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Ms. Susan M. Cosper
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14 August 2015

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

Dear Ms. Cosper,

We appreciate the opportunity to comment on the Proposed Accounting Standards Update, *Improvements to Employee Share-Based Payment Accounting* (the Proposal), from the Financial Accounting Standards Board (FASB or Board).

We support the FASB's objective in its simplification initiative to reduce the cost and complexity of financial reporting while improving or maintaining the usefulness of the information provided to financial statement users. We believe that the Proposal would contribute to that objective and simplify the way many entities account for share-based payments.

The Proposal should reduce costs and complexity by allowing all entities to elect to account for forfeitures of share-based payments as they occur and by providing practical expedients for nonpublic entities to use to estimate the expected term of certain awards and to measure liability-classified awards at intrinsic value. We believe that the Proposal would continue to maintain the usefulness of information provided to financial statement users in these areas because entities would have to disclose both their accounting policy election to use the practical expedients and the effect, upon adoption, of the election on their financial statements.

We agree with the FASB's proposal to eliminate the accounting for the pool of excess tax benefits. However, we believe that excess tax benefits and tax deficiencies should be recorded in additional paid-in capital, rather than in the income statement. We also support eliminating the requirement to delay recognition of excess tax benefits until taxes payable are reduced.

We support increasing the threshold for the exception to liability classification related to shares withheld for employees' taxes. However, we suggest that the exception be extended to awards issued by partnerships and similar pass-through entities that do not currently have a withholding obligation for share-based payments to certain employees, because employees of these entities also are required to pay taxes on their share-based payments.

We agree with providing the proposed practical expedients for nonpublic entities to use to estimate the expected term for certain awards and to measure liability-classified awards at intrinsic value. We support allowing nonpublic entities the option to elect these practical expedients as of their effective dates. We recommend that the effective dates should be extended one year for nonpublic entities to allow them time to understand and consider the elections.

Our responses to the questions posed in the Proposal are included in the Appendix to this letter.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst + Young LLP

Responses to questions raised in the Proposed Accounting Standards Update, *Improvements to Employee Share-Based Payment Accounting*

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 believe that the Proposal would result in a reduction of cost and complexity. However, we note that many entities already have systems and procedures in place to facilitate the accounting for share-based payments. Some of these entities would have to change or update their accounting systems in order to comply with the proposed requirements (e.g., the change to income tax accounting for share-based payments), which would result in a temporary increase in costs. We believe that the Proposal would continue to maintain the usefulness of information provided to financial statement users.

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?

Recognition of excess tax benefits and tax deficiencies

Consistent with the views expressed in our 2004 comment letter on the Proposed Statement of Financial Accounting Standards, *Share-Based Payment*, we believe that the most appropriate accounting for excess tax benefits and deficiencies is to recognize them in additional paid-in capital (APIC). While the Board's proposal is not in line with this view, we do believe the Board's proposal would greatly simplify the accounting for share-based payments. We believe that the detailed tracking of the APIC pool required by the current accounting model creates recordkeeping challenges for many companies. Additionally, numerous practice issues have arisen since the issuance of Statement 123(R) related to the accounting for an APIC pool (e.g., accounting for the effects of business combinations and dispositions, including spinoffs).

Excess tax benefits and deficiencies recorded in APIC

We believe that conceptually the payment for employee services with an equity instrument encompasses two transactions, a compensatory transaction and an equity transaction. We believe that the tax effects of the compensatory transaction should be based on compensation expense recognized in the income statement. Additionally, the tax effects of the equity transaction (i.e., due to changes in value that are not recognized as adjustments to compensation) should be recognized in APIC. We acknowledge that recording excess tax benefits or tax deficiencies in APIC would result in the application of Accounting Standards Codification (ASC) 740's intraperiod tax allocation guidance, which would be a different source of complexity.[1] However, this approach would significantly simplify current US GAAP by eliminating the concept of the APIC pool, which is in line with the Board's objective.

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1 The new source of complexity would arise because companies would need to understand and apply fairly complex intraperiod tax allocation rules. In addition, companies would also need to adopt an ordering policy when partial valuation allowances are present. Such ordering policies are also likely to lead to complexity and diversity in practice.

