NASPP
National Association of
Stock Plan Professionals

August 16, 2015

Technical Director
director@fasb.org
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Via Email

Dear Technical Director,

I am writing on behalf of the National Association of Stock Plan Professionals to comment on the proposed Accounting Standards Update (ASU) to ASC 718. The National Association of Stock Plan Professionals (NASPP) is a professional association representing over 6,000 members. Our members are directly involved in the design, oversight, and administration of stock compensation programs and include stock plan administrators; Human Resource professionals; corporate secretaries; financial and accounting professionals; securities, tax, and benefits attorneys; and compensation consultants. Our membership includes corporate issuers of all sizes, from all regions of the United States, and in a wide spectrum of industries.

Overall, we are very supportive of most of the proposed amendments to ASC 718. We believe that the majority of these amendments will simplify application of the standard and will be welcomed by our members. However, we have significant concerns about the amendments relating to accounting for income taxes, and we suggest a few enhancements that we think will make some of the remaining amendments more practical.

We respectfully submit the following comments.

Issue 1: Accounting for Income Taxes
While we appreciate the FASB's objective of simplifying the guidance on accounting for the tax effects of stock awards, we are opposed to the approach described in the proposed ASU. We are concerned that accounting for all excess tax benefits and shortfalls in tax expense will be confusing to users of the financial statements.

This is a highly complex and esoteric aspect of ASC 718, and one that many accounting and tax professionals have difficulty understanding. It follows that, most financial statement users, who typically have only a general understanding of US GAAP, are unlikely to understand the technical requirements or how certain factors (in this case, stock price) flow through and impact earnings and earnings per share. Moreover, we do not consider it appropriate for companies to show significant profits or losses merely as a result of fluctuations in their stock price. We believe this will be unintuitive to financial statement users, who would expect income or losses to be the result of operations and fully within the control of the company, and we believe that this might cause them to over- or undervalue companies.

We further note that tracking the amount of additional paid-in capital attributable to prior stock plan transactions is only one component of what is otherwise a very complex requirement and that many other factors contribute to this complexity. In a survey of our members, 79% of respondents indicated that they find it necessary to supplement the standard automated reports provided in their stock plan recordkeeping systems with manual processes (e.g., calculations in an Excel spreadsheet) for various aspects of tax accounting that are unrelated to tracking paid-in capital. Many of these complexities arise not only from the specific guidance on accounting for income taxes but in the intersection of this guidance with other requirements of the standard (e.g., accounting for modifications, liability awards, awards granted to non-employees).

For those reasons, even after the requirement to track paid-in capital is removed, compliance with this area of the standard will remain largely a manual process with a high risk of error. Under the current standard, errors are generally corrected through equity; we are concerned that once these errors are reflected in tax expense in the income statement, the implications of any such errors will be significantly magnified for users of the financial statements. While there are mechanisms that allow companies to address errors reported in the income statement, there is ultimately no way to rewrite history for users of financial statements who have made investment decisions based on erroneous information.

Finally, we note that requiring all excess tax benefits and shortfalls to be recorded in tax expense will introduce significant volatility into the income statement. Based on very limited and preliminary research, we have found that the impact of accounting for excess tax benefits and shortfalls in tax expense can be significant. In several companies we reviewed, we found that earnings per share would have been altered by roughly 10% and, in one case, by over 60% had excess tax benefits been recorded to tax expense. The impact on newly public and smaller companies would be especially significant and potentially disproportionate by comparison with the impact on larger, more mature public companies. In light of our concern that financial statement users will not understand the technical requirements that underlie this volatility, or that the fluctuations in earnings and losses are generated solely by changes in the value of the company's stock, we believe that this could be very confusing for financial statement users.

Given all of the aforementioned concerns, while we agree that elimination of the requirement to track paid-in capital from excess tax benefits for prior stock plan transactions would simplify compliance with the standard (as 73% of our members report that manual processes are necessary to perform this function), we believe that the proposed approach of recording all excess tax benefits and shortfalls in tax expense is less desirable than the current process. Instead, we suggest recording all excess tax benefits and shortfalls in paid-in capital. This would also eliminate the need to track paid-in capital from excess tax benefits attributable to stock plan transactions but, with this approach, stock price fluctuations would not generate additional profits or losses for the entity. If, however, the Board is not amenable to this alternative, we would prefer that the current guidance remain in place.

We do not support the approach utilized under IFRS 2; we feel this approach presents an unbalanced picture of the entity for financial statement users, as shortfalls are reflected in tax expense, and excess tax benefits are reflected in paid-in capital. We doubt that many financial statement users understand the differing treatment of shortfalls versus excess tax benefits. And, as noted above, we do not feel it is appropriate for companies to report significant losses arising solely from changes in their stock price.

We support the Board's decision to no longer delay recognition of tax benefits until the benefits are realized through reductions to taxes payable.

Issue 2: Classification of Excess Tax Benefits on the Statement of Cash Flows
We support the reclassification of excess tax benefits as an operating activity.

Issue 3: Forfeitures
We support the proposal allowing entities to make a policy election to recognize forfeitures as they occur.

