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August 14, 2015

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2015-270
Re: Proposed Accounting Standards Update, *Improvements to Employee Share-Based Payment Accounting*

Dear Ms. Cosper:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Improvements to Employee Share-Based Payment Accounting*.

We support the Board's efforts to improve aspects of U.S. GAAP that are unnecessarily complex and costly as part of its simplification initiative. We believe that the proposed ASU furthers these objectives and will reduce complexity for financial statement preparers without adversely affecting the utility of the financial statements.

The appendix of this letter contains our responses to the proposed ASU's questions for respondents as well as additional clarifications for the Board's consideration.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Rob Morris at 203-563-2357 or Sandie Kim at 415-783-4848.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl

Appendix
Deloitte & Touche LLP
Responses to Questions for Respondents

Question 1: Do you agree that the proposed amendments result in a reduction (or potential reduction) of cost and complexity while maintaining or improving the usefulness of information provided to users of financial statements? If not, why?

Overall, we support the proposed amendments and believe that they will reduce cost and complexity while maintaining or improving the usefulness of the information provided to users of financial statements. Our responses to the questions below include observations regarding, and suggested improvements to, the proposed amendments.

Question 2: Should excess tax benefits and tax deficiencies be recognized in the income statement? If not, why, and are there other alternatives that are more appropriate? Should an entity delay recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable? If yes, why?

We believe that the tax effects of share-based payment transactions should be recognized in the income statement and should be measured in accordance with the general approach to accounting for deferred taxes under ASC 740.[1] We agree that because the tax effects are associated with compensatory arrangements, it is appropriate to recognize such taxes in the income statement in a manner similar to how the tax effects of other non-share-based compensation are recognized. This approach gives greater weight to the compensatory nature of the transaction versus current guidance that gives greater weight to the existence of a difference between book and tax expense coupled with the form of the consideration given.

However, we would not object if the Board were to instead retain the current two-transaction approach in which fair value changes in the award and the related tax deduction between the measurement date for financial statement purposes (i.e., generally the grant date for equity-classified awards) and the date of the tax deduction (i.e., generally upon vesting or exercise of the award) are viewed as an equity transaction. We believe that if the two-transaction approach is retained, excess tax benefits and deficiencies should be recognized in additional paid-in capital (APIC), which would still eliminate the requirement to calculate the APIC pool and would achieve the Board's goal of simplification. An added benefit to eliminating the APIC pool would be the corresponding elimination of the requirement for an entity to calculate a hypothetical APIC pool when calculating diluted EPS under the treasury stock method.

We also support the proposed amendment to recognize excess tax benefits when they occur, even if the benefit is not realized through a reduction to current taxes payable.

[1] FASB Accounting Standards Codification Topic 740, *Income Taxes.*

Question 3: Should the effect on tax cash flows related to excess tax benefits be classified as an operating activity on the statement of cash flows? If not, what classification is more appropriate and why?

We believe that all cash inflows and outflows related to income taxes should be classified as an operating activity, even if the Board ultimately decides that some or all excess tax benefits and deficiencies should be recognized in APIC. No other authoritative literature requires entities to bifurcate their tax payments between operating, investing, and financing activities. For example, if an entity generates cash inflows from the sale of property at a gain, the related tax effects of the gain are not bifurcated from other taxes within the operating section and reported as an investing outflow. In addition, no other tax cash flows related to items allocated to equity in accordance with ASC 740-20[2] are classified as a financing activity. Our view is consistent with paragraph 92 of the Basis for Conclusions (Appendix B) of FASB Statement 95,[3] which discusses the Board's basis for requiring that all income taxes paid be classified as an operating activity:

> The Board decided that the allocation of income taxes paid to operating, investing, and financing would be so complex and arbitrary that the benefits, if any, would not justify the costs involved.

Question 4: Should entities be permitted to make an accounting policy election either to account for forfeitures when they occur or to estimate forfeitures? If not, why?

