FINANCIAL ACCOUNTING STANDARDS BOARD

MEMO

Memo No.	**11**
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Project	**PCC Issue No. 2018-01, "Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards"**
Project Stage	**Redeliberations**
Issue	**Staff Analysis of Comment Letter Responses**

Memo Purpose

1. The purpose of this memo is to provide the Private Company Council (PCC) with analysis of comments received on the proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards, a Proposal of the Private Company Council* and staff recommendations based on that analysis. The proposed Update was issued for public comment on August 17, 2020, with comments due by October 1, 2020.

2. This memo provides a summary of the feedback received from the 24 comment letters submitted by stakeholders in response to the proposed Update.

3. The memo is organized as follows:

    a) Project Background

    b) General Summary of Comments Received

    c) Issue 1: Decision Usefulness of Share-Based Compensation Information

    d) Issue 2: Cost Savings

e) Issue 3: Scope

f) Issue 4: References to Section 409A

g) Issue 5: Award-by-Award Basis

h) Issue 6: Transition Requirements

i) Issue 7: Other Approaches Suggested

j) Issue 8: Other Noteworthy Comments

k) Next steps

Project Background

4. At the December 16, 2019 PCC meeting, the PCC voted to direct the staff to draft the proposed Update for a practical expedient to determine the current price input for an option pricing model used to calculate the grant-date fair value of an equity-classified share-option award (the practical expedient). The PCC decided that the practical expedient should allow a nonpublic entity to determine the current price input in accordance with certain valuation procedures described in the U.S. Internal Revenue Code Section 409A and the associated Treasury Regulations (referred to collectively as Section 409A).

5. The Board endorsed the PCC's decisions at its February 12, 2020 meeting, leading to the issuance of the proposed Update.

General Summary of Comments Received

6. Twenty-four comment letters were received on the proposed Update. Not all respondents addressed every question. Some focused only on specific questions and issues, while others answered all questions and provided comments on each issue. The following table provides information on the composition of the comment letter respondents:

Type of Respondent[1]	Number of Respondents
Audit Practitioner	10
Consulting Firm	3
Independent Consultant	2
Industry Group	3

[1] No comment letters were received from financial statement users. One industry group respondent has a blended perspective of a financial statement preparer and a financial statement user. User outreach was already performed to assess the relevance of share-based compensation expense information (a key point in deciding to pursue a practical expedient).

CPA Society	6
Total Respondents	**24**

7. The level of detail in the feedback received varied depending on the issue. Most respondents indicated that the practical expedient would not compromise the decision usefulness of share-based compensation information. However, most respondents also indicated that the practical expedient would neither reduce the number of valuations that a company obtained nor reduce the cost to audit the current price input.

8. Many respondents recommended expanding the scope of the practical expedient to include other forms of equity-classified share-based payments and some respondents recommended a further scope expansion to incorporate liability-classified share-based payments.

9. Several respondents recommended that the PCC explore another version of the practical expedient that would provide for the current price input to be estimated within the 12 months preceding the grant date rather than as of the grant date, subject to a trigger-based assessment that an up-to-12-month-old valuation would not have been materially different as of the grant date. Along the same lines, some respondents recommended providing guidance within the proposed practical expedient to clarify the types of events that an entity should consider when evaluating whether a valuation performed within 12 months of the grant date was not "grossly unreasonable."

10. Respondents also provided other suggestions to improve the operability of the practical expedient. Those suggestions included adjusting the references to the Section 409A guidance by either incorporating additional paragraphs or removing portions of the paragraphs currently referenced and adjusting the discussion of audit and valuation procedures over the current price input in the basis for conclusions.

Issue 1: Decision Usefulness of Share-Based Compensation Information

Background

11. In determining whether to develop a **practical expedient** as opposed to an **accounting alternative**, the PCC and the Board considered the guidance in the *Private Company Decision Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (PCDMF or the Guide). Specifically, the Guide acknowledges two possibilities for recognition and measurement differences between private companies and public companies: a private company accounting alternative and a practical expedient.

