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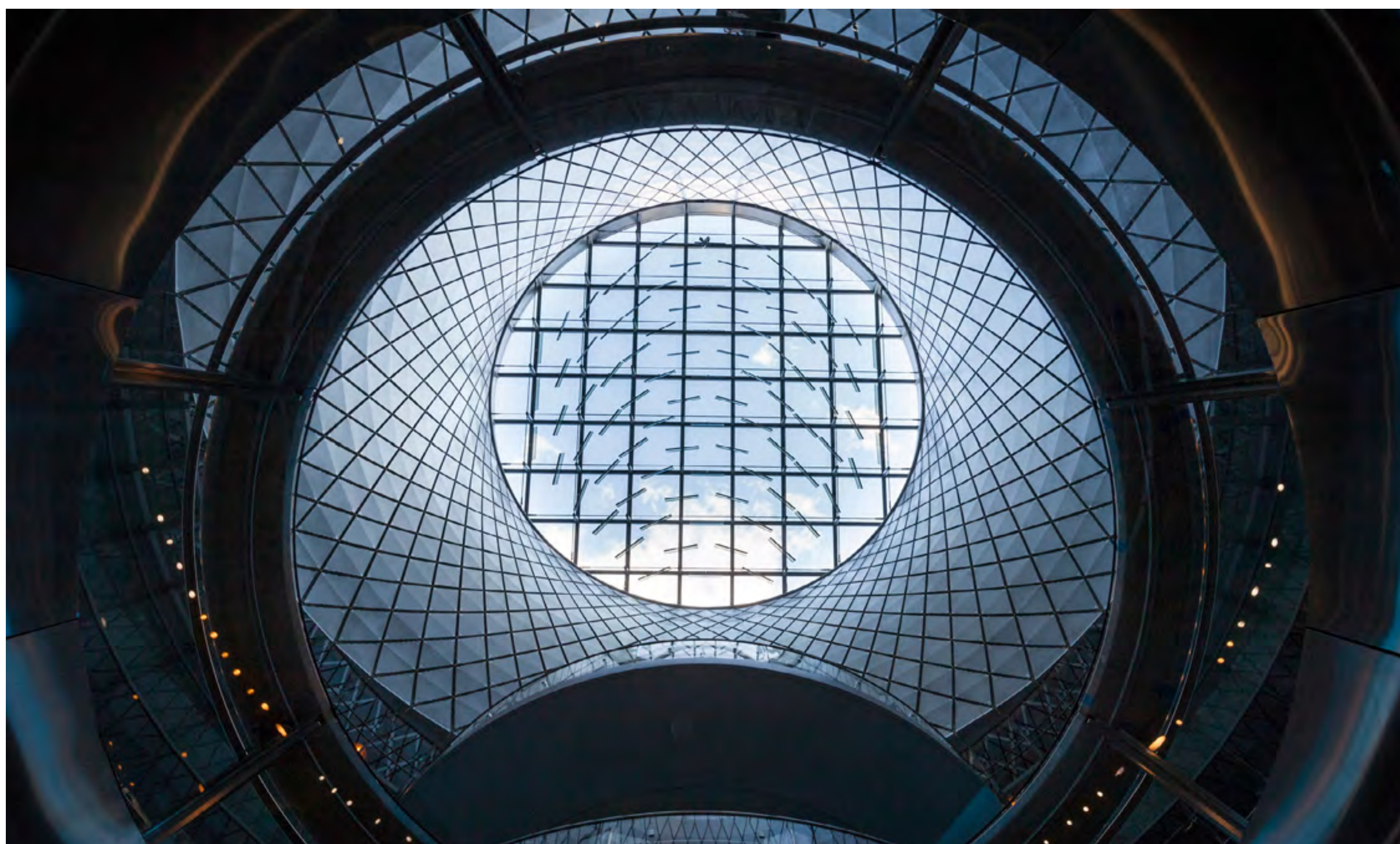

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Frequently Asked Questions About ASU 2016-09

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Since the FASB's issuance of ASU 2016-09[1] in March of this year, a number of questions have arisen about its implementation. The new guidance simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The ASU also contains two practical expedients for nonpublic entities. The questions and answers below discuss many aspects of the new guidance that may be of interest to stakeholders.