Interim reporting

If the Board moves ahead with its proposal to require recognition of excess tax benefits and tax deficiencies in the income statement, the Board should also address the accounting treatment of these items in a company's estimate of its annual effective tax rate. We believe that companies should account for the tax effects of exercised or vested awards as discrete items in the reporting period in which they occur. However, we believe that our suggested approach would generally represent an exception to the principles of the interim reporting guidance because many companies would not be able to assert that their excess tax benefits or tax deficiencies are significant unusual or infrequently occurring items. Providing a specific exception to the interim reporting guidance for excess tax benefits and tax deficiencies would be a practical solution to address the challenges a company faces predicting both its stock price and its employees' exercise patterns, which also require predictions of the company's stock price. Absent further clarification from the Board, we would expect that diversity in practice would emerge in this area.

Realization of excess tax benefits

We support the proposal to eliminate the requirement to delay recognition of excess tax benefits until taxes payable is reduced because of the associated cost and complexity.

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?

Consistent with our views expressed in Question 2, we believe that excess tax benefits should continue to be classified as a financing activity in the statement of cash flows. However, if the Board moves ahead with its proposal to include the excess tax benefits and tax deficiencies in the income statement, we agree that excess tax benefits should be classified as an operating activity in the statement of cash flows.

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 support this proposed accounting policy election because it allows an entity to eliminate the cost and complexity associated with estimating forfeitures. Also, either accounting policy election would lead to the ultimate recognition of the compensation cost only for awards that vest. We support allowing companies the option to make this election as of the effective date. We recommend that the effective date should be extended one year for nonpublic entities to allow them time to understand and consider the election.

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 increasing the threshold for the exception to liability accounting related to net share settlement for withholding taxes. However, we note that the exception continues to be limited to employers that have a withholding tax obligation. We understand that partnerships and similar pass-through entities do not have such a withholding obligation for awards issued to certain employees (e.g., partners) and, as a result, are unable to use the exception.

We suggest extending the exception to pass-through entities because employees of these entities also are required to pay taxes on the value of their share-based payments when they vest or are exercised. For these entities, which tend to be nonpublic entities with limited liquidity for their equity, any net settlement to provide liquidity to the employees to settle their resulting tax obligations still would result in a liability-classified award.

One way to extend this exception to pass-through entities would be to base it on whether the employee has an income tax obligation resulting from vesting or exercising an award rather than whether the entity has a statutory tax withholding obligation. Basing the exception on the employee's tax obligation would be consistent with using the maximum individual statutory tax rate for employees in the applicable jurisdiction as the threshold amount for the exception to liability classification for the award. We note that extending this exception to pass-through entities would align the guidance in this area for all entities.

As noted in Paragraph BC16, the Board intended that an entity would determine the maximum withholding rate in a jurisdiction (i.e., determine a single maximum withholding rate for a given jurisdiction). Paragraph ASC 718-10-25-18 as revised suggests that the withholding rate should be determined at the individual employee level. The Board may wish to clarify in ASC 718-10-25-18 that the rate should be the maximum withholding rate for an employee in a given jurisdiction.

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 paid by an employer for tax withholding purposes should be classified as a financing activity on the statement of cash flows because the substance of this transaction is a repurchase of shares (i.e., a treasury stock transaction) from employees.

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 aligning the guidance on assessing repurchase features that are contingent on an event within the employee's control with the guidance on assessing contingent events outside the employee's control. We note that the Board's intent in Statement 123 (R) is to consider the substantive terms of an arrangement in determining whether the arrangement gives rise to a liability or an equity instrument. Therefore, until the contingent event occurs, an entity may not have an obligation to transfer assets. We further note that the guidance in paragraph 31 of Statement 123 (R) was intended to be an interim guidance pending completion of the Board's project on liabilities and equity. This proposed change would eliminate current diversity in practice that results from lack of clear guidance under current GAAP.

Paragraph BC21 clarifies that the proposed classification guidance would be applied to share-based payments on an award-by-award basis. The Board may want to add a sentence at the end of paragraph ASC 718-10-25-9 that states, "The probability assessment should be applied to share-based payments on an award-by-award basis." The Board may want to add a similar sentence at the end of paragraph ASC 718-10-25-11(b).

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 believe that this practical expedient would be useful to nonpublic entities that do not have sufficient historical exercise data to develop the expected term assumption as required in ASC 718. Currently, these entities must use data of comparable entities for purposes of estimating the expected terms for their awards. We note that Securities and Exchange Commission staff guidance currently provides similar relief for public companies that do not have historical exercise data for the expected term assumption in certain circumstances. The FASB may wish to provide this practical expedient to all public companies to further simplify the accounting for share-based payments.

We support allowing nonpublic entities the option to make this election as of the effective date. We recommend that the effective date should be extended one year for nonpublic entities to allow them time to understand and consider the election.

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 support this one-time election and allowing nonpublic entities the option to elect it as of the effective date. As we note in our response to Question 8, we recommend that the effective date should be extended one year for nonpublic entities to allow them time to understand and consider the election.

