AICPA

Private Companies
Practice Section

September 29, 2020

Hillary Salo
Technical Director
FASB
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Re: August 17, 2020 Proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards*, a proposal of the Private Company Council [Project No. 2020-200]

Dear Ms. Salo:

The American Institute of CPAs (AICPA) is the world's largest member association representing the accounting profession, with more than 418,000 members in 143 countries, and a history of serving the public interest since 1887. One of the objectives that the Council of the AICPA established for the PCPS Executive Committee is to speak on behalf of local and regional firms and represent those firms' interests on professional issues in keeping with the public interest, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

First and foremost, TIC appreciates the efforts of the PCC and the FASB dating back to 2014 to address some cost and complexities that private companies encounter when dealing with stock-based compensation. TIC believes that valuing the underlying share is generally the most costly and complex input in any option pricing model for private companies because of the lack of observable prices for private company shares. The increase in cost usually stems from the use of valuation specialists when private companies issue stock-based awards.

TIC believes that in certain situations whereby private companies are already obtaining valuations of share-based compensation under Section 409A of the IRC, there could be some cost savings in that those companies would no longer have to duplicate efforts on the valuation front in order to comply with US GAAP. However, many of TIC's private company clients are not obtaining 409A valuations and therefore would not be able to elect this practical expedient.

Generally, 409A valuations are obtained to avoid significant tax implications under Section 409A. However, the risk of being subject to Section 409A taxes is not consistent for all awards. For example, some companies may avoid the cost of obtaining an upfront 409A valuation because it is easier for them to prove their awards have not been granted "in-the-money" (an award where the strike price has been set below the underlying share price). In these situations, a private company may determine the costs of obtaining an upfront 409A valuation do not justify the benefits.

TIC agrees with the working group's outreach performed back in 2018 that indicated that such a practical expedient may not provide sufficient relief because tax and GAAP valuation requirements are generally aligned with some nuanced differences. To the extent that share-based compensation is material, outreach with valuation experts suggests that, compared with current GAAP requirements, a similar level of rigor would be applied when complying with a tax valuation that would ultimately be used for audited financial statements. Therefore, that group had suggested that in the event a private company has made a good faith determination that a share-based award is not in-the-money, then for purposes of calculating the fair value of the awards issued, the company can assume the fair value of the underlying share is equal to the strike price.

TIC believes that the initial proposed expedient noted above would have been further reaching and resulted in additional savings from both an accounting and auditing perspective than that proposed in this ED.

The following are TIC's detailed responses to each of the questions posed in the ED. TIC's comments in this letter mainly are focused on the ED questions and provisions related to issues impacting their private company client base therefore not every question in the ED has a response from TIC.

Question 1: *Is the practical expedient as drafted in this proposed Update operable? If not, please explain why.*

TIC believes that the practical expedient as drafted is operable.

However, TIC believes the proposed practical expedient will only benefit private companies that are already obtaining a valuation under Section 409A of the IRC.

Question 3: *Will the proposed practical expedient reduce costs, including audit costs or fees, associated with the current price input? Please explain why or why not.*

TIC believes that in situations where private companies are already obtaining 409A valuations, this expedient could result in some reduction in accounting costs as a company would not have to engage another specialist or perform their own valuation of share-based equity awards in order to comply with US GAAP requirements.

Further, TIC has discussed with Auditing Standards Board and they agree that any potential audit savings would likely be minimal. They also fear preparers and their auditors may incorrectly assume that this practical expedient permits them to base the accounting purely on the 409A valuation <u>without consideration of</u> the reasonableness of the assumptions and process used therein. However, the same level of audit evidence would be required to validate the estimated share price value as is required today.

Question 4: *Do you or your clients obtain separate valuations to satisfy GAAP requirements (Topic 718) and tax regulations (Section 409A)?*

TIC noted the majority of their firms' clients do not obtain 409A valuations upon issuance of equity-based awards.

Question 5: *Do you agree with allowing the proposed practical expedient to be elected on an award-by-award basis?*

Yes, TIC agrees with the basis provided in paragraph BC8 supporting the decision that the practical expedient should be elected on an award-by-award basis.

Question 6: *Will the proposed practical expedient compromise the decision usefulness of information related to equity-classified share-option awards? If yes, please explain how.*

Although TIC does not represent the user community, TIC has observed the following that may inform the FASB and PCC of user relevance of private company financial statements:

- most debt agreements permit a private company borrower to add back share-based payment expense to EBITDA when assessing whether a private company borrower is in compliance with its debt covenants

- most equity investors focus on some form of adjusted EBITDA that also allows an add back for any share-based payment expense

TIC also believes that there should be disclosure requirements for private companies that have elected to use this practical expedient. This is consistent with the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*, but perhaps could be included in the standard just to make clear what the disclosure requirements are when electing this expedient.

Question 7: *Do you agree with the proposed prospective transition requirements? If not, please explain why.*

TIC agrees with prospective application for all qualifying awards granted or modified during fiscal years beginning on or after the effective date and interim periods within the following years consistent with the Private Company Decision-Making Framework. TIC agrees that early adoption should be permitted so that entities that are currently obtaining valuations under Section 409A of the IRC are able to start taking advantage of this expedient and recognize any cost savings as soon as possible.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.

Sincerely,

Danielle Supkis-Cheek, Chair
On Behalf of the PCPS Technical Issues Committee