We believe that it is appropriate for entities to estimate forfeitures when recognizing share-based compensation cost. However, because forfeiture estimates typically are not significant, we do not object to the proposed amendment to permit entities to make an accounting policy election either to account for forfeitures when they occur or to estimate forfeitures in accordance with the current guidance in ASC 718.[4]

We also have the following comments on the proposed amendments related to forfeitures:

- As described in the proposed guidance in ASC 718-10-50-2 and in paragraph BC12 of the Basis for Conclusions, the Board concluded that the accounting policy election of accounting for forfeitures when they occur only applies to service conditions. We believe that the Board intended the amendments to apply when entities have vesting conditions that include both performance and service conditions. For example, an entity may have a performance condition for which (1) vesting is probable and (2) an implicit service period must be estimated. Under current guidance, the entity must estimate forfeitures over the requisite service period, which is estimated on the basis of when the performance condition is

[2] FASB Accounting Standards Codification Subtopic 740-20, *Income Taxes — Intraperiod Tax Allocation*.
[3] FASB Statement No. 95, *Statement of Cash Flows*.
[4] FASB Accounting Standards Codification Topic 718, *Compensation — Stock Compensation*.

expected to be achieved. We agree with the Board's conclusion that, in such circumstances, the assessment of the performance condition's probability should continue to be required. However, we believe that the proposed guidance should allow an entity to account for forfeitures when they occur during the requisite service period regardless of whether the requisite service period is determined on the basis of a service condition or a performance condition. Accordingly, the accounting policy election should be allowed for awards with service and performance conditions. The same would hold true for an award with combined service and market conditions.

- As described in the proposed guidance in ASC 718-20-35-3A, an entity that has an accounting policy of accounting for forfeitures when they occur in accordance with the proposed amendments must assess whether the performance or service conditions of the original award are expected to be satisfied as of the award's modification date. While we agree with that conclusion because it affects the cumulative compensation cost recognized, we believe that additional clarification would be helpful with respect to the accounting after the modification. Specifically:

    - As described in the proposed implementation guidance in ASC 718-20-55-121 (Example 15), if Entity Z's accounting policy was to account for forfeitures when they occur, compensation cost recognized before the decision to close Plant J would not be reversed until the awards are actually forfeited. However, if the date on which Entity Z decided to close Plant J (December 12, 20X7) coincided with the modification date (i.e., the decision to accelerate vesting occurred on December 12, 20X7, instead of on June 30, 20X8), it is not clear whether the compensation cost for the original award would continue to be recognized or whether such compensation cost would be reversed on the modification date. While the proposed guidance suggests that it is not reversed until the awards are actually forfeited, we believe it is appropriate to reverse compensation cost on the modification date, since (1) the original award effectively no longer exists on the modification date (i.e., it has been exchanged for a new award in accordance with ASC 718-20-35-3) and (2) the entity is already required to assess whether the requisite service for the original award is expected to be rendered as of the modification date.

    - It is not clear whether an entity that has a policy of accounting for forfeitures as they occur would continue to apply that policy to the newly modified award. We note that although the proposed guidance in ASC 718-20-35-3A only refers to the original award, the proposed implementation guidance in ASC 805-30-55-11 specifies that the accounting policy election does not apply to the accounting for replacement awards in a business combination. While we agree that the policy election should not affect the portion of the replacement award attributable to precombination service (and therefore the portion included in consideration transferred in a business combination), it is not clear how the accounting for forfeitures should be treated for the portion attributable to postcombination service.

Question 5: Is the proposed expansion of the exception to liability classification related to the amount withheld for employee's taxes appropriate? If not, is there another exception that is more appropriate and why?

We support the proposed simplification to permit the repurchase of shares for employee tax withholdings up to the maximum statutory tax rate that applies to employees in the relevant jurisdiction without resulting in liability classification. While paragraph BC16 of the Basis for Conclusions notes that only one maximum tax rate, rather than a rate for each employee, needs to be determined in each jurisdiction, the amended language in ASC 718-10-25-18 and paragraph BC15 implies that tax rates need to be determined at the level of the individual employee, since withholdings "cannot exceed the amount determined on the basis of the **employee's** maximum **individual** statutory tax rate in the applicable jurisdiction" (emphasis added). Accordingly, we recommend that the Board modify the language in ASC 718-10-25-18 and paragraph BC15 to clarify that entities are required to determine only one maximum tax rate in each jurisdiction.

Because this proposed simplification is largely converged with the IFRIC's tentative decisions, we encourage the Board to follow the IFRIC's project on this same issue to maintain convergence to the extent possible.

Question 6: Should the cash paid by an employer to the taxing authorities when directly withholding shares for tax-withholding purposes be classified as a financing activity on the statement of cash flows? If not, what classification is more appropriate and why?

We agree that the cash an employer pays to the tax authorities when directly withholding shares for tax-withholding purposes should be classified as a financing activity in the statement of cash flows. The substance of this transaction is (1) a gross issuance of shares and (2) a repurchase of the amount of shares necessary to satisfy the employee's tax withholding requirement. While the employee does not receive the cash directly, the employer has, in substance, repurchased the shares from the employee and remitted the cash consideration to the tax authority on the employee's behalf. Because the cash payment is related to a repurchase of shares, it should be presented as a financing cash outflow.

