The Association of Accountants and Financial Professionals in Business

November 10, 2021

Ms. Hillary H. Salo
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

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Dear Ms. Salo:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (FASB or Board) Proposed Accounting Standards Update *Fair Value Measurement (Topic 820) Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* (Proposed Update).

The IMA is a global association representing over 140,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities, and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The Committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics, and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals, and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at www.imanet.org (About IMA, Advocacy, Financial Reporting Committee).

The Committee supports the Board's efforts to clarify the guidance related to the effects of a contractual restriction that prohibits the sale of an equity security on the equity security's fair value measurement. We agree that diversity in practice exists related to the treatment of such contractual sale restrictions and that clarification will improve comparability among financial statement preparers.

The Committee believes that the Board should provide additional clarity on the accounting for contractual sale restrictions and is concerned that without such further clarification, diversity in practice may continue to exist. Further, most Committee members believe that contractual sale restrictions should receive accounting recognition either through the fair value measurement of the equity security or through separate accounting.

If the Board concludes that contractual sale restrictions do not require accounting recognition, the Committee believes that quantitative and qualitative disclosures would be helpful in improving comparability among entities when the impact of contractual sale restrictions is significant to the entity.

The Committee also believes that the definition of restricted security provided in the Proposed Update is confusing and should be amended to reflect the Board's intent regarding when a restriction should be included in the fair value measurement of the equity security.

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The Committee's views are expressed in further detail below.

Contractual Sale Restrictions

The Committee notes that the conclusion in the Proposed Update does not provide explicit guidance as to the accounting for contractual sale restrictions. The Committee is concerned that without specific guidance, diversity in practice related to the accounting for contractual sale restrictions may continue counter to one of the primary objectives of the clarifying guidance.

Committee members largely agree that contractual sale restrictions have economic substance and should receive accounting recognition. That is, the accounting should reflect the economic distinction that exists between entities that hold equity securities that are subject to contractual sale restrictions and those that hold equity securities that are not subject to such restrictions.

Entities holding equity securities subject to contractual sale restrictions are exposed to additional risks as a result of an inability to access the public equity markets. Thus, the economic value of an equity security with a contractual sale restriction is typically less than that of an equity security without the restriction. If the restriction is not considered by the restricted entity, the economic discount that market participants would assign to the value of the equity security is ignored and the equity security measured at the undiscounted trade price. This accounting ignores the entity's ongoing obligation to adhere to the requirements of the contractual sale restriction. Most Committee members believe that this economic difference should be reflected in the accounting of the entities holding such equity securities such that the initial measurement of a transaction that results in the acquisition of the equity security more closely aligns with its economic value.

Recognition of a contractual sale restriction on an equity security would result in the difference in fair value between a restricted and an unrestricted security being deferred and recognized over the period of the restriction. This discount would then be subsequently recognized either through periodic fair value measurements with each subsequent measurement capturing the decreasing risks to the entity as the restriction approaches its end date or, if the contractual sale restriction was not accounted for at fair value, through the periodic amortization of the deferred amount over the period of the restriction. Most Committee members believe that recognizing the discount in the fair value related to the restriction on the equity security over the period of the restriction better reflects the economics of the contractual sale restriction to the entity.

If the Board does not mandate that the contractual sales restriction be recognized as a part of this guidance, we do not anticipate that the restriction will be separately recognized by some entities. In current practice, it is our understanding that those entities that treat the contractual sales restriction as a separate unit of account do not separately record a contra asset or liability for the value of the restriction This is in part due to the fact that there does not appear to be guidance that is directly applicable to this fact pattern. Although entities may analogize to existing guidance to account for contractual sale restrictions, we believe that many entities will interpret the amendments in the Proposed Update to indicate that recognition of contractual sale restrictions is not required. Therefore, the Committee believes that the Board should provide specific guidance on the accounting for contractual sale restrictions to the extent that they are excluded from the fair value measurement of the equity security. Alternatively, if the Board believes that the accounting for contractual sale restrictions is already covered by existing guidance, the Board should reference that guidance as part of the amendments to ASC 820.

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Though the majority of Committee members agree that contractual sale restrictions should receive accounting recognition, some Committee members expressed concern that identifying and measuring discount for the restriction may be complex in certain scenarios and that providing information about contractual sale restrictions is better accomplished through disclosure. Those Committee members believe that the Board should exempt contractual sale restrictions from accounting recognition if such restrictions are expected to be resolved in a short period of time.

