FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: May 11, 2023
Comments Due: July 10, 2023

Compensation—Stock Compensation (Topic 718)

Scope Application of Profits Interest Awards

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 718 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2023-ED300, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until July 10, 2023. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2023-ED300
- Sending a letter to “Technical Director, File Reference No. 2023-ED300, FASB, 801 Main Avenue, PO Box 5116, Norwalk, CT 06856-5116.”

All comments received are part of the FASB’s public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The FASB is issuing the amendments in this proposed Update to improve generally accepted accounting principles (GAAP) by adding an illustrative example to demonstrate how an entity would apply the scope guidance in paragraph 718-10-15-3 to determine whether profits interest and similar awards ("profits interest awards") should be accounted for in accordance with Topic 718, Compensation—Stock Compensation.

Certain entities provide employees or other service providers with profits interest awards to align compensation with an entity's operating performance and provide those holders with the opportunity to participate in future profits and/or equity appreciation of the entity. The term *profits interest* is not defined in GAAP but differentiates those interests from capital interests held by investors that provide those holders with rights to the existing net assets in a partnership. Because profits interest holders only participate in future profits and/or equity appreciation and have no rights to the existing net assets of the partnership, stakeholders have indicated that it can be complex to determine whether a profits interest award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, Compensation—General, or other Topics). As a result, stakeholders have highlighted existing diversity in practice.

Currently, entities evaluate the terms, conditions, and characteristics of a profits interest award and apply judgment to determine whether to account for the award under Topic 718 or Topic 710. However, stakeholders have indicated that there is diversity in practice even when evaluating similar fact patterns. Therefore, stakeholders requested examples to clarify when the guidance in Topic 718 should be applied to profits interest awards (referred to herein as the "scope application issue"). In addition, entities accounting for economically similar awards consistently would benefit investors and other allocators of capital.

The scope application issue, along with other related issues, was identified and discussed by the Private Company Council (PCC) because of the prevalence of profits interest awards among private companies. However, given that the PCC research indicated that certain public business entities (PBEs) also may be required to account for profits interest awards, the PCC recommended that the Board add a project to address the scope application issue for PBEs and entities other than PBEs (that is, all reporting entities). The Board added that project, Scope Application of Profits Interests Awards: Compensation—Stock Compensation (Topic 718), to its technical agenda in December 2022.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all reporting entities that account for profits interest awards as compensation to employees in return for goods or services.

What Are the Main Provisions and Why Would They Be an Improvement to GAAP?

The amendments in this proposed Update would improve GAAP by adding an illustrative example that includes four fact patterns to demonstrate how an entity would apply the scope guidance in paragraph 718-10-15-3 to determine whether a profits interest award should be accounted for in accordance with Topic 718.

The fact patterns in the proposed illustrative example focus on the scope conditions in paragraph 718-10-15-3. The proposed illustrative example is intended to reduce (1) complexity in determining whether a profits interest award is subject to the guidance in Topic 718 and (2) existing diversity in practice.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied either (1) retrospectively to all prior periods presented in the financial statements or (2) prospectively to profits interest awards granted or modified on or after the effective date. If the proposed amendments are applied prospectively, an entity would be required to disclose the nature of and reason for the change in accounting principle. The effective date and whether early adoption of the proposed amendments should be permitted will be determined after the Board considers stakeholder feedback on the proposed amendments.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Do you agree that the amendments in this proposed Update should apply to all reporting entities (including PBEs and entities other than PBEs)? Please explain why or why not.

Question 2: Is the proposed illustrative example included in paragraphs 718-10-55-138 through 55-148 to determine whether a profits interest award should be accounted for in accordance with Topic 718 clear and operable? Please explain why or why not. Should the illustrative example include other considerations or exclude any considerations? If yes, please explain how you would change the proposed illustrative example.

Question 3: An entity would be required to apply the proposed amendments either (a) retrospectively to all prior periods presented in the financial statements or (b) prospectively to awards granted or modified on or after the effective date with an associated disclosure that describes the nature of and reason for the change in accounting principle. Do you agree with the proposed transition provisions? If not, why not, and what basis would be more appropriate and why?