For more information about ASU 2016-09, see Deloitte's April 21, 2016, *Heads Up*.

[1] FASB Accounting Standards Update No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*.

Scope

1. Do the income tax aspects of ASU 2016-09 apply to nonemployee awards issued under ASC 505-50?[2]

Yes. ASC 718-740-15-2 states that the "guidance in [ASC 718-740] applies to share-based payment transactions with both employees and nonemployees." Accordingly, the ASU's income tax aspects apply, when appropriate, to nonemployee awards that are accounted for under ASC 505-50.

2. Does ASU 2016-09 apply to foreign jurisdictions?

Yes. ASU 2016-09 applies to all entities that issue share-based payment awards to their employees.

Transition and Effective Date

3. What are the transition requirements for the adoption of ASU 2016-09?

The following table outlines the transition methods for an entity's adoption of ASU 2016-09:

Type	Transition Method
Recognition of excess tax benefits and tax deficiencies (accounting for income taxes)	Prospective
Unrecognized excess tax benefits (accounting for income taxes)	Modified retrospective
Classification of excess tax benefits in the statement of cash flows	Retrospective or prospective
Accounting for forfeitures	Modified retrospective
Classification and statutory tax withholding requirements	Modified retrospective
Classification of employee taxes paid in the statement of cash flows when an employer withholds shares for tax withholding purposes	Retrospective
Nonpublic entity practical expedient for expected term	Prospective
Nonpublic entity practical expedient for intrinsic value	Modified retrospective

4. What is the effective date of ASU 2016-09?

For public business entities, the ASU is effective for annual reporting periods beginning after December 15, 2016, including interim periods within those annual reporting periods.

For all other entities, the ASU is effective for annual reporting periods beginning after December 15, 2017, and interim periods within annual reporting periods beginning after December 15, 2018.

5. Can an entity early adopt ASU 2016-09, including in an interim period other than its first fiscal quarter?

Yes. ASU 2016-09 permits entities to early adopt in any interim or annual period for financial statements that have not been issued or have not been made available for issuance.

[2] For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

6. If an entity early adopts ASU 2016-09, must it adopt all aspects of the ASU?

Yes. Upon adoption of ASU 2016-09, an entity must adopt all aspects of the ASU.

7. If an entity early adopts ASU 2016-09 in an interim period other than its first fiscal quarter, how does the entity apply the amendments that must be adopted on a modified retrospective basis or prospective basis?

When an entity early adopts ASU 2016-09 in an interim period other than its first fiscal quarter, it does so as of the beginning of its fiscal year.

For amendments that are to be applied on a modified retrospective basis (e.g., previously unrecognized excess tax benefits), a cumulative-effect adjustment is calculated on the first day of the fiscal year of adoption and recorded in retained earnings. For amendments that are to be applied on a prospective basis (e.g., excess tax benefits and tax deficiencies), the change is reflected in the applicable interim periods of adoption such that any adjustments are reflected as of the beginning of the fiscal year. Corresponding changes to the balance sheet, income statement, and statement of cash flows must be made to reflect the adoption of ASU 2016-09 in each interim period, including interim periods for which financial statements have been previously issued or previously made available for issuance. Accordingly, an entity adopting ASU 2016-09 on an interim date other than its first fiscal quarter (e.g., its second fiscal quarter) will be required to recast its previously issued interim financial statements (e.g., its first fiscal quarter) to reflect the adoption of the standard as of the beginning of its fiscal year.

For SEC registrants, a previously issued Form 10-Q does not need to be amended and reissued; however, in future filings (e.g., Form 10-Q, Form 10-K, or registration statements) that include the previously issued interim financial information, registrants will present such interim financial information on a recasted basis to reflect the adoption of ASU 2016-09 as of the beginning of the fiscal year.

