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August 14, 2015

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

**RE: Exposure Draft, Compensation – Stock Compensation (Topic 718):  
Improvements to Employee Share-Based Payment Accounting (File Reference No.  
2015-270)**

Dear Technical Director:

We appreciate the opportunity to comment on the Board's Exposure Draft, *Compensation – Stock Compensation (Topic 718) – Improvements to Employee Share-Based Payment Accounting*. We support the Board's objectives of the simplification initiative and agree that areas of U.S. generally accepted accounting principles (GAAP) for which cost and complexity can be reduced without sacrificing the usefulness of the information provided to users should be evaluated and improved.

The areas for simplification proposed by the Board involve several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. Some of the areas for simplification apply only to nonpublic entities. We agree with the Board's expectation that certain of the proposed changes could reduce cost and complexity while maintaining or improving the usefulness of the information provided to users of financial statements.

**Reducing Complexity**

Consistent with our past comments, while we support the Board's efforts to address unnecessary complexity in accounting standards through its narrow-scope projects within the simplification initiative, we believe that there are significant instances of complexity in the Board's ongoing



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major projects and existing accounting standards and financial reporting that transcend the scope of narrow projects intended to simplify specific provisions within existing standards.

We encourage the Board to expand its efforts to address concerns about complexity in accounting standards beyond the narrow scope projects within the simplification initiative and develop an overall plan and framework to address the broader systemic causes of complexity in financial reporting. We believe the development of a framework on complexity and a plan to address complexity in existing standards beyond the scope of the narrow projects within the simplification initiative should be subject to due process, including exposure for public comment.

### **Convergence**

We continue to support efforts by the FASB and IASB for further convergence of U.S. GAAP and International Financial Reporting Standards (IFRS) to provide more comparable global accounting standards. The proposed change to allow withholding above the statutory minimum without requiring liability classification is moving in a different direction than the IASB which has a pending Exposure Draft which would align IFRS with current U.S. GAAP requirements. For other proposed amendments, generally, IFRS neither has comparable guidance nor explicitly permits a practical expedient. Although these differences would not be significant in the overall efforts to develop more comparable global accounting standards, we believe that the Board should clarify its priorities related to convergence of U.S. GAAP and IFRS and develop a framework, which would be subject to due process, on how it would intend to consider the benefits of convergence in its deliberations on potential changes to U.S. GAAP, including simplification initiatives. In some cases, the benefits of convergence may be sufficient to support changes to U.S. GAAP even when there may not be substantial improvements in U.S. GAAP. In other cases, convergence may not be sufficient to support a change to U.S. GAAP if that change would significantly reduce the usefulness of information reported under U.S. GAAP.



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We look forward to working with the Board as it continues to explore other opportunities for change as part of the simplification initiative. Our responses to the Board's specific questions and our other observations are set forth in Appendix I. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact Kimber K. Bascom at (212) 909-5664 or Jeffrey N. Jones at (212) 909-5490.

Sincerely,

*KPMG LLP*

KPMG, LLP

## Appendix I

***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?*

We generally agree that the proposed changes will simplify the accounting for share-based payments. However, as further discussed below, certain of the amendments likely will result in increased volatility in the income statement which may increase complexity for financial statements users. Consequently, we encourage the Board to conduct further outreach to the user community to determine whether the proposed changes impact the usability of the financial statements.

***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?*

We support the Board's proposed amendment to recognize all excess tax benefits and tax deficiencies as income tax benefit or expense in the income statement. However, the proposed amendment likely will result in increased volatility in the income statement caused by factors such as timing of vesting of awards (or exercise of share options) and stock prices on those dates relative to stock prices on the grant date not directly related to an entity's operating performance. This could potentially make it more difficult for users to understand changes in an entity's earnings and compare an entity's earnings from one period to the next. Also, recording excess tax benefits and deficiencies in the income statement will result in a new reconciling item between statutory tax and effective income tax rates for most companies, making it more difficult to estimate the annual effective tax rate and increasing complexity in tax disclosures.

While we support the Board's proposed amendment to recognize all excess tax benefits and tax deficiencies in earnings, we believe that recording these amounts in additional paid in capital (APIC) also would be an acceptable approach and would reduce complexity compared with the current requirements without creating the increased complexity in using the financial statements described in the preceding paragraph. Many preparers of financial statements currently exclude the compensation cost for share-based payments as well as any associated tax aspects through non-GAAP disclosures to reflect their results of operations consistent with measures commonly used by investors to evaluate performance. We encourage the Board to consider outreach to determine if users think that recording all excess tax benefits and tax deficiencies in APIC would result in more decision-useful information than the proposed changes. If the Board ultimately rejects this view, we also encourage the Board to expand on the basis for its conclusions in this regard compared to what is included in paragraph BC6.