Question 4: Regarding the effective date, how much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than PBEs be different from the amount of time needed by PBEs? Should early adoption be permitted? Please explain your response.

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2–4. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is underlined, and deleted text is ~~struck out~~.

Amendments to Subtopic 718-10

2. Add paragraph 718-10-15-3B, with a link to transition paragraph 718-10-65-17, as follows:

Compensation—Stock Compensation—Overall

Scope and Scope Exceptions

> Transactions

718-10-15-3 The guidance in the Compensation—Stock Compensation Topic applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor's own operations or provides consideration payable to a customer by **issuing** (or offering to issue) its shares, share options, or other equity instruments or by incurring liabilities to an **employee** or a nonemployee that meet either of the following conditions:

a. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase *at least in part* is used because an **award** of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a **market**, **performance**, or **service condition**.)
b. The awards require or may require **settlement** by issuing the entity's equity shares or other equity instruments.

718-10-15-3A Paragraphs 323-10-25-3 through 25-5 provide guidance on accounting for share-based compensation granted by an investor to employees or nonemployees of an equity method investee that provide goods or services to the investee that are used or consumed in the investee's operations.

718-10-15-3B An entity shall apply the guidance in paragraph 718-10-15-3 to determine whether a profits interest or similar award is within the scope of this Topic. Paragraphs 718-10-55-138 through 55-148 illustrate how the guidance in paragraph 718-10-15-3 applies to common features in a profits interest or similar award.

3. Add paragraphs 718-10-55-138 through 55-148 and their related headings, with a link to transition paragraph 718-10-65-17, as follows:

Implementation Guidance and Illustrations

> Illustrations

. > Example 10: Profits Interest Awards

718-10-55-138 This Example illustrates how an entity should apply the guidance in paragraph 718-10-15-3 to determine whether a profits interest or similar award is within the scope of this Topic. The following Cases illustrate the application of the guidance in paragraph 718-10-15-3 for individual profits interest and similar awards to determine whether the award is a share-based payment arrangement and is within the scope of this Topic or is not a share-based payment arrangement and, therefore, is within the scope of other Topics. The guidance in this Example is limited to the application of paragraph 718-10-15-3 and does not address how to apply other Sections of this Topic, including recognition, initial measurement, subsequent measurement, other presentation matters, and disclosure.

718-10-55-139 Cases A, B, C, and D share the following assumptions:

a. Entity X is a partnership. Before June 1, 20X1, Entity X had a single class of equity interests outstanding—Class A units. On June 1, 20X1, Entity X grants profits interest units (Class B units) to employees of a subsidiary of Entity X in exchange for services.
b. An exit event may include an initial public offering, a change in control, or a liquidation of Entity X's assets.

. . > Case A: Profits Interest Award Is a Share-Based Payment Arrangement

718-10-55-140 Additional assumptions are as follows:

a. The Class B units are subordinated to the Class A units and after vesting participate pro rata with the Class A units once the holders of the Class

A units have received distributions equal to a predetermined distribution threshold established on the grant date of the Class B units.

b. The Class B units cliff vest at the end of three years of service.

c. Upon an exit event, the Class B units vest immediately if a grantee is still providing services. Upon such an event, the grantee would retain the vested Class B units, or if Class B units are settled through the exit event, Entity X would distribute proceeds to the Class B unit holders in the same manner as is described in (a).

d. If a grantee of the Class B units terminates employment with the subsidiary of Entity X (whether voluntarily, upon death, disability, or retirement or at the election of Entity X for reasons other than cause), any unvested Class B units will be forfeited for no consideration. If a grantee of the Class B units terminates employment after vesting, the grantee retains ownership of those units, but upon the grantee's termination of employment, Entity X has a call right to repurchase the Class B units. If the call right is exercised, Entity X would pay the grantee of the Class B units the fair value of the Class B units on the call date.

