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November 12, 2021

Ms. Hillary Salo

Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

RE: Proposed Accounting Standards Update, *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions* (File Reference No. 2021-005)

Dear Ms. Salo:

We appreciate the opportunity to comment on the proposed ASU, *Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*.

We support the Board's proposals to clarify Topic 820 to reduce diversity in practice related to whether a contractual restriction that prohibits the sale of an equity security should be considered in measuring the fair value of that equity security. We agree with the Board that only security specific attributes should be considered part of the unit of account when measuring the fair value of an equity security.

In view of the diversity in practice, the Board's proposals would promote more comparability in considering the fair value of equity securities with contractual sale restrictions. However, the proposals distinguish between only a 'restricted security' (a newly-defined term) and an equity security with a contractual sale restriction, and appear to assume that all contractual sale restrictions are an attribute of the holder rather than an attribute of the security. We believe that certain types of contractual sale restrictions are security specific and should be considered in measuring the security's fair value. We recommend that the Board make the proposed amendments more operable by providing further guidance on factors to consider in evaluating whether a contractual sale restriction is an entity specific or a security specific characteristic.

Additionally, we believe the Board should address whether an entity specific contractual sale restriction should be accounted for as a separate unit of account. Our response to Question 7 recommends additional considerations that we believe would help resolve diversity in practice.

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Our responses to the Questions for Respondents are included in the Appendix.

If you have questions about our comments or wish to discuss the matters addressed in this comment letter, please contact Kimber Bascom at (212) 909-5664 or kbascom@kpmg.com, or Mahesh Narayanasami at (212) 954-7355 or maheshnarayanasami@kpmg.com.

Sincerely,

A handwritten signature in black ink that reads "KPMG LLP". The letters are bold and slightly slanted, with a casual, professional appearance.

KPMG LLP

Appendix – Responses to Questions for Respondents

Question 1: *Do you agree with the Board’s decision on scope to include all contractual restrictions that prohibit the sale of an equity security? Please explain why or why not.*

Yes, we agree with the Board’s decision to include all contractual sale restrictions in the scope of the proposals rather than narrowly focusing on only one type of contractual sale restriction in the form of underwriter lock-up agreements. We believe the Board should develop accounting principles that can be applied broadly to similar transactions, rather than limiting the principles to a narrow set of transactions. Additionally, the Board’s intent to reduce diversity in practice is more likely to be achieved by including all contractual restrictions in the scope of the proposals because an underwriter lock-up is only one form of contractual restriction on the sale of an equity security.

Question 2: *Do you agree with the Board’s decision that a contractual restriction prohibiting the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, should not be considered in measuring fair value? Alternatively, should the Board amend the guidance in Topic 820 (or elsewhere in GAAP) such that contractual sale restrictions would be required to be considered in determining fair value?*

If the contractual sale restriction is an attribute of the holder of an equity security (i.e. an entity specific characteristic), we agree that the restriction is not part of the equity security’s unit of account and, therefore, should not be considered in measuring its fair value under Topic 820. However, the proposals appear to assume that all contractual sale restrictions are an entity specific characteristic. In our experience, determining whether a sale restriction is a security specific or an entity specific characteristic requires judgment, including considering whether the restriction:

- would transfer with the security to a potential buyer in an assumed sale;
- is imposed on a holder by regulations;
- is part of the contractual terms of the security; or
- is attached to the security through a purchase contract or another commitment.

We recommend that the Board provide additional guidance on when a contractual sale restriction should be considered an entity specific versus a security specific characteristic. In addition, we recommend that the Board clarify that contractual sale restrictions that are security specific should be included in the fair value measurement of the security.

See also our response to Question 7.

Question 3: *Should all types of entities use the same unit of account when measuring the fair value of an equity security subject to a contractual sale restriction, or should certain types of entities (for example, investment companies, broker dealers, and pension plan financial statements) have a different unit of account? Please explain your response.*

We believe the unit of account considerations should be the same regardless of the nature of the reporting entity and that the same accounting model should apply to all industries. Similarly, our recommendation to the Board in Question 7 to explore recognizing entity specific contractual sale restrictions as a liability, presented separately from the underlying equity security, is not industry-specific.

Question 4: *Would qualitative or quantitative disclosures (for example, describing the nature of a contractual sale restriction on an equity security and the related amount recognized on the balance sheet) help users in understanding the effects of a contractual restriction on the sale of an equity security held by a reporting entity? Please explain why or why not. For reporting entities, what costs would be incurred to disclose that information?*

Regardless of the direction the Board takes in this project, we believe that qualitative disclosures about the nature and length of security specific and entity specific sale restrictions on equity securities held by an entity at the measurement date would provide meaningful information to the users of the financial statements to help assess the liquidity of the entity's holdings. However, we believe that users of financial statements are best positioned to provide input about which specific quantitative and/or qualitative disclosures would help them to understand the effects of a contractual sale restriction on an equity security.

We believe that preparers are best positioned to provide input on the potential costs that they would incur to disclose additional qualitative and/or quantitative information.