Question 7: When assessing the classification of an award with a repurchase feature that can only be exercised on the occurrence of a contingent event, should a contingent event within the employee's control be assessed in the same manner as a contingent event outside the employee's control? If not, why should there be a difference in the assessment?

We agree with the proposed amendments that conform (1) the guidance on determining the classification of an award with a contingent repurchase feature for which the contingent event is within the employee's control with (2) the guidance on contingent repurchase features for which the contingent event is outside an employee's control. We believe that it is appropriate to assess contingent events consistently for both put and call provisions. We also agree with the Board's view in paragraph BC21 that contingent events should be assessed on an award-by-award basis; however, we believe that this guidance should be included directly in the Codification rather than in the Basis for Conclusions.

In addition, we encourage the Board to consider making the following revisions (proposed inserts are underlined) to the proposed amendments in ASC 718-10-25-9(a), since an employee could begin to bear the risks and rewards of equity share ownership even if the shares are not legally issued yet (e.g., restricted stock units that are fully vested but have not yet settled with the issuance of shares):

> The repurchase feature permits the employee to avoid bearing the risks and rewards normally associated with equity share ownership for a reasonable period of time from the date the requisite service is rendered and the share is issued <u>or issuable</u>. An employee begins to bear the risks and rewards normally associated with equity share ownership when all the requisite service has been rendered <u>and the share is issued or issuable</u>.

Further, we encourage the Board to try to eliminate diversity in practice by including additional guidance on accounting for repurchase provisions that are not at fair value. Because such repurchase provisions are not at fair value, even after six months have elapsed from the date the requisite service has been rendered and the shares are issuable, the employee still may not be subject to the risks and rewards of ownership. Many practitioners may find this guidance difficult to apply because it may not be immediately apparent to them that employees may not bear the risks and rewards of equity share ownership when the repurchase provision is not based on fair value upon repurchase, even if the shares are held for six months or more. For example, in the case of a repurchase provision based on a formula (e.g., book value, a stated multiple of EBITDA), even six months after the requisite service has been rendered and the shares are issuable, an employee may not bear the risks and rewards of ownership since the repurchase provision could (and likely would) be exercised at other than fair value. Hence, the guidance on repurchase provisions should clearly address how non-fair-value terms affect whether the employee is subject to the risks and rewards of ownership, regardless of whether the repurchase provision is exercisable at least six months after the requisite service has been rendered and the shares are issuable.

We suggest that the Board consider doing the following:

- Clarifying that employees would not bear the requisite risks and rewards of equity share ownership if the repurchase price is not at fair value upon repurchase. That is, if the repurchase provision is not based on fair value upon repurchase, the six-month holding period is irrelevant and the repurchase provision could potentially affect classification for as long as the repurchase provision is outstanding.

- Applying the same model that is being proposed for contingent fair value repurchase provisions but providing the additional guidance discussed below. In line with the proposed simplification, we believe that it is appropriate to retain equity classification (provided that all other requirements for equity classification are met) — as long as it is not probable that the contingent event will occur — on an award-by-award basis and regardless of whether the contingent event is within the employee's control.

    - If the non-fair-value repurchase provision applies upon **any** termination event (termination by the company with or without cause, voluntary termination by the employee with or without good reason, termination upon retirement, or termination upon death or disability), the "contingent" event is certain to occur at some point. In this circumstance, there may not be a substantive contingency if the non-fair-value repurchase provision does not have a set expiration. Hence, in such circumstances, the employee will never be subject to the risks and rewards of ownership and the award would be a liability.

    - Assume the same facts as in the preceding bullet, except that the repurchase provision expires upon a liquidity event, such as an initial public offering or a change in control. In this circumstance, even though a liquidity event is typically not deemed probable until it occurs, we believe that it is still appropriate to evaluate whether it is probable that the employee termination event will occur before a liquidity event, particularly when the entity is owned by a private equity fund that has defined exit strategies. That is, the likelihood of a liquidity event may be high enough for an entity to conclude that it is not probable that a termination event will occur before the liquidity event, in which case the award would not be a liability.