Example

Entity A, an SEC registrant, adopts ASU 2016-09 in its third fiscal quarter. Entity A had $50 of excess tax benefits in each quarter in its current fiscal year to date and is not affected by adopting any of the other provisions of ASU 2016-09. In its previously issued financial statements in Form 10-Q, Entity A recognized a total of $100 ($50 in each quarter) of excess tax benefits in additional paid-in capital (APIC). In its third fiscal quarter, the period in which the ASU is adopted, Entity A recognizes $50 of excess tax benefits in its income statement. That is, the *quarter-to-date* income tax provision will only include the third fiscal quarter excess tax benefits ($50). In addition, the *year-to-date* income tax provision will include excess tax benefits of $150 to reflect the reversal of the excess tax benefits recognized in APIC for the first two fiscal quarters ($100) and the recognition of those benefits in the income statement in those prior quarters (the $100 in excess tax benefits related to the first and second fiscal quarters are *not* recognized in the third quarter but are reflected on a recasted basis in the applicable prior quarters). In the quarterly information footnote of its subsequent Form 10-K filing, Entity A will present a schedule reflecting the first and second fiscal quarters' excess tax benefits ($50 each quarter) in the income statement even though these amounts were reported in APIC in previously issued financial statements in Form 10-Q. Finally, Entity A's financial statements in Form 10-Q issued in the year after Entity A's adoption of the ASU will reflect the prior-year quarterly excess tax benefits (i.e., first and second fiscal quarters of the prior year) on a recasted basis in the income statement rather than in APIC.

Accounting for Income Taxes

8. If an entity has historical excess tax benefits that were not previously recognized because the related tax deduction had not reduced current taxes payable[3] ("previously unrecognized excess tax benefits"), what amount is recorded upon adoption of ASU 2016-09? Is the amount recorded through retained earnings or APIC?

ASU 2016-09 states that previously unrecognized excess tax benefits should be recognized on a modified retrospective basis. Entities should therefore record a deferred tax asset for previously unrecognized excess tax benefits outstanding as of the beginning of the annual period of adoption, with an offsetting adjustment to retained earnings.

9. Does an entity have to reclassify its prior-year APIC pool from APIC to retained earnings upon adoption of ASU 2016-09?

No. An entity's prior-year APIC pool is not affected because those excess benefits have already been recognized in the financial statements, and the recognition of excess tax benefits and tax deficiencies in the income statement is prospective only in the fiscal year of adoption. As a result, there is no reclassification between APIC and retained earnings in the fiscal years before adoption. The modified retrospective transition guidance only applies to previously *unrecognized* excess tax benefits outstanding upon adoption of ASU 2016-09 with a cumulative-effect adjustment to retained earnings (as discussed above in question 8).

10. Does ASU 2016-09 affect how entities evaluate whether a valuation allowance is necessary?

No. ASU 2016-09 does not change the general guidance on how entities evaluate whether a valuation allowance is required (i.e., an entity must still evaluate all available positive and negative evidence). Entities will, however, need to consider the impact, if any, that the balance sheet recognition of previously unrecognized excess tax benefits and anticipated excess tax benefits may have on their ability to realize a benefit for their overall portfolio of deferred tax assets.

11. Does an entity need to consider a valuation allowance in transition when setting up a deferred tax asset for previously unrecognized excess tax benefits?

Yes. Deferred tax assets recognized as a result of the transition guidance in ASU 2016-09 should be assessed for realizability in accordance with ASC 740. A valuation allowance for deferred tax assets recorded as a result of this transition guidance is recognized through a cumulative-effect adjustment to retained earnings.

12. If an entity adopts ASU 2016-09 in an interim period other than its first fiscal quarter and records or releases a valuation allowance in an interim period before adoption, how does the adoption affect the entity's valuation allowance analysis?