718-10-55-141 Entity X evaluates the conditions in paragraph 718-10-15-3 to determine whether to account for the Class B units by applying the guidance in this Topic. The condition in paragraph 718-10-15-3(a) is met because of both of the following:

a. The grantee can retain the vested Class B units upon termination of service, subject to repurchase by Entity X at fair value on the call date, and, therefore, is exposed to the changes in the fair value of Entity X's equity.

b. The grantee of the Class B units has the right to participate in the residual net assets of Entity X upon dissolution, liquidation, or an exit event proportionate to ownership of Class B units of Entity X in accordance with the distribution waterfall described in paragraph 718-10-55-140(a).

Therefore, Entity X would account for the Class B units by applying the guidance in this Topic.

. . > Case B: Profits Interest Award Is a Share-Based Payment Arrangement

718-10-55-142 Additional assumptions are as follows:

a. The Class B units are subordinated to the Class A units and once granted participate pro rata with the Class A units once the holders of the Class A units have received distributions equal to a predetermined distribution threshold established on the grant date of the Class B units.

b. The Class B units only vest upon an exit event. Upon such an event, a grantee would retain the vested Class B units, or if Class B units are settled through the exit event, Entity X would distribute proceeds to the Class B unit holders in the same manner as is described in (a). Class B units are forfeitable upon the grantee's termination for any reason at any time before the exit event.

c. The grantee of Class B units is eligible to begin participating in nonforfeitable operating distributions at the grant date.

718-10-55-143 Entity X evaluates the conditions in paragraph 718-10-15-3 to determine whether to account for the Class B units by applying the guidance in this Topic. The condition in paragraph 718-10-15-3(a) is met because if the Class B units are settled through an exit event, the grantee of the Class B units has the right to participate in the residual net assets of Entity X upon the exit event proportionate to ownership of Class B units of Entity X in accordance with the distribution waterfall described in paragraph 718-10-55-142(a). Therefore, Entity X would account for the Class B units by applying the guidance in this Topic.

718-10-55-144 The grantee of the Class B units is not entitled to retain the units if the grantee ceases to provide services before an exit event. Upon termination of employment before an exit event, the grantee of the Class B units would forfeit all rights to future distributions and would forfeit Class B units for no consideration. Entity X would account for the grantee's right to participate in nonforfeitable operating distributions in accordance with paragraph 718-10-55-45.

. . > Case C: Profits Interest Award Is Not a Share-Based Payment Arrangement

718-10-55-145 Additional assumptions are as follows:

a. The grantee of the Class B units is eligible to participate in operating distributions made by Entity X equal to 1 percent of the preceding fiscal year's net income. The grantee of the Class B units becomes eligible to begin participating in these operating distributions after three years of service are rendered.
b. Class B units are forfeitable upon the grantee's termination for any reason at any time (including after the grantee has rendered three years of service).
c. The grantee of the Class B units is not eligible to participate in any proceeds distributed upon an exit event.
d. Class B units do not entitle the grantee to receive equity of Entity X.

718-10-55-146 Entity X evaluates the conditions in paragraph 718-10-15-3 to determine whether to account for the Class B units by applying the guidance in this Topic. The condition in paragraph 718-10-15-3(a) is not met because the proceeds that would be received by the grantee in all circumstances are based on an operating metric (1 percent of the preceding fiscal year's net income) of Entity X and are not based, at least in part, on the price of the entity's shares. Furthermore, the condition in paragraph 718-10-15-3(b) is not met because Entity X is not required to issue equity shares. Therefore, Entity X would not apply the guidance in this Topic to account for the Class B units and, instead, would account for the Class B units in accordance with other Topics.

