

PROPOSED SEC STAFF ANNOUNCEMENT

Topic No. D-110

Topic: Escrowed Share Arrangements and the Presumption of Compensation

Date Discussed: June 18, 2009

The SEC Observer made the following announcement of the SEC staff's position on escrowed share arrangements. The SEC Observer has been asked to clarify SEC staff views on overcoming the presumption of compensation for specific shareholders.

Historically, the SEC staff has expressed the view that escrowed share arrangements involving the release of shares to promoters based on certain performance criteria are presumed to be tantamount to reverse stock splits followed by the grant of restricted stock awards under a performance-based plan. As such, these arrangements were compensatory.

The SEC staff continues to believe that no compensation expense should be recognized for escrowed share arrangements in which specific shareholders have had no relationship to the registrant other than as shareholders (for example, are not officers, directors, employees, consultants, or contractors), and do not expect to have any other relationships with the company in the future. Moreover, the SEC staff believes that an escrowed share arrangement in which the shares are automatically forfeited if employment terminates is compensation, consistent with the principle articulated in paragraph A87(a) of FASB Statement No. 141 (revised 2007), *Business Combinations*.

In addition, in evaluating whether the presumption of compensation may be overcome for escrowed share arrangements, entities should consider the substance of the transaction(s), including whether the transaction(s) was entered into for purposes not related to employment, such as to facilitate a financing transaction. For example, as a condition of the transaction, investors may request specific significant shareholders who may also be officers or directors to participate in an escrowed share arrangement. If the escrowed shares will be released or canceled without regard to continued employment, the arrangement may be more appropriately viewed as an inducement to facilitate the transaction on behalf of the company rather than as compensatory. In such cases, the SEC staff generally believes that the escrowed shares should be reflected as a discount in the allocation of proceeds to the newly-issued securities and amortized accordingly.^{1,2}

¹ The SEC staff notes that discounts on debt instruments are amortized using the effective interest method as discussed in APB Opinion No. 21, *Interest on Receivables and Payables*, while discounts on common equity are not generally amortized.

² Consistent with the views in SAB Topic 5.T., *Accounting for Expenses or Liabilities Paid by Principal Stockholder(s)*, and SAB Topic 1.B., *Allocation of Expenses and Related Disclosure in Financial Statements of Subsidiaries, Divisions or Lesser Business Components of Another Entity*, the SEC staff believes that the benefit created by the shareholder's escrow arrangement should be reflected in the company's financial statements.