12. As indicated in paragraph 1.3 of the Guide, an alternative is a different method for recognizing or measuring a transaction or event, whereas a practical expedient is "a more cost-effective way of

achieving the same or a similar accounting or reporting objective." If information is relevant to the users of private company financial statements, then a practical expedient should be used to lower the cost and complexity of applying the guidance. If the information is not relevant or if it is relevant but costly and no practical expedient is available, only then should the PCC and the Board consider an accounting alternative for recognition and measurement.

13. The FASB staff's research and outreach with users of private company financial statements from 2013 through 2014 and in 2018 indicated that share-based payment expense information is relevant to users of private company financial statements. Consequently, the Guide would support considering a practical expedient that would achieve the same objective as the current guidance. Per paragraph 718-10-30-6, "The measurement objective for equity instruments awarded to employees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue [when the conditions are met]."[2] Thus, it was concluded that to measure the grant-date fair value of an award, a practical expedient (as opposed to an accounting alternative) should be developed.

14. The following question was included in the proposed Update to assess whether the proposed Update would compromise the decision usefulness of information:

> **Question 6:** Will the proposed practical expedient compromise the decision usefulness of information related to equity-classified share-option awards? If yes, please explain how.

Summary of Comments

15. Twenty respondents commented on Question 6. Of those respondents, greater than a majority indicated that application of the practical expedient would not compromise the decision usefulness of information, several indicated that it would, and several others had views that were contingent on the way the practical expedient would be audited.

Decision Usefulness Would Not Be Compromised

16. A few respondents indicated that the practical expedient would not compromise the decision usefulness of information but did not elaborate on that view. The remaining respondents provided mixed reasons for their views.

17. Two audit practitioners (CLA CL #13 and Baker Tilly CL #22) reasoned that because many of their clients already used one valuation to satisfy both tax and GAAP requirements, simply codifying that practice would not change the quality of financial reporting information.

18. A few respondents implied or stated directly that the decision usefulness of share-based compensation expense may be overstated. A CPA society (CTCPA CL #12) and an industry group (NVCA CL #11)

[2] Once Accounting Standards Update No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, is effective, paragraph 718-10-30-6 will be updated to apply to all grantees and not just employees. The measurement objective remains the same, however: "The measurement objective for equity instruments awarded to grantees is to estimate the fair value at the grant date of the equity instruments that the entity is obligated to issue [when the conditions are met]."

indicated that financial statement note disclosures about share-based compensation were more useful to private company financial statement users than expense information. Another CPA society (CALCPA CL #23) and a consulting firm (CG CL #24) indicated that measurement of share-based awards is typically not precise enough to have material implications for the users of private company financial statements—even if changes in the amounts were large and would be seen as material cash-based expenses. However, the consulting firm (CG CL #24) noted that investors have focused more on share-based compensation information in the past two years. One industry group (TIC CL #07) stated:

> …most debt agreements permit a private company borrower to add back share-based payment expense to EBITDA when assessing whether a private company borrower is in compliance with its debt covenants…
>
> …most equity investors focus on some form of adjusted EBITDA that also allows an add back for any share-based payment expense…

19. An audit practitioner (KPMG CL #08) and a CPA society (FICPA CL #02) that stated that the practical expedient would not compromise the decision usefulness of information both caveated those statements. The audit practitioner stated that the practical expedient could result in a lack of comparability within and between companies. The CPA society stated that its valuation expert members urged caution regarding assumptions about similarity in measurement objectives between Section 409A and Topic 718.

Decision Usefulness Would Be Compromised

20. Of the several respondents who stated that the practical expedient would compromise the decision usefulness of information, some were concerned that valuations performed under Section 409A and Topic 718 could result in different amounts. For example, an audit practitioner (EY CL #05) stated:

> …in the few instances where we observed companies obtaining separate Section 409A and ASC 718 valuations, the Section 409A valuation generally results in a significantly lower per-share value. If such a valuation is determined not to be "grossly unreasonable" and, therefore, not subject to challenge under Section 409A, an unintended consequence that results from the application of the proposed practical expedient may be that valuations used for financial reporting purposes are lower than historical valuations obtained to satisfy the requirements of ASC 718.

21. A CPA society (NYSSCPA CL #04) stated that audit procedures and management responsibility for the current price input could diminish as a result of the proposed Update, thereby compromising the decision usefulness of information.