Whichever model the Board selects for the recognition of excess tax benefits and tax deficiencies, we agree with the Board's proposed amendment to remove the delayed recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable. The amendment would eliminate the current requirement for entities in a net operating loss (NOL) position to track the NOL carryforwards from each year related to excess share-based payment deductions and from other sources as well as the timing of their utilization, which will reduce cost and complexity.

Other points – We recommend the Board consider clarifying when the excess tax benefit should be recognized. If read literally, the phrase “in a period when actual tax deductions for compensation expense taken by an entity on its tax return...” in the proposed changes to ASC 718-740-35-2, indicate the excess tax benefit should be recorded in the period the entity files its tax return. We believe the Board's intent is that the excess tax benefit be recognized in the accounting period in which the deduction arises rather than the period the tax return is filed.

***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, why?*

We agree with the Board's proposed amendment to recognize excess tax benefits as an operating activity in the statement of cash flows, provided the Board decides to adopt the changes as proposed. However, as noted in our response to question 2, if the Board decides to recognize all excess tax benefits and tax deficiencies as part of APIC, we believe the excess tax benefit should continue to be presented as a cash inflow from financing activities to be consistent with the treatment in APIC.

***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 the Board's proposal to allow an accounting policy election either to account for forfeitures when they occur or to continue to estimate forfeitures.

We believe that the Board should further clarify how the election to record forfeitures as they occur would apply to awards with service *and* performance conditions. We note the discussion in paragraph BC12, but observe that it is not clearly articulated in any of the proposed changes to authoritative guidance. In addition, there is guidance in ASC 718-10-30-12 that equates the term *forfeiture* (which is not a defined term in the Master Glossary) with failing to satisfy a service condition or a performance condition. We believe an illustrative example of how the Board believes the principles in BC12 should be applied to awards with both performance *and* service conditions would clarify these concepts.

Furthermore, we believe that the Board should also provide illustrative examples to demonstrate how this practical expedient works in relation to modified awards or replacement awards in a business combination. It is not apparent how an entity should apply a mixed policy of recognizing forfeitures as they occur for some awards but not to those that have been modified and/or replaced in a business combination. In addition, the increased complexity of accounting for different populations of awards under different accounting policies could be a significant deterrent to making the election to recognize forfeitures as they occur.

Other points – There appears to be a computational error in the proposed example to be added in Case C, which begins at paragraph ASC 718-20-55-34A. The cumulative compensation cost recognized in the illustrated journal entries at the end of the second year is \$8,141,472. Based on the total number of awards that remain subject to vesting, it appears that amount should be \$7,909,645 ( $\$11,864,467 \times 2/3$ ). The difference is \$231,827, which is the amount of compensation cost reversed in the proposed journal entry in paragraph 718-20-55-34F. However, that is only one year's worth of compensation cost for those forfeited awards and, since they were forfeited in the second year, the entry should reflect two years of reversal of compensation cost.

***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 the Board's proposal to permit withholding up to the maximum individual statutory tax rate in the applicable jurisdiction without, by itself, resulting in liability classification of the award. However, we do not believe the Board's statement in BC16 that "the amendments would require an entity to determine only one maximum rate in each jurisdiction rather than determining a rate for each employee under the existing exception" is accurate for all jurisdictions. For instance, in the U.S., the IRS publishes rules on the acceptable methods for determining the withholding for supplemental wages (which is the general characterization of share based payments for individual income tax purposes). Those rules generally do not provide for using the maximum individual statutory withholding rate. In order to implement the Board's proposal to use that rate, companies would need to obtain written authorizations from each employee to permit withholding above the amounts specified in the withholding rules. We encourage the Board to perform further research regarding an entity's ability to unilaterally withhold more than the required amounts based on IRS regulations. We believe such restrictions should be clearly explained in the final ASU to avoid confusion.

Other points - We note that the IASB has an Exposure Draft outstanding that would change IFRS 2 to allow similar accounting as current U.S. GAAP. Since there is an existing GAAP difference between IFRS 2 and ASC 718 on the impact of withholding on classification, we recommend both Boards consider whether convergence could be achieved given that each standard setter has active projects with proposed changes on this point that would result in new GAAP differences.

**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 with the Board's proposed amendment to classify cash paid by an employer to the taxing authorities when directly withholding shares for tax-withholding purposes as a financing activity in the statement of cash flows because this treatment is consistent with the cash paid for the reacquisition of treasury shares.

