Simplifying the Complexities of Compensation Awards

Key Aspects of ASU 2024-01:

ASU 2024-01 Compensation – Stock Compensation (Topic 718) – Clarifies the scope of Topic 718 for profits interest and similar awards which allow holders to share in future appreciation and earnings of the entity. In addition, the ASU clarifies that if the award is determined to be within the scope of topic 718, the existing disclosure requirements of topic 718 apply. There are no changes to the recognition, classification, or measurement guidance – only to scope determination. Entities must analyze the specific facts/terms of each award. This ASU will help entities determine whether to apply topic 718, Stock compensation, or topic 710, General compensation.

Key Reporting Distinction:

- ASC 718 applies if the award is an offer to issue the entity's equity or the award's value is based on the entity's overall equity value (e.g., linked to an exit event).
- ASC 710 applies if the award is based on internal accounting measures (e.g., net operating profit) and is not linked to the entity's equity value.

Situational Example #1 – Share-based Payment Arrangement:

Class B units are granted with a vesting period and a participation right in an exit event alongside Class A units.

Since the award is linked to an exit event, topic 718, or stock compensation, applies.

Situational Example #2 – Share-based Payment Arrangement (with a hurdle):

Class B units vest upon an exit event, but only after Class A holders receive a predefined return.

Even with the pre-defined return (hurdle) the payout is based on equity appreciation, and the award is based on an exit event, so topic 718, or stock compensation, applies.

Situational Example #3 – Not a Share-based Payment:

Class A holders will receive a 10% distribution which is based on net income and there are no proceeds from an exit event.

Since the payout is not tied to equity value, ASC 710, general compensation applies.

Situational Example #4 – Not a Share-based Payment (with cash payout at exit):

Class B holders receive a cash payout at an exit event, but the value is based on a calculation tied to net income rather than the entity’s equity value.

Since the payout is not tied to equity value, ASC 710, general compensation applies.

Required Disclosures under Topic 718 (Existing – Not New):

- Nature and terms of share-based payment arrangements.
- Number and weighted-average grant-date fair value of awards.
- Method and significant assumptions used to estimate fair value of awards.
- Nature and reason for change in accounting principle (if applicable), the transition method used (prospective or retrospective), and the effect of the change on the financial statement line items, if material.

Summary

ASU 2024-01 applies to all entities that grant profits interests or similar awards as compensation, and it brings clarity and consistency to the complexities of compensation awards. This ASU is effective for annual periods beginning after December 15, 2025, with early adoption permitted for financial statements not yet issued or made available for issuance.