accounted for as share-based payment arrangements.

Jason Bramwell • Mar. 21, 2024

An Accounting Standards Update (ASU) issued by the Financial Accounting Standards Board (FASB) on March 21 provides illustrative guidance to help companies determine whether profits interest and similar awards should be accounted for as share-based payment arrangements within the scope of Topic 718, *Compensation—Stock Compensation*.

The purpose of profits interest awards is generally to give employees the opportunity to participate in the upside of the entity—typically private companies—upon an initial public offering or a sale, or perhaps an incentive to assist the entity to achieve a specific operating metric. Profits interests have become a prevalent form of

> 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 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 highlighted existing diversity in practice.

The PCC recommended that the FASB add a project that would provide illustrative guidance for all reporting entities that account for profits interest and similar awards. The board added that project, *Scope Application of Profits Interests Awards: Compensation—Stock Compensation (Topic 718)*, to its technical agenda in December 2022 and issued a proposed ASU last May.

The ASU provides an illustrative example intended to demonstrate how entities that account for profits interest and similar awards would determine whether a profits interest award should be accounted for in accordance with Topic 718.

For public business entities, the ASU is effective for annual periods beginning after Dec. 15, 2024, and interim periods within those annual periods. For all other entities, the amendments are effective for annual periods beginning after Dec. 15, 2025, and interim periods within those annual periods. Early adoption is permitted.

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