**

# Forfeitures

## What's changing?

- Option of estimating forfeitures (current GAAP), or reversing compensation cost of forfeitures when they occur
- Does not apply to modifications or business combinations

**Applies to 'service condition' only**

## Observations

- Election applies to all award types
- Earnings volatility if forfeitures occur unevenly
- May have known future forfeitures that can't be eliminated yet (e.g. planned layoff)
- Careful consideration of historical data when electing the policy

**Transition – Cumulative catch to opening retained earnings in year of adoption**

# Tax withholding requirement

| What's changing? | Observations |
|---|---|
| ▪ Balance Sheet – withholding up to the maximum individual statutory tax rate in the applicable jurisdiction would not by itself prohibit equity classification<br>▪ SoCF - Share withholding disbursements are required to be classified as a financing activity | ▪ Allows a single rate for all employees in a jurisdiction<br>▪ Possible implementation complexities<br>▪ Still have to monitor rates and employees who move jurisdictions<br>▪ Is it a modification? |

| | |
|---|---|
| **Transition** | • **Balance Sheet classification – Cumulative catch to opening retained earnings in year of adoption**<br>• **SoCF - Retrospective** |

# Tax withholding requirement

## New guidance and its application

- Employer must have a statutory obligation to withhold
  - ✓ Be careful of international assignees in no-withholding tax countries
- Rate cannot exceed the maximum statutory rate in the employees' applicable jurisdictions
  - ✓ Cross-border employees require separate country analysis based on income subject to "withholding" in each jurisdiction to determine blended tax rate
  - ✓ An employee's obligation to social tax alone does not allow for the use of higher income tax rates

- Rate in excess of that which applies to the specific award grantee is permissible
  - ✓ Does NOT give issuer license to apply withholding rate not prescribed by local tax law
  - ✓ U.S. supplemental wage flat rate withholding above 25% for ytd supplemental wages that do not exceed $1mil NOT supported by the IRC, Treasury Regulations or IRS guidance unless

# Practical expedients for nonpublic entities

| What's changing? | Observations |
| --- | --- |
| ■ Election to use the simplified method to determine expected term of awards<br>■ Permits a one-time policy election to change from measuring all liability-classified awards at fair value to intrinsic value | ■ Could be useful for nonpublic entities that do not have relevant historical data<br>■ Measurement change provides another opportunity for entities to make this policy election |

Expected term method used for awards with performance conditions depends.

| | |
| --- | --- |
| **Transition** | • **Expected term – Prospective**<br>• **Measurement change - Cumulative catch to opening retained earnings in year of adoption** |

# Effective date and transition

| | Public Business Entity | Other than Public Business Entity |
|---|---|---|
| Annual financial statements | 2017 | 2018 |
| Interim financial statements | Q1 2017 | Q1 2019 |
| Effective date of adoption | January 1, 2017 | January 1, 2018 |

| | |
|---|---|
| Early adoption | • Any interim or annual period |
| Package deal | • Must adopt the entire ASU in the same period |
| Other than Q1 adoption | • Issues adopted prospectively or by cumulative catch as of beginning of yr |

# Key points to remember!

- No more APIC pools
- Election to account for forfeitures as they occur
- Consider increased earnings volatility
- Transition provisions for each issue is different
- Maximum statutory withholding rate permissible to maintain equity
- Early adoption is permitted in any interim or annual period. However, entities must adopt the entire ASU in the same period.
- See Defining Issues 16-11.

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# Thank you