While the adoption of ASU 2016-09 does not directly affect an entity's valuation allowance assessment, the entity will need to assess any deferred tax asset recognized upon adoption related to previously unrecognized excess tax benefits for realizability as of the beginning of the fiscal year. To the extent that an entity adopts ASU 2016-09 in an interim period other than its first fiscal quarter, the entity will also need to update its valuation allowance assessment in each of the interim periods since the effective date of the adoption (since the

[3] ASC 718-740-25-10 (i.e., footnote 82 of FASB Statement No. 123(R), *Share-Based Payment*) states that an entity should not recognize excess tax benefits if the related tax deduction has not been realized through a reduction in taxes payable. Before the issuance of ASU 2016-09, entities tracked unrealized excess tax benefits off the balance sheet and deferred the recognition of these benefits until they were realized through a reduction in taxes payable.

effective date of adoption is the beginning of the fiscal year). Accordingly, the amount of the valuation allowance recorded or released in the current year interim periods before adoption could change.

13. Does the ASU change the requirement to recognize a deferred tax asset for a future tax deduction that is equal to the cumulative amount of compensation cost recognized in the financial statements for equity-classified awards?

No. A deferred tax asset must still be recognized for the cumulative amount of compensation cost recognized in the financial statements to the extent that such compensation is related to instruments classified as equity that ordinarily would result in a future tax deduction.

14. If an entity recognizes a tax deficiency for share-based payment awards after adoption of ASU 2016-09, will it have to record the corresponding charge to the income statement?

Yes. Upon adopting ASU 2016-09, entities will be required to recognize the income tax effects of share-based payment awards in the income statement when the awards vest or are settled (i.e., APIC pools will be eliminated). The shortfall will be recognized as a current-period tax expense in the income statement in the period in which the award either results in a tax deduction on the tax return or expires unexercised. See ASC 718-740-35-2.

15. Should an entity forecast excess tax benefits (or tax deficiencies) for share-based payment awards (e.g., options or restricted stock) in its ASC 740-270 annual effective tax rate (AETR)?

No. For interim reporting purposes, ASC 740-270-30-4 requires entities to account for excess tax benefits and tax deficiencies as discrete items in the period in which they occur (i.e., entities should exclude them from the AETR).

16. How does an entity determine the amount of the discrete item related to excess tax benefits or tax deficiencies?

Historically, for intraperiod allocation considerations, the following three approaches have been generally accepted for the calculation of the tax effects of excess tax benefits and tax deficiencies:

- *Direct effect* — Difference between (1) the actual tax deduction multiplied by the applicable tax rate (i.e., excludes indirect effects) and (2) the deferred tax asset recognized.
- *Full ASC 740 "with-and-without"* — Difference between (1) the entire incremental tax effect (i.e., includes indirect effects) of the actual tax deduction and (2) the entire incremental tax effect of the cumulative amount of compensation costs recognized for book purposes as if it were the actual tax deduction.
- *Entire incremental effect* — Difference between (1) the entire incremental tax effect (i.e., includes indirect effects) of the actual deduction and (2) the deferred tax asset recognized.

These approaches[4] would continue to be appropriate for determining the amount of excess tax benefits or tax deficiencies to be recognized in the financial statements after the effective date of the adoption. For more information about the three approaches, see Section 10.16, "Measuring the Excess Tax Benefit Associated With Share-Based Compensation: Tax Credits and Other Items That Affect the ETR," of Deloitte's *A Roadmap to Accounting for Income Taxes*.

[4] The approach chosen is treated as an accounting policy decision and should be applied consistently.

17. May an entity change its accounting policy and approach (see question 16 above) for determining the discrete amount related to excess tax benefits and tax deficiencies upon the adoption of ASU 2016-09?

Yes. Given the lack of definitive guidance on this topic in ASU 2016-09, upon adoption entities may choose a new policy and approach for determining the amount related to excess tax benefits and tax deficiencies. Entities should consistently apply that approach after adoption.

18. With the elimination of the APIC pool under the ASU, does an entity need to continue tracking its excess tax benefits and tax deficiencies?

While an entity will no longer need to separately track excess tax benefits and tax deficiencies for APIC pool purposes, it will still need to calculate them for determining the discrete amount in calculating its interim tax provision.