We encourage the Board to consider allowing entities to change their policy election with respect to the treatment of forfeitures without treating this as a change in accounting principle (requiring a preferability assessment, retrospective application, etc.). We believe the decision with respect to the treatment of forfeitures will relate primarily to entity size; we expect that private and small public companies will elect to account for forfeitures as they occur and that larger public companies will elect to apply an estimated forfeiture rate. As entities grow and shrink in size, we expect that they may wish to change their policy election with respect to forfeitures. Treating this decision as a change in accounting principle will present a significant obstacle to doing so, to the point where we expect many entities will simply decide not to change their approach and will continue to account for forfeitures in a manner that is unsuited to their needs and fails to provide the best information for financial statement users.

Issue 4: Minimum Statutory Tax-Withholding Requirements
We strongly support modification of the current exception to liability classification to provide that partial cash settlement of an award for tax-withholding purposes would not result in liability treatment, provided that the amount withheld does not exceed the maximum individual statutory tax rate in the applicable jurisdiction.

We encourage the Board to provide further guidance on the maximum tax rate in situations where award holders are subject to tax in multiple jurisdictions. We recommend providing that partial cash settlement doesn't trigger liability treatment provided that the taxes withheld do not exceed the combined maximum tax rate for all of the jurisdictions in which the individual is subject to tax.

Taxation in multiple jurisdictions is a frequent occurrence for temporary and permanent assignees, relocated employees, and business travelers. For example, assume that an employee is granted an award in New York and moves to California and resides there at the time when the award is settled. The employee would be liable for California state tax on the entire gain at settlement and would likely also be liable for New York state tax on a portion of the gain at settlement. If the shares withheld to cover the tax withholding must be limited to the maximum tax rate in either jurisdiction, this would likely be insufficient to fulfill the tax withholding required for the settlement. This is a relatively simple example; it is often very difficult for companies to determine the correct withholding rate when more than two jurisdictions are involved and when some of those jurisdictions are located outside the United States.

We encourage the Board to eliminate the requirement that the employer have a statutory obligation to withhold tax. There are jurisdictions outside the United States where it may be advisable for employers to withhold taxes even when not legally mandated to do so. Moreover, we don’t see any basis for making this distinction. Provided that the cash issued upon settlement is applied to taxes withheld with respect to the award and the transaction is subject to the same parameters that apply when withholding is mandated, we do not believe the accounting treatment should differ. We feel that any such difference in treatment would be confusing for users of financial statements.

Issue 5: Classification of Employee Taxes Paid on the Statement of Cash Flows When an Employer Withholds Shares for Tax-Withholding Purposes
We support classifying the cash paid when withholding shares for tax purposes as a financing activity.

Issue 6: Classification of Awards with Repurchase Features
We support considering whether a contingent event is probable of occurring regardless of whether the employee controls the occurrence of the contingent event when determining the equity or liability treatment of repurchase features.

Issue 7: Practical Expedient—Expected Term
We support the inclusion of a practical expedient that private companies can use to determine expected term for purposes of valuing stock option grants, and we agree that the midpoint between the end of the service period and the contractual term is appropriate for this purpose. We believe this will make it easier for private companies to value their stock options.

We suggest eliminating the requirement that the practical expedient can be applied only to awards that are exercisable for a limited period of time after termination of employment. In our experience, it is typical for awards to be exercisable for longer periods of time in the event of certain types of terminations such as retirement, death, or disability. Inclusion of this limitation severely inhibits the usefulness of the practical expedient. In addition, many factors other than termination of employment influence exercise behavior; in fact, where award holders remain employed, this has no bearing whatsoever on their decision to exercise their awards. In private companies, terminating employees are often unable to exercise their awards because, without a public market for the underlying stock, they may have no practical way to finance payment of the purchase price and taxes due upon exercise. For that reason, the fact that awards are exercisable for an extended period after termination may have little impact on whether or when they are exercised, particularly for employees of private companies.

We also recommend eliminating the prohibition on application to awards with market conditions and of the requirement to assess the probability that performance conditions will be achieved. We recommend allowing the midpoint between the service period and contractual term to be treated as the expected term for these awards without regard to the performance or market conditions, as we feel that these requirements unnecessarily complicate what is otherwise a very clean solution. It is very rare that awards subject to performance or market conditions would not have a fixed service period. In most cases, performance or market conditions simply determine whether the awards will vest but do not influence when vesting occurs—that is, either the conditions have been met by the end of the fixed service period, in which case vesting occurs at that time, or they have not, in which case vesting does not occur. The existing standard already addresses how these conditions are accounted for, either by applying an estimated forfeiture rate and truing up to the actual outcome (in the case of performance conditions) or by adjusting the grant date fair value for market conditions. We do not believe that these conditions need to be further considered in determining the expected term.

Issue 8: Intrinsic Value
We support the proposal to allow private companies a one-time opportunity to elect to change their measurement of all liability awards to the intrinsic value approach as of the effective date of the ASU.

Issue 9: Eliminating the Indefinite Deferral in Topic 718
We support removing the guidance that is currently indefinitely deferred under ASC 718.

Thank you for considering our comments. The NASPP would welcome the opportunity to meet with members of the FASB staff to further discuss our comments, to respond to questions, and to provide additional information. At the staff's convenience, we would be happy to come to Norwalk to meet with you on this matter. If you have any questions regarding this letter, please do not hesitate to contact me at (510) 493-7599 or bbaksa@naspp.com.

Sincerely,

Barbara A. Baksa, CEP
Executive Director