We note that the PCC recently decided that private companies should be allowed to make a one-time election to adopt PCC alternatives after their effective dates without demonstrating preferability. The PCC also recommended that the FASB staff research whether the Board should provide a similar one-time election for private company relief the FASB has developed using the private company decision-making framework. This might be one of the areas of relief the FASB may wish to research.

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

We generally believe the transition requirements are appropriate, but note the following on specific aspects of the Proposal.

Recognition of excess tax benefits

We support the prospective transition approach that has been proposed because we believe that many companies would incur significant costs to apply the Board's proposal on a retrospective basis.

Realization of excess tax benefits

We note that the proposed guidance does not state explicitly that entities should assess the realizability of any deferred tax assets recognized upon adoption of the Proposal. In the absence of additional guidance, we believe that entities may overlook this requirement within ASC 740. Additionally, we believe that the guidance should clarify that any valuation allowance recorded against deferred tax assets recognized on the adoption date should be part of the cumulative-effect adjustment and, under the Proposal, recorded to retained earnings. Therefore, we believe that ASC 718-10-65-4(b)(2) should be amended as follows.

> **718-10-65-4(b)(2):** On a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the annual reporting period in which the pending content that links to this paragraph is effective for all tax benefits that were not previously recognized because the related tax deduction had not reduced taxes payable. <u>Any deferred tax assets recorded on the date of adoption shall be assessed for realizability in accordance with the provisions of Topic 740. Any valuation allowance recognized on the date of adoption for deferred tax assets recognized as a result of the adoption of the pending content shall be recorded as part of the cumulative-effect adjustment to retained earnings.</u>

Classification of excess tax benefits on the statement of cash flows

We do not support the retrospective transition approach that has been proposed. We believe that it is fundamentally inconsistent to require prospective recognition of excess tax benefits in the income statement and to require retrospective classification of excess tax benefits as cash flows from operating activities. These excess tax benefits will continue to be recognized in APIC in historical periods. Thus, we believe the proposed change in the classification of excess tax benefits in the statement of cash flows should be adopted on a prospective basis.

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?

Since the Proposal generally contains narrow scope amendments, we expect that the amount of time necessary to adopt many of the proposed changes would be minimal. However, some entities, especially those that would have to change their systems to adopt the proposed changes, would need more time to adopt them. Many entities currently use third-party software to manage their share-based payments (e.g., accounting for forfeitures). For these entities, the amount of time needed to adopt the proposed amendments may depend on the time it takes their third-party software providers to update their software, and this may affect whether entities would be able to make the accounting policy election for forfeitures before the effective date. We believe the Board should focus particularly on the input of preparers when evaluating the time necessary to adopt the proposed amendments.

The Board may want to consider providing a one-year deferral of the effective date for nonpublic entities so that they have time to educate themselves on the new guidance. We note that if the FASB decides to provide nonpublic entities with an unconditional one-time election to adopt the practical expedients, a one-year deferral of the effective date would no longer be necessary for the practical expedients. We believe that early adoption should be permitted for all entities.

Eliminating the indefinite deferral in ASC 718

The Board proposed eliminating the guidance in ASC 718-10-35-13 that it had indefinitely deferred pending the completion of its then-active liabilities and equity project. The Board decided not to provide transition guidance and an effective date for this proposed amendment, since it would not change currently effective GAAP.

While the provisions of ASC 718-10-35-13 are not currently effective, they have been used by analogy in practice to determine when share-based payment awards issued to nonemployees that are accounted for under ASC 505-50 become subject to other GAAP (i.e., when a nonemployee's performance is complete). The guidance in ASC 815 does not apply to share-based payments issued to nonemployees to acquire goods or services until the nonemployees' performance is complete.[2] A nonemployee's continued service sometimes is necessary to retain an award for its entire term, (e.g., an option with a 10-year term may truncate to three months if the nonemployee ceases to provide services). In these cases, some entities analogize to the guidance in ASC 718-10-35-13(b) to determine when the award would be subject to other GAAP (i.e., ASC 480 or ASC 815).

Absent the guidance in ASC 718-10-35-13, it is unclear how entities would determine when certain awards issued to nonemployees would be subject to ASC 480 or ASC 815. Instead of eliminating the guidance in ASC 718-10-35-13, the FASB may want to consider including it in ASC 505-50.

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[2] ASC 815-40-15-3(c) clarifies that ASC 815 does not apply to contracts that are issued to acquire goods or services from nonemployees when performance has not yet occurred.