The Effect on Decision Usefulness Depends on How the Practical Expedient Is Applied and Audited

22. Two audit practitioners (PwC CL #05 and RSM CL #16) and one consulting firm (SRR CL #15) viewed the effect on decision usefulness as conditional upon either the way management applied the practical expedient or the way the practical expedient was audited. For example, one audit practitioner (RSM CL #16) stated:

> If the practical expedient was inappropriately applied (i.e., an improper valuation method was selected under Section 409A) or the responsibilities of management or the auditor were viewed as reduced, and the valuation held to less rigorous standards, the decision usefulness of the information could be compromised.

23. The two audit practitioners were concerned that the proposed Update could introduce confusion that would result in inappropriate application of the practical expedient and, as a result, compromise decision usefulness. The consulting firm (SRR CL #15) was unclear as to the intent regarding audit effort:

> We infer that the auditability of the valuation report is a major underlying issue. Put plainly, is it the FASB's view that the presumption of reasonableness extends to auditing the Section 409A valuation? Can auditors rely on the third-party specialist with lesser procedures as a result of the Update?

Issue 2: Cost Savings

Background

24. The PCC expected the practical expedient to save costs in the following ways:

    a) Nonpublic entities currently obtaining two independent valuations, one for GAAP and one for tax requirements, would be able to obtain just one to satisfy both purposes.

    b) Valuations by independent appraisal that satisfy Section 409A are valid for 12 months unless determined to be "grossly unreasonable." That could potentially reduce the number of valuations that a nonpublic entity would have to obtain.

    c) Documentation and audit procedures currently required in practice to substantiate the current price input should decrease.

25. The Board endorsed the PCC's decisions on the basis that the practical expedient would save costs for the reasons noted in paragraphs 24(a) and 24(b). That is, the Board did not expect that audit procedures around the current price input would be reduced by the practical expedient.

26. The following questions were included in the proposed Update to obtain feedback on the nature of the cost savings of the practical expedient:

> **Question 3:** Will the proposed practical expedient reduce costs, including audit costs or fees, associated with the current price input? Please explain why or why not.
>
> **Question 4:** Do you or your clients obtain separate valuations to satisfy GAAP requirements (Topic 718) and tax regulations (Section 409A)?

Summary of Comments

Preparation Costs—Effect of the Practical Expedient on the Number of Valuations Obtained

27. Twenty-one respondents commented on the number of valuations that a nonpublic entity obtains. Nearly all those respondents indicated that nonpublic entities do not typically obtain separate valuations for GAAP and tax purposes. The few remaining respondents indicated that multiple valuations are obtained.

One Valuation Is Obtained and Used for Both Tax and GAAP Purposes

28. About half of the respondents who indicated that nonpublic entities do not typically obtain separate valuations for GAAP and tax purposes did not elaborate significantly on their view. For example, one audit practitioner (PM CL #21) simply stated:

> In our experience most entities do not obtain separate valuations to satisfy GAAP requirements and tax regulations.

29. The remaining half of the respondents who indicated that nonpublic entities do not typically obtain separate valuations for GAAP and tax purposes had more nuanced views. Two consulting firms (CFGI CL #20 and SRR CL #15), a CPA society (CALCPA CL #23), and an audit practitioner (EY CL#19) indicated that it was very rare for companies to obtain separate valuations, but when a separate valuation was required, it was typically prepared retrospectively because the valuation performed for tax purposes was judged not to meet the Topic 718 measurement objective or because of "cheap-stock" issues. The following two comments illustrate that view:

> **Comment 1 (CFGI CL#20):** In a few cases, we have experienced our private company clients obtaining separate ASC 718 and Section 409A valuations, generally with the ASC 718 valuation performed retrospectively when the Section 409A has been determined by management and their auditors to be insufficient for purposes of supporting fair values under ASC 718.
>
> **Comment 2 (SRR CL #15):** In fact, the only reason we can imagine that an entity would obtain two separate valuations is that the Section 409A valuation was not prepared with sufficient diligence, care, and quality to stand up to financial statement audit, and therefore a second report was required.