Question 5: *Do you agree with the transition guidance in this proposed Update? Please explain why or why not.*

For the reasons identified in BC17 of the proposals, we agree with the transition guidance for investment companies because we believe it would mitigate the impact of adopting the proposals on an investment company's net asset value computation, which is an important metric for investors in investment companies (e.g. the price an investor would use to redeem units in a mutual fund).

With respect to the transition guidance for entities other than investment companies, we believe that the proposed requirement to apply a prospective transition method under which an entity would adjust current period earnings in the period of adoption would result in recognizing amounts in the current reporting period that relate to a previous reporting period and create noncomparability. To prevent this out-of-period adjustment, we recommend that the Board require non-investment companies to adopt the proposals using a modified retrospective transition method, whereby the cumulative-effect adjustment would be recognized in the opening balance of retained earnings on the adoption date of the standard. We believe that applying a modified retrospective transition method would not be overly burdensome to preparers and would promote comparability of financial statements.

Question 6: *How much time would be necessary to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.*

We believe that preparers are best positioned to respond to this question.

Question 7: *Do you agree that the proposed amendments and, in particular, the definition of a restricted security provide the necessary clarity to resolve existing diversity in practice? Please explain why or why not. Are the proposed amendments operable and auditable? If not, which proposed amendment or amendments pose operability or auditability issues and why?*

We suggest that the Board clarify and expand the guidance related to:

Determining whether a contractual sale restriction is entity specific or security specific:

We do not believe that defining a restricted security clarifies whether a contractual sale restriction is entity specific or security specific.

We recommend that the Board provide additional guidance about when a contractual sale restriction would be considered an entity specific versus a security specific characteristic. The proposals provide only two examples (lock-up agreements and market standoff agreements) and no clear criteria to evaluate whether a contractual sale restriction is entity specific or security specific. The illustrative examples in 820-10-55-51 to 55-52A would resolve some ambiguity but may still result in diversity in practice for other types of sale restrictions. For example, some preparers have interpreted that a contractual sale restriction that would transfer with the asset to a potential buyer in an assumed sale is an attribute of the security and should be considered in the security's fair value measurement under Topic 820. In this case, the security itself may not meet the proposed definition of a restricted security. However, the proposals appear to assume that all contractual sale restrictions are entity specific. Providing additional criteria to help preparers evaluate whether a sale restriction is entity specific or security specific would help make the proposals more operable.

Further, we recommend that the Board provide guidance on how to evaluate legal restrictions on the sale of securities. Certain jurisdictions place statutory restrictions on the sale of an equity security by certain holders of the security for a period of time after an initial public offering. For example, the Securities and Exchange Board of India requires a statutory 'lock-in' for promoters and certain other holders of securities in an initial public offering. In these instances, while the holder is not able to sell the security because of a sale restriction, it does not appear to meet the definition of a restricted security because the shares are registered for sale with a national securities exchange. However, the restriction is not a contractual sale restriction and, therefore, it is unclear whether the statutory restriction would be characterized as entity specific or security specific.

Definition of a restricted security

We believe the proposed definition of a restricted security should be clarified. The proposed definition states that a restricted security, "is not registered for sale with a national securities exchange or an over-the-counter market, either domestic or foreign, *when other equity securities from the same class of stock are registered for sale with a national securities exchange or over-the-counter market* [...]" [emphasis added].

It is unclear how the proposed definition would apply to a private company that does not have any equity securities that are registered for sale on a national securities exchange or over-the-counter market. We recommend that the board clarify whether these types of securities would meet the definition of a restricted security.

Recognizing the economic value of an entity specific contractual sale restriction

Assuming that a contractual sale restriction is an attribute of the holder of the security (i.e. an entity specific characteristic), we agree with the arguments in the alternative view that market participants would consider contractual sale restrictions to have an economic value. Excluding that economic value from the financial statements would reduce the decision-usefulness for the users of the financial statements. Economically, the contractual sale restriction may be viewed as the holder of the security having sold the marketability of the security to the counterparty by writing an option.

We believe the Board should consider requiring recognition of this type of contractual sale restriction as a liability, presented separately from the underlying equity security (as discussed in BC27). We acknowledge that the Board would need to consider which assets that are subject to contractual sale restrictions to scope in, and the cost-benefit analysis of this proposal.

We also believe that recognizing the economic value of this type of contractual sale restriction would better reflect the economic substance of a transaction in which a purchaser of a security pays a lower price than its fair value because the purchaser is contractually restricted from selling it for a period of time. In this scenario, recognizing a contractual sale restriction as a liability would prevent the purchaser from recognizing a day 1 gain, which would be inconsistent with the economic substance of the transaction.

For example, X buys an equity security from A for \$95 when its quoted market price is \$100. X pays a lower amount than the quoted market price because A contractually restricts X from selling the security for six months. The following journal entries illustrate a liability approach.

Description	Debit	Credit
Equity security	100	
Cash		95
Liability for contractual sale restriction		5

We do not agree with the view in BC25 that the Board should distinguish between securities pledged as collateral and other entity specific contractual sale restrictions and believe that all entity specific contractual sale restrictions on securities should be treated similarly. We also believe the Board should not develop guidance that is industry-specific, as explained in our response to Question 3.