SEMLER BROSSY

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PSU Modifications

ACCOUNTING & DISCLOSURE IMPLICATIONS

NOTE
Semler Brossy Consulting Group does not provide tax, legal or accounting advice and does not provide regulatory guidance in the jurisdictions being considered. The Company should consult its respective experts in those fields on such matters, as appropriate.

Summary of Modifications to Performance Share Awards

Many companies are considering adjustments to in-flight performance share awards as a result of COVID-19. The following outlines the accounting and disclosure implications of a modification to the awards.

Modifications to the goals for in-flight performance share awards require additional disclosure and incur additional accounting expense if the goals are modified from an award that is unlikely to be earned to an award that is likely to be earned, or to be earned at a higher level following the modification[1]

In certain circumstances, some adjustments are applied without requiring a modification

- If the terms of the award agreement prescribes an adjustment ("shall adjust" and not "may adjust"), it is not considered a modification for these purposes (e.g., adjustments related to changes to accounting standards)
- The distinction is that "shall adjust" ties directly to the goal measurement already in-use in the program (e.g., adjusted metrics), whereas "may adjust" implies after-the-fact discretion to adjust certain items that may not be covered in adjusted metric definitions. This distinction is a "fine-line," thus we recommend reviewing actions against agreements and discussing adjustments with counsel and accountants.

If a modification does apply, the amount of the additional expense is based on the stock price at the time of the modification multiplied by the number of additional shares expected to vest after the modification

- Expense is recognized over the remaining period of the award
- Incremental value of the award is disclosed as a new grant in the Summary Compensation Table and the Grants of Plan-Based Awards Table

Illustrative Modification Example

Scenario	Share Price	Target Shares	Probable Achievement?	Accrual Percent	Anticipated Vesting Shares	Probable Expense ($MM)
Original Grant	$25.00	100,000	No	0%	0	$0.0
Grant at Modification	$15.00	100,000	Yes	100%	100,000	$1.5
					GOPBA- and SCT-Reportable Incremental Value	**$1.5**

[1] *Award modification could also result in new cumulative accounting based on the modification share price even if an incremental cost is not recognized at modification. This cumulative expense would be based on the number of shares ultimately earned.*

Performance Share Modification Accounting (1 of 2)

A change to the terms and conditions of a share-based award must be accounted for as a modification if the change:

- Affects any of the valuation inputs used to value the award,
- Changes the vesting conditions, or
- Changes the classification (as equity or liability) of the award
- Is not prescribed by language in the award agreement (e.g., a provision that requires an adjustment for unusual events)

There are two primary variables that impact a modification accounting expense on the date of the modification: the then-current share price and the probability of award achievement.

- Note that the probability of award achievement should be considered at all points on a potential payout curve (i.e., threshold, target, and maximum)—and that “probable” is more than 50% likely (whether 51% or 100%)1

If a modification produces an incremental accounting expense, then the value of the additional expense is recognized over the remaining service period.

- The full incremental value of the modified award will appear in the Grants of Plan-Based Awards Table and Summary Compensation Table for any Named Executive Officers. <u>Disclosure in these tables is required only to the extent that an incremental expense exists at the time of modification</u>

[1] The probable/ improbable analysis needs to be applied to the various payout points. For example, achievement of a pre-modified target may be improbable, while the achievement of the threshold goal for the same award may be probable. A modification of this grant could result in threshold and target being probable.

Performance Share Modification Accounting (2 of 2)

For performance shares, there are four general types of modifications to think about. For simplicity, the following assume that there is only one goal (i.e., either all or none of the shares will be earned) rather than separate threshold, target, and maximum goals:

Type of Modification	Description	Formula to Determine Incremental Value
Probable Achievement to Probable Achievement	Adjusting goals such that achievement of the goal remains probable, but easier to achieve	(current stock price * number of shares expected post-modification) *Minus* (current stock price * number of shares expected pre-modification) In our case (only one goal) there is no initial incremental expense. If the now lower goal is met, the cumulative expense is still based on the original grant date fair value even if the original goal is not met (as the original goal was probable at the time of the modification)
Probable Achievement to Improbable Achievement	Adjusting goals such that achievement of the goal changes from Probable to Improbable (a rare situation) results in no incremental expense	Using the above formula, there is no incremental expense Cumulative expense is based on original grant date fair value and is recognized so long as the original goal is met (regardless of whether the modified goal is met.)
Improbable Achievement to Probable Achievement	Adjusting goals from Improbable achievement to Probable achievement will inherently have a modification expense since Improbable implies an accrual of 0%; however, the magnitude of the modification expense will hinge upon stock price at the time of the modification and the level of the Probable goal achievement	Incremental expense is determined using the above formula; effectively, the incremental cost will be equal to the stock price at the time of the modification (regardless of whether higher or lower than the stock price on the grant date) times the number of shares expected to vest under the modified goal The cumulative expense is based on the stock price at the time of the modification times the number of shares that actually vest
Improbable Achievement to Improbable Achievement	Adjusting goals from Improbable achievement to Improbable achievement means that no incremental expense is recognized on the modification date; if expected achievement moves to Probable in the future, then the fair value on the date of the modification would be used for the accrual	Using the above formula, there is no incremental expense The cumulative expense, to the extent that shares are ultimately earned, is based on the stock price at the time of the modification times the number of shares that actually vest—but does not have a disclosable incremental cost at the time of modification

NOTE: For awards subject to market conditions (e.g., absolute or relative TSR), the same basic fair value analytical framework applies, except that there is no estimation of the shares expected to vest—meaning the formula is the fair value of the awards post-modification minus the fair value of the awards just prior to the modification. The original grant date fair value and any incremental cost is recognized so long as the service condition is met, regardless of whether the market condition is met.

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