19. Does an entity still need to track its deferred tax assets related to share-based payment compensation cost?

Yes. ASC 718-740-25-2 continues to apply. It states:

> The cumulative amount of compensation cost recognized for instruments classified as equity that ordinarily would result in a future tax deduction under existing tax law shall be considered to be a deductible temporary difference in applying the requirements of Subtopic 740-10. The deductible temporary difference shall be based on the compensation cost recognized for financial reporting purposes. Compensation cost that is capitalized as part of the cost of an asset, such as inventory, shall be considered to be part of the tax basis of that asset for financial reporting purposes.

In addition, under ASC 718-10-50-2A, an entity is required to disclose the total recognized tax benefit related to compensation cost for share-based payment arrangements.

20. How are uncertain tax benefit (UTB) liabilities treated if the UTBs can be offset by previously unrecognized excess tax benefits recognized as a deferred tax asset upon adoption of ASU 2016-09?

There is no adjustment for UTBs upon the adoption of the ASU. However, an entity must apply ASC 740-10-45-10A and 45-10B and present a UTB as a reduction of a deferred tax asset for a net operating loss carryforward, a similar tax loss, or a tax credit carryforward to the extent that such tax attributes are available to settle the UTB as of the reporting date. Further, such UTBs should be considered part of the assessment of the realizability of the associated deferred tax assets recognized upon adoption.

21. Does the inclusion of excess tax benefits and tax deficiencies in the income statement affect the earnings-per-share (EPS) calculation?

Yes. The ASU's guidance on recording excess tax benefits and tax deficiencies in the income statement has a corresponding effect on the computation of basic and diluted EPS. In a manner similar to the transition associated with excess tax benefits and tax deficiencies, an entity would prospectively recognize the resulting change to EPS.

An entity that uses the treasury stock method to compute diluted EPS currently estimates (on the basis of current prices) the excess tax benefits and tax deficiencies to be recognized in APIC in determining the assumed proceeds available to repurchase shares. After adoption of the ASU, the entity would exclude excess tax benefits and tax deficiencies from the calculation of assumed proceeds since it recognizes such amounts in the income statement. Therefore, if the entity uses the treasury stock method, the ASU will affect the denominator of diluted EPS. For periods in which excess tax benefits exceed tax deficiencies, the ASU will have an increased dilutive effect on the denominator because there will be fewer hypothetical shares to be purchased with fewer assumed proceeds.

In addition, the ASU affects the numerator of both basic and diluted EPS because net income will change as a result of the recognition of excess tax benefits and tax deficiencies in the income statement. For periods in which excess tax benefits exceed tax deficiencies, the ASU will positively affect the numerator.

The ASU's effect on the numerator in basic and diluted EPS calculations and the denominator in diluted EPS may significantly affect an entity's EPS (as well as net income).

Accounting for Forfeitures

22. Does ASU 2016-09 require an entity to change its accounting policy for forfeitures?

No. An entity is not required to change its accounting policy for forfeitures, but it must disclose its accounting policy for them.

23. After adopting ASU 2016-09, can an entity subsequently change its forfeiture policy?

Maybe. When contemplating making changes to its forfeiture policy in a period after adopting the ASU, an entity must apply ASC 250, including the requirement that its new accounting policy be preferable to its existing one.

24. If an entity adopts a policy to account for forfeitures as they occur, are there instances in which the entity would still need to estimate forfeitures?

Yes. An entity must still estimate forfeitures when an award is (1) modified (the estimate applies to the original award in the measurement of the effects of the modification) and (2) exchanged in a business combination (the estimate applies to the amount attributed to precombination service). However, the accounting policy for forfeitures will apply to the subsequent accounting for awards that are modified or exchanged in a business combination.

25. If the entity adopts a policy to account for forfeitures as they occur, how does the accounting for nonforfeitable dividends change under the ASU?

If an entity elects to account for forfeitures when they occur, all nonforfeitable dividends are initially charged to retained earnings and reclassified to compensation cost only when forfeitures of the underlying awards occur.