    - If the repurchase price is based on the fair value of the shares but fair value is determined on the date of the termination event (or another date before the repurchase date), the repurchase price would generally not be at fair value on the repurchase date. In such cases, the employee might not be subject to the risks and rewards of ownership, even six months after the requisite service has been rendered and the shares are issuable. We believe that the employee would be able to bear the risks and rewards of equity share ownership if fair value is determined on a date reasonably approximate to the repurchase date that is at least six months after the date on which the requisite service period has been rendered and the shares are issuable.

We also believe that some of the practice issues can be reduced by codifying some of the guidance from Issue 23 in EITF Issue 00-23.[5] Although Issue 00-23 was superseded by FASB Statement 123(R)[6] (codified as ASC 718), much of that guidance (e.g., probability assessment on an individual grantee-by-grantee basis, irrelevance of six-month period if repurchase provision is not at fair value) is still relevant by analogy and will help reduce some of the current practice challenges we often see.

Question 8: Is the practical expedient for nonpublic entities to estimate the expected term of all awards with performance conditions that affect vesting or service conditions appropriate? If not, are there other practical expedients that are more appropriate and why? Should the expedient be limited to nonpublic entities?

We support the practical expedient that allows nonpublic entities to estimate the expected term of all awards with performance conditions that affect vesting or service conditions.

However, the proposed amendment requires an entity that elects the practical expedient to estimate the expected term as the contractual term of the award if it is not probable that a performance condition will be achieved. While we support this guidance for performance awards with an undefined service period (e.g., an initial public offering) for which an implicit service period would otherwise have to be estimated, an explicit service period is associated with many awards that contain a performance condition. For example, if an award has an explicit three-year requisite service period that is tied to the performance period (e.g., the award vests if the employee provides service for three years and the entity achieves a three-year EBITDA target) and it was initially not deemed probable that the performance condition would be achieved, under the proposed guidance, an entity's expected term would be the contractual term of the award. We believe that in this and similar situations, an entity's expected term under the practical expedient should be the midpoint between the explicit requisite service period and the contractual term of the award as long as the performance condition is associated with an explicit service period.

Further, because the SEC has already provided a practical expedient for public entities that have awards with service conditions, we support extending this practical expedient to public entities that have performance conditions if such entities conclude that their historical share option exercise experience does not provide a reasonable basis upon which to estimate the expected term. Since current SEC staff guidance does not allow for the use of the simplified method when an award has a performance condition, we encourage the Board to work with the SEC staff on extending this practical expedient.

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[5] EITF Issue No. 00-23, "Issues Related to the Accounting for Stock Compensation Under APB Opinion No. 25 and FASB Interpretation No. 44."
[6] FASB Statement No. 123(R), *Share-Based Payment*.

Question 9: Should nonpublic entities be allowed to make a one-time election to switch from measuring liability-classified awards at fair value to intrinsic value? If not, why? While not proposed, should the Board consider making the ability to elect intrinsic value an ongoing election alternative for nonpublic entities?

We do not object to allowing entities to make a one-time election to switch from measuring liability-classified awards at fair value to measuring them at intrinsic value. In addition, we agree that entities should not be allowed to elect intrinsic value on an ongoing basis since fair value measurement is preferable to intrinsic value measurement.

Question 10: Are the transition requirements for each area appropriate? If not, what transition approach is more appropriate?

We generally agree with the transition requirements and believe that they are appropriate. However, the proposed transition guidance in the amendments related to the statutory tax withholding requirements is inconsistent with the transition guidance related to the classification of awards with repurchase features and we believe that they should be the same unless there is a conceptual or practical reason for the difference. The transition method for both is a modified retrospective basis for all unsettled liability-classified awards as of the effective date; however, the cumulative-effect adjustment for the statutory tax withholding requirements is made to retained earnings and the cumulative-effect adjustment for awards with repurchase features is made to APIC by applying the liability-to-equity classification guidance on modified awards. For many entities, it may be difficult to determine the cumulative-effect adjustment to retained earnings for liability-classified awards, since the fair-value-based measure of the awards may not have been determined as of the grant date (since liability-classified awards are remeasured in each reporting period). Therefore, we believe that the cumulative-effect adjustment should be to APIC for both and that the cumulative-effect adjustment should be determined in accordance with the guidance on modifying an award from liability classification to equity classification.

Question 11: How much time will be necessary to adopt the amendments in this proposed Update? Should the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?

Given the nature of the proposed changes and transition methods, we would not expect entities to need a significant amount of time to analyze the necessary adjustments related to many of the proposed amendments. However, many entities currently use software applications to process and record their share-based payment transactions and the time necessary to modify and test these applications could be significant.