Committee members concluding that a contractual sale restriction on an equity security should receive accounting recognition have differing views on how such restrictions should be recognized. While certain Committee members view the equity security and the contractual sale restriction as a single unit of account, other Committee members support an approach that results in the separate recognition of the contractual sale restriction, apart from the accounting for the equity security. These alternative views are discussed further below.

Single-Unit of Account

Committee members who support the treatment of the contractual sale restriction and the equity security as a single unit of account agree with the alternative view expressed in the Proposed Update. Specifically, these Committee members believe that determining whether a contractual sale restriction on an equity security is an entity-specific or instrument-specific restriction is arbitrary because in either case, the holder of the equity security is contractually precluded from transferring the security and such restriction constrains the holder from fully realizing the economic benefits of the security during the period of the restriction. Further, these Committee members note that the constraint to transfer the security is particularly significant to equity securities subject to contractual sale restrictions as holders are often unable to realize the economic benefits of these instruments through alternative means such as the collection of contractual cash flows or use of the asset. Thus, these Committee members note that the restriction is so integrated with the security that even if it were viewed as a separate unit of account, it changes the value of the security. As such, proponents of this view believe the appropriate accounting is to consider the restriction when determining the fair value of the security.

Separate Performance Obligation

Other Committee members support an approach that treats the contractual sale restriction as a separate unit of account from the equity security. These Committee members note that contractual sale restrictions are a characteristic of the entity rather than the asset and thus the fair value measurement for the equity security should not include the restriction, consistent with the current guidance in ASC 820. These Committee members note that the restriction is not a characteristic of the asset as equity securities that are otherwise identical to the equity security subject to the contractual sale restriction are typically held and traded by other market participants.

These Committee members also believe that a contractual sale restriction has economic substance and should be recognized by the entity. Therefore, these Committee members support an approach that treats the contractual sale restriction as a separate unit of account from the equity security. The contractual sale restriction could be recognized as a contra asset or as a liability of the entity, reflecting its obligation to refrain from selling the asset during the period of the restriction. Committee members supporting this approach believe that the Board should provide explicit guidance on the accounting for the contractual sale restriction outside of the fair value measurement of the equity security.

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Those Committee members supporting the recognition of the contractual sale restriction as a separate performance obligation suggest replacing the third sentence in ASC 820-10-55-52A with the following (changes in italics): "In that instance, the restriction is not a characteristic of the asset and is ignored *in measuring the fair value of the equity security*."

Disclosures

The Committee believes that a contractual sale restriction of an equity security should receive accounting recognition in the financial statements of an entity that is subject to the restriction. However, if the conclusions in the Proposed Update are retained such that contractual sale restrictions do not receive accounting recognition, the Committee believes that qualitative and quantitative disclosures about the contractual sale restrictions are necessary to improve comparability among entities. At a minimum, these disclosures should include the nature of the restrictions, the timing of when such restrictions are expected to expire, whether the entity expects to sell the equity securities prior to the expiration of the restrictions, the fair value of equity securities that are subject to contractual sale restrictions at the balance sheet date and the amount of the discount received by the entity during the period for acquiring equity securities that are subject to contractual sale restrictions. The Committee believes that an entity should be required to provide these disclosures only when the impact of contractual sale restrictions is significant to the entity.

Definition of Restricted Security

The Committee believes that the definition of Restricted Security added to the ASC Master Glossary in the Proposed Update is confusing. The Committee understands that the intent of this definition is to distinguish between regulatory restrictions that are required to be included in the fair value of the equity security from contractual sale restrictions that are within the scope of the Proposed Update. Further, the Committee understands that this distinction is based on the fact that a regulatory restriction causes the security to be ineligible for sale in the same market as that of an otherwise identical equity security without the restriction. The Committee suggests the following definition of Restricted Security to clarify the Board's intent.

> An equity security that is restricted from sale on a national securities exchange or over-the-counter market because it has neither 1) been registered for sale nor 2) satisfied the conditions necessary for exemption from registration.

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We appreciate the opportunity to provide comments on the Proposed Update and would be pleased to discuss our comments with the FASB or its staff at your convenience.

Sincerely,

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Institute of Management Accountants
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