30. Two audit practitioners (KPMG CL #08 and GT CL #17) indicated that while it was uncommon to obtain multiple valuations on the initial grant date, adjusted or completely new valuations may be required under Topic 718 after the initial valuation date. The following comment illustrates that view:

> …depending on how current the valuation is, the company typically adjusts the value for grants at dates other than the measurement date or obtains more frequent valuations to meet the Topic 718 fair value measurement objective. (KPMG CL #08)

31. A CPA society (NYSCPA CL #04) indicated that it was very uncommon to obtain multiple valuations for plain-vanilla share-option awards, but that multiple valuations are obtained for other types of awards such as profits interests.

32. An industry group (TIC CL #07) indicated that the majority of their member firms' clients did not obtain valuations for purposes of compliance with Section 409A.

Separate Valuations Are Obtained for Tax and GAAP Purposes

33. Two CPA societies (FICPA CL #02 and VSCPA CL #09) that indicated that nonpublic entities obtain separate valuations did not elaborate significantly on that view. One industry group (NVCA CL #11) indicated that while early stage companies may only obtain one valuation, the valuations typically become more complex once the company begins preparing GAAP financial statements. That group stated:

> [Section] 409A valuations must occur at every stage of company development and must be done regularly to satisfy ongoing IRS requirements. Consequently, all private companies that issue stock options to employees incur the cost to obtain valuations that meet the IRS standards from their very beginnings through—and in some cases well beyond—an exit event.
>
> Audited GAAP financial statements are often not required in the earliest days of a private company. However, as the company grows and matures, audited GAAP financial statements are required by later stage investors, banks, and other financing sources. In many cases, this necessitates valuation work beyond the [Section] 409A valuation report. In some cases, a separate experts' report, or substantial supplemental work to analyze market data in addition to that included in the [Section] 409A, is required for audited financials.

Audit Costs

34. Twenty-two respondents commented on whether audit costs would be reduced if an entity applied the practical expedient. A few of those respondents indicated that audit costs would be reduced, one respondent (CALCPA CL #23) was not sure whether audit costs would be reduced, and most other respondents did not expect a reduction in audit costs.

Audit Costs Would Be Reduced

35. A mix of reasons were provided for the view that audit costs would be reduced by application of the practical expedient. A CPA society (FICPA CL #02) indicated that the practical expedient would reduce the pressure on auditors to "over-document" procedures and conclusions around the current price input. An industry group (NVCA CL #04) indicated that auditors would spend less time auditing valuations obtained for purposes of complying with the practical expedient:

> Elimination of the requirement to obtain a separate Topic 718 valuation may well cause auditors to evaluate the 409A valuation in more detail. However, this work should require less auditor time and significantly less PC employee time than the current requirements.

36. A CPA society (CALCPA CL #23) that was not sure whether audit costs would be reduced indicated that the 12-month window afforded by Section 409A for use of a valuation performed by independent appraisal that is not "grossly unreasonable" could potentially reduce audit costs:

> On the other hand, costs could be reduced when an earlier IRS section 409(A) was already validated in connection with an earlier stock option grant, and another grant is made within 12 months. Under today's practice, the entity would need to assess and document, and auditors would audit, the change in the fair value of the underlying shares during the intervening period. Under the proposed practical expedient, little if any additional validation procedures would be required apart from ascertaining that no "material events" have occurred.

Audit Costs Would Not Be Reduced

37. Most respondents did not think that the practical expedient would reduce audit costs. Those respondents provided a mix of reasons for that view. However, nearly all respondents with that view did not expect a reduction in audit costs because the practical expedient would not change AICPA U.S. Auditing Standards (AU-C). That is, those respondents highlighted that the same level of audit procedures would be required to audit a valuation performed to comply with Section 409A as would be required to audit a valuation performed to comply with Topic 718. Some of those respondents simply stated that an auditor would still need to audit the inputs and assumptions of any valuation report. Four audit practitioners (PwC CL #05, Deloitte CL #10, RSM CL #16, and EY CL #19) went further and cited provisions in the AU-C to support their view. The following paragraphs of the AU-C were cited:

    a) Paragraphs A2 and A3 of AU-C Section 200 *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*

    b) Paragraphs 6, 8, 13, 14, A30, A69 