. . > Case D: Profits Interest Award Is Not a Share-Based Payment Arrangement

718-10-55-147 Additional assumptions are as follows:

a. The grantee of the Class B units does not participate in distributions in the ordinary course of business.
b. The grantee of the Class B units is eligible to participate only in specified distributions upon an exit event. Upon an exit event, the Class B units vest immediately and must be settled in cash in accordance with a formula that is based on an operating metric (1 percent of the preceding fiscal year's net income) of Entity X. The grantee of Class B units must be providing services when the exit event occurs to receive any proceeds, and the Class B units are forfeitable upon the grantee's termination for any reason at any time before an exit event.
c. Class B units do not entitle the grantee to receive equity of Entity X.

718-10-55-148 Entity X evaluates the conditions in paragraph 718-10-15-3 to determine whether to account for the Class B units by applying the guidance in this Topic. The condition in paragraph 718-10-15-3(a) is not met because the proceeds that would be received by the grantee in all circumstances are based on a formula that is not based, at least in part, on the price of Entity X's shares. Furthermore, the condition in paragraph 718-10-15-3(b) is not met because Entity X is not required to issue equity shares. Therefore, Entity X would not apply the guidance in this Topic to account for the Class B units and, instead, would account for the Class B units in accordance with other Topics.

4. Add paragraph 718-10-65-17 and its related heading as follows:

Transition and Open Effective Date Information

> Transition Related to Accounting Standards Update No. 2023-XX, *Compensation—Stock Compensation (Topic 718): Scope Application of Profits Interest Awards*

718-10-65-17 The following represents the transition and effective date information related to Accounting Standards Update No. 2023-XX, *Compensation—Stock Compensation (Topic 718): Scope Application of Profits Interest Awards:*

a. The pending content that links to this paragraph shall be effective [date to be inserted after exposure].
b. An entity shall apply the pending content that links to this paragraph either:
   1. Retrospectively to all prior periods presented in the financial statements in accordance with paragraphs 250-10-45-5 through 45-8.
   2. Prospectively to profits interest or similar awards granted or modified on or after the effective date with an associated disclosure that describes the nature of and reason for the change in accounting principle.

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Richard R. Jones, *Chair*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Frederick L. Cannon
Susan M. Cosper
Marsha L. Hunt

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Board's considerations in reaching the conclusions in this proposed Update. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

BC2. Certain entities provide employees or other service providers with profits interest awards to align compensation with an entity's operating performance and provide those holders with the opportunity to participate in future profits and/or equity appreciation of the entity. Profits interest awards also may incentivize recipients to assist the entity to achieve a specific operating metric or objective. In October 2018, the FASB received an agenda request that asked the Board to provide specific guidance about whether a profits interest award should be accounted for as a share-based payment arrangement under Topic 718 or similar to a cash bonus or profit-sharing arrangement under Topic 710 or other Topics. The agenda request described a "facts and circumstances based approach" that many entities have applied in practice to determine whether a profits interest award is within the scope of Topic 718 or another Topic. The agenda request indicated that the application of this approach has resulted in diversity in practice and inconsistent conclusions regarding similar fact patterns.

BC3. *Profits interest* is not a defined term in the Master Glossary of the Codification. *Profits interest* is defined in IRS Revenue Procedure (Rev. Proc.) 93-27 as a "partnership interest other than a capital interest." Under Rev. Proc. 93-27, a profits interest is an interest in a partnership that would receive no proceeds if the partnership were immediately liquidated at the time of receipt of the partnership interest. Profits interests are contrasted with *capital interests*, which are partnership interests whose holders would receive proceeds if the entity were immediately liquidated. A profits interest provides the holder with rights to a share of only the partnership's future profits and/or equity appreciation and does not provide the holder with rights to the existing net assets of the partnership. Typically, legal form profits interests are issued by limited partnerships (LPs) and limited liability companies (LLCs) but may be issued by other types of partnerships.

BC4. While the term *profits interest* is not defined in the Master Glossary, Topic 718 indicates that partnership interests could be included within its scope. The term *share-based payment arrangements* is defined in the Master Glossary and states, in part:

> The term shares includes various forms of ownership interest that may not take the legal form of securities (for example, partnership interests), as well as other interests, including those that are liabilities in substance but not in form.