Statutory Tax Withholding Requirements

26. Does the exception to liability classification in ASU 2016-09 related to statutory tax withholding requirements allow net settlement at the highest marginal rate in all jurisdictions for all awards?

No. The ASU's exception to liability classification does not apply to jurisdictions, individuals, or awards for which an entity does not have a statutory tax withholding obligation. Any net settlement for employee taxes would result in liability-classified awards.

27. An employer may apply a "hypothetical" withholding rate to net settle the share-based payment awards for certain employees who work in multiple jurisdictions (i.e., mobile employees) or are on international assignment (e.g., "ex-pat" employees). How does the exception to liability classification in ASU 2016-09 related to statutory tax withholding requirements apply in such circumstances?

The fundamental principles in ASU 2016-09 apply to any net settlement related to tax withholdings. For an award to remain equity classified, the entity must have a statutory tax withholding requirement in each jurisdiction in which amounts are withheld for that particular individual and award, and such amounts cannot exceed each jurisdiction's maximum statutory tax rate.

28. If an entity changes the terms of its existing awards related to net settlement for withholding taxes from the minimum statutory tax rate to a higher rate up to the maximum statutory tax rate, should such change be accounted for as a modification under ASC 718-20-35-3?

No. An entity would not be required to account for such a change as a modification. However, this accounting treatment applies only in these narrow circumstances (i.e., solely to change the net-settlement provisions from the minimum statutory tax rate to a higher rate up to the maximum statutory tax rate for statutory tax withholding purposes) and should not be analogized to other situations.

Practical Expedients for Nonpublic Entities

29. Does the expected-term practical expedient apply to a nonpublic entity's liability-classified awards?

Yes. The expected-term practical expedient applies to liability-classified awards measured at fair value, even if the awards cease to be at the money upon remeasurement.

30. Can a nonpublic entity apply the expected-term practical expedient to awards with market conditions?

No. ASC 718-10-30-20B lists the criteria that must be met for an entity to use the expected-term practical expedient, and the practical expedient cannot be applied to awards with market conditions. Other criteria include the following: (1) the award must be granted at the money (the exercise price is equal to the market price of the underlying share on the grant date), (2) the employee must have a limited period in which to exercise the award (typically 30 to 90 days) if the employee terminates service after vesting, and (3) the employee can only exercise the award (the employee cannot sell or hedge the award).

31. Are there differences between a public entity's ability to apply a simplified method of estimating the expected term and a nonpublic entity's ability to do so?

Yes, since there are some differences between the guidance in ASU 2016-09 and SAB Topic 14.[5] For example, a nonpublic entity can apply the simplified method to awards with performance conditions (as along as the nonpublic entity meets the other criteria to use the practical expedient), whereas a public entity cannot. Further, a public entity must demonstrate that its historical share option exercise experience is not a reasonable basis upon which to estimate expected term to apply the simplified method; a nonpublic entity is not required to do so.

[5] SEC Staff Accounting Bulletin Topic 14, "Share-Based Payment."

32. If a nonpublic entity has a policy of measuring its liability-classified awards at intrinsic value (including a nonpublic entity that elects to change the measurement of its liability-classified awards from fair value to intrinsic value upon adoption of ASU 2016-09), can a nonpublic entity make a subsequent change in accounting policy to measure its liability-classified awards at fair value?

Yes, provided that it applies the guidance in ASC 250 on changes in accounting principle. ASC 718-30-35-4 states that "[t]he fair-value-based method is preferable for purposes of justifying a change in accounting principle under Topic 250." Thus, an entity can change the measurement of its liability-classified awards to fair value from intrinsic value if the entity also applies the guidance in ASC 250 on changes in accounting principle.

33. If a nonpublic entity has a policy of measuring its liability-classified awards at fair value, can the entity change from fair value measurement to intrinsic value measurement without demonstrating preferability after its adoption of ASU 2016-09?

No. The one-time election must be made on the date of adoption of ASU 2016-09.

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