**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 the Board's proposed amendment to permit an award that is contingently redeemable for cash to be equity classified, with reclassification to a liability only required if the contingent event becomes probable, even if the employee controls its occurrence. However, in the proposed amendments to ASC paragraph 718-10-25-9, the probability of the event occurring before the employee has borne the risks and rewards of ownership triggers the award's reclassification. We believe that the guidance should instead focus on whether the repurchase is probable of occurring before the employee bears the risks and rewards of stock ownership for a reasonable period of time. It is fairly common for companies to structure contingent put options so that after the specified event occurs, the put option is not exercisable until the employee has borne the risks and rewards of ownership for a reasonable period of time. Therefore, we believe the Board should modify the proposed language in the final ASU to clarify that in those situations the awards continue to be equity classified.

Other points – We recommend the Board either eliminate or explain further the comments in BC25 about formula repurchase features. That paragraph indicates that repurchases based on a formula would not expose the holder to risks and rewards of ownership because the formula may not be consistent with fair value. While that is true, the Board should also acknowledge the exception for nonpublic companies with book value plans that allows for the use of an alternative to fair value in some circumstances. (Example 8 - ASC 718-10-55-131).

**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 agree with the Board's proposed amendment to allow nonpublic entities to use a practical expedient to determine the expected term of all share option awards with performance conditions that affect vesting or service conditions with some clarifications.

The amendments proposed in paragraph 718-10-30-20B indicate that the practical expedient would be applied to a share option or similar award that is granted at-the-money. We encourage the Board to clarify the rationale for assessing this practical expedient at the grant date, which is presumably because whether an award is granted at-the-money affects the employee's exercise behavior. For awards that are equity-classified, this treatment would be consistent with SAB Nos. 107 and 14.C. However, for liability-classified awards that a nonpublic entity elects to account for at fair value, we encourage the Board to clarify whether continuing to use this practical expedient in future periods would be permissible, since those awards are likely to cease to be "at-the-money" on future remeasurement dates and the "moneyness" of an award tends to affect the exercise behavior of employees.

We do not agree with the proposed guidance in ASC paragraph 718-10-30-20A for all awards with performance conditions that are not probable of achievement at the grant date. For performance conditions structured to have an uncertain point of achievement (e.g., the award vests in the first quarterly period when revenues exceed a stated target), we believe the proposed guidance is reasonable. However, it is much more common for awards with performance conditions to provide for a specific fixed measurement period where the award's vesting status will be determined shortly after that period ends (e.g., the award vests if the revenues for the two-year period following the grant exceed a stated target). We do not believe companies that grant those types of awards should be required to use the contractual term of the award (which will likely lead to an overstatement of fair value) to determine its expected life simply because the performance condition was not probable of achievement on the grant date.

***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 the Board's proposed amendment to allow nonpublic entities to make a one-time election to switch from measuring liability-classified awards at fair value to intrinsic value without considering preferability. In determining whether the Board should consider making the ability to elect intrinsic value an ongoing election alternative, we encourage the Board to align its decision with the Private Company Council (PCC) framework in evaluating whether private companies would be required to make elections to follow certain alternatives only on the effective date of the PCC ASUs or whether accounting changes to adopt the elections could be made at some time in the future.



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

We support the Board's transition requirements for each area in this circumstance. We would also encourage the Board to consider to allow nonpublic entities to early adopt the proposed amendments given that the proposed changes relate to narrow-scope projects within the simplification initiative.

***Question 11:*** *How much time will be necessary to adopt the amendments in the proposed Update? Should the amount of time needed to apply the proposed amendment by entities other than public business entities be different from the amount of time needed by public business entities?*

We do not believe entities will require significant time to adopt the proposed amendments as the share-based payment information should be readily available.

### **Deferral of ASC 718-10-35-12 and 13**

We note that the Board has proposed to eliminate the indefinite deferral to the requirements of ASC 718-10-35-12 and 13. We believe that there may be an unintended consequence of removing that deferral. ASC 505-50-35 has subsequent accounting guidance for awards with market conditions granted to nonemployees and specifies that other GAAP should be applied after performance is complete. However, there is no guidance for awards that contain only service and/or performance conditions. As a result, some companies have analogized to the deferred guidance for employee awards in ASC 718-10-35-12 and 13 and continued to classify the awards based on the principles in ASC 718 if continued service from the nonemployee is required to avoid truncation of the ability to exercise a share option. Therefore, we recommend the Board either allow the deferral to continue or clarify the accounting for those awards in ASC 505-50 and provide transition guidance for any resulting changes in classification.