BC5. The characteristics of a profits interest award can vary such that in some instances the award may be more akin to other types of equity awards (such as stock options), but in other instances the award may be more akin to a performance bonus or profit-sharing arrangement. Common terms and characteristics of profits interest awards include but may not be limited to:

a. Management's intent is to award the recipient compensation upon a sale, liquidity event (for example, an initial public offering [IPO] or other change of control), or final liquidation of the entity.
b. Awards have a relatively high distribution hurdle. Recipients of such awards generally will not receive distributions in the normal course of business because of the high threshold required and the level of subordination. Recipients are more likely to receive residual value upon a sale or liquidity event.
c. Awards frequently have an explicit performance condition linked to a change in control, recapitalization, IPO, or other liquidity event.
d. Awards may or may not have an explicit service condition required for vesting.
e. Forfeiture and repurchase provisions vary significantly. Some awards are forfeited upon separation from the entity for any reason, while other awards include a call option exercisable at fair market value, calculated value, or some other amount.
f. Awards typically (1) do not grant voting rights, (2) contain various transfer restrictions, and (3) require no initial monetary investment by the grantee.
g. Profits interest awards may qualify the recipient for beneficial tax treatment.

BC6. When discussing the scope application issue, stakeholders have indicated that the existing diversity in practice applies to both (a) awards that meet the legal definition of a profits interest and (b) other types of awards. There are other types of awards that are economically similar to profits interest awards but that do not meet the legal definition of a profits interest. Examples include share appreciation rights or phantom units granted by a partnership that convey rights that are similar to those of a profits interest award but that do not convey legal equity. Such awards are common in grants to international employees and service providers.

BC7. In response to the 2018 agenda request, in August 2020 the PCC formed a working group to conduct outreach to determine whether there were pervasive practice-related issues that should be addressed. To assist the working group, the

FASB staff performed additional research and outreach on issues related to profits interest awards, including various discussions with the PCC.

BC8. At the April 2022 PCC meeting, the FASB staff presented an analysis and recommendations on the scope application issue to assist the PCC Technical Agenda Consultation Group when discussing whether to recommend that the PCC or the Board add a project to its technical agenda. Through research and outreach conducted with the assistance of the PCC working group, the PCC determined that the largest population of operating companies with profits interest awards is private equity portfolio companies; however, profits interest awards also can be issued by other types of private companies. The PCC also determined that the scope application issue is not solely limited to private companies because certain PBEs also may be required to account for profits interest awards that remain outstanding when (a) the entity has not yet completed an IPO but has filed or furnished financial statements with or to the U.S. Securities and Exchange Commission (SEC) or (b), less commonly, in situations in which profits interest awards have remained outstanding following an IPO. Because the scope application issue is not limited to private companies, the PCC recommended that the Board add a project to its technical agenda. Given the prevalence of profits interest awards in private company compensation plans, the PCC also provided input for the Board's consideration about a potential illustrative example and transition guidance.

BC9. The Board added a project in response to the PCC's recommendation to improve GAAP by developing an example to illustrate how an entity would apply the scope guidance in paragraph 718-10-15-3 to determine whether a profits interest award should be accounted for in accordance with Topic 718. Given the existing diversity in practice, the Board expects that the clarifications from the amendments in this proposed Update may result in more profits interest awards being accounted for in accordance with Topic 718.

Benefits and Costs

BC10. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Board's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC11. Overall, the Board concluded that the expected benefits of the amendments in this proposed Update would justify the expected costs for all reporting entities.

The proposed example illustrates the application of paragraph 718-10-15-3 across profits interest award types with different terms and characteristics and is intended to reduce (a) complexity in determining whether a profits interest award is subject to the guidance in Topic 718 and (b) diversity in practice. Investors and other allocators of capital would benefit from entities accounting for economically similar awards consistently.

BC12. The Board acknowledged that some preparers that currently are accounting for certain profits interest awards under Topic 710 or other Topics may conclude on the basis of the proposed illustrative example that those profits interest awards should be accounted for under Topic 718. Those preparers may incur incremental costs to apply the guidance in Topic 718. However, the Board does not anticipate that the amendments in this proposed Update would result in a significant change for most entities because outreach has indicated that, over time, more entities have been concluding that their profits interest awards should be accounted for in accordance with Topic 718.

