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## Potential Revision of Statement 123R's Classification Requirements for Contingently Cash-Settleable Share Options

Share options and similar instruments granted as employee compensation that could require cash settlement when a contingent event occurs will be classified as either liabilities or equity, depending in part on an assessment of the contingent event's probability, if a planned Staff Position is developed and approved in line with the decisions made at yesterday's FASB meeting. The Board instructed the staff to revise the approach in Statement 123R by drafting a Staff Position that incorporates the probability assessment.<sup>1</sup> If adopted, the revision would affect whether companies have to reclassify share-option awards as liabilities when they adopt Statement 123R.

### Statement 123R's Current Requirement

Statement 123R's paragraph 32 requires an employee share option or similar instrument to be classified as a liability if the terms of the instrument require, or permit at the employee's election, cash settlement on the occurrence of "any" circumstance. Liability classification is therefore mandatory if the company can be compelled to cash settle the award based on any circumstance, no matter how unlikely it is that the circumstance will occur.

Under Opinion 25 and Statement 123, an entity assesses the probability that the contingent event will occur and incorporates the assessment in evaluating whether the award is classified as equity or a liability.<sup>2</sup> If the event's occurrence is not considered probable, the share option or similar instrument would be equity classified as long as the award would otherwise be share settled. Similarly, paragraph 31 of Statement 123R, on classifying awards with share-repurchase features, takes into consideration the likelihood that an event's occurrence may trigger a repurchase feature. Because assessing probability is not included in classifying share option awards with repurchase features under the current requirements in Statement 123R, practice would be different under Statement 123R than it has been under Opinion 25 and Statement 123 if the revision is not made.

### Alert

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<sup>1</sup> FASB Statement No. 123 (revised 2004), Share-Based Payment, December 2004, available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> APB Opinion No. 25, Accounting for Stock Issued to Employees, October 1972; FASB Statement No. 123, Accounting for Stock-Based Compensation, October 1995, available at [www.fasb.org](http://www.fasb.org).



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### The Potential Revision

The planned Staff Position would revise paragraph 32 of Statement 123R to include a requirement that companies assess the probability of an event's occurrence that could require a company to repurchase a share option or similar instrument. The assessment would be consistent with footnote 16 to paragraph 31 of Statement 123R. According to footnote 16, a share-repurchase feature exercisable only upon the occurrence of a contingent event that is outside the employee's control would not result in liability classification until it becomes probable that the event will occur within a reasonable period of time.

Under the planned approach, share-based payment plans with repurchase features that are triggered by events that are unlikely to occur would be equity-classified until the contingent event that would require, or permit the holder of the award to elect, cash settlement became probable of occurring, provided the award would otherwise be equity classified under Statement 123R. Events that may require or permit cash settlement include a change in control, the employee's death or disability, a change in ownership that meets a specified threshold, or a liquidity event, such as an IPO. SEC registrants must also consider the requirements of EITF D-98, which may require that some or all of the equity-classified amount be displayed outside of permanent equity.<sup>3</sup>

### Transition

The FASB staff recommended that any revised guidance be applied when Statement 123R is initially adopted. An entity that adopted Statement 123R before the final Staff Position is issued would apply its guidance in the first reporting period beginning after the date that the final Staff Position is posted to the FASB's Web site. A company that applied Statement 123R and treated share options or similar instruments that allow cash settlement upon the occurrence of a contingent event in accordance with the guidance in the Staff Position would not be required to restate prior periods. However, it is expected that the proposed Staff Position will state that an entity that treated share options or similar instruments that require cash settlement upon the occurrence of a contingent event as a liability under Statement 123R's current provisions would be required to apply the proposed guidance retrospectively to prior-period results as though the Staff Position had been in effect at the date the company first applied Statement 123R.



The planned Staff Position must be exposed for public comment for 15 days, after which the Board will consider the comments and determine whether a final Staff Position should be issued. Until that time, the provisions of paragraph 32 of Statement 123R remain in effect for companies that have adopted it.

The descriptive and summary statements above are not intended to substitute for the text of Statements 123R and 123, APB Opinion 25, the FASB Staff Position that is entering development, or any other cited, actual, or potential requirements. Nor are any of the cited documents necessarily applicable to any entity's specific circumstances. Those accounting for share-based-payment arrangements and complying with SEC filing requirements should refer to the texts of the applicable documents that set out requirements and consult their accounting and legal advisors.

<sup>3</sup> EITF Topic No. D-98, Classification and Measurement of Redeemable Securities.