Basis for Conclusions

Scope

BC13. The amendments in this proposed Update would apply to all reporting entities that account for profits interest awards as compensation to employees in return for goods or services (including PBEs and entities other than PBEs).

BC14. As discussed in paragraphs BC3–BC6, given the variability in legal form, terms, and characteristics of profits interest awards, the Board decided not to define the term *profits interest* in the Codification. Rather, the amendments in this proposed Update would apply to both profits interest and similar awards.

Illustrative Example

BC15. The illustrative example included in the amendments in this proposed Update is intended to demonstrate how an entity would apply the scope guidance in paragraph 718-10-15-3 to determine whether a profits interest award should be accounted for in accordance with Topic 718.

BC16. Paragraph 718-10-15-3 includes two conditions for an entity to consider in determining whether an award should be accounted for in accordance with Topic 718. Those conditions include the following:

a. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase *at least in part* is used because an award of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a market, performance, or service condition.)

b. The awards require or may require settlement by issuing the entity's equity shares or other equity instruments.

BC17. The approach generally applied in practice today (discussed in paragraph BC2) to determine whether a profits interest award should be accounted for under Topic 718 or another Topic has led to diversity in practice. The proposed illustrative example is intended to highlight common fact patterns. Cases A through D emphasize relevant facts to be evaluated when determining whether a profits interest award meets the scope guidance in paragraph 718-10-15-3. The proposed illustrative example does not address how to apply other guidance in Topic 718, including whether a profits interest award should be classified as a liability or as equity.

BC18. The proposed illustrative example includes four fact patterns and highlights key considerations to help an entity determine how to evaluate common terms and characteristics of profits interest and similar awards that were identified as part of research and outreach, including a grantee's forfeiture of an award that, upon termination of employment with the entity, has vested according to the contract but that does not meet the definition of *vested* in Topic 718.

BC19. The proposed illustrative example demonstrates how an entity might apply paragraph 718-10-15-3 to a profits interest award on the basis of the limited facts presented. However, the illustrative example is not intended to be all-inclusive. Entities should consider all relevant facts and circumstances when determining whether a profits interest award should be accounted for in accordance with Topic 718.

Effective Date and Transition

BC20. The Board decided to require that an entity apply the amendments in this proposed Update either (a) retrospectively to all prior periods presented in the financial statements in accordance with paragraphs 250-10-45-5 through 45-8 or (b) prospectively to awards granted or modified on or after the effective date with a disclosure that describes the nature of and reason for the change in accounting principle.

BC21. Because the Board expects that the clarifications provided by the proposed illustrative example may result in more entities accounting for profits interest awards under Topic 718, the Board considered that a prospective approach would be less costly to apply than a retrospective approach. For example, an entity applying the amendments in this proposed Update retrospectively might incur costs to acquire certain information required by Topic 718 (such as the grant date fair value for equity-classified awards or having to determine whether modifications were made after the award's grant date). However, the Board considered that some entities may prefer to apply the proposed amendments retrospectively so that similar awards are accounted for consistently going forward. Therefore, the Board decided to permit either retrospective application or prospective application.

BC22. If an entity applies the amendments in this proposed Update prospectively, the Board decided to require that the entity disclose the nature of and reason for the change in accounting principle to provide transparency to investors and other allocators of capital.

BC23. The Board will determine the effective date and whether early application should be permitted after it considers stakeholder feedback on the amendments in this proposed Update.

Amendments to the GAAP Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require improvements to the GAAP Financial Reporting Taxonomy and SEC Reporting Taxonomy (collectively referred to as the "GAAP Taxonomy"). We welcome comments on these proposed improvements to the GAAP Taxonomy at xbrled@fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, the proposed improvements to the GAAP Taxonomy will be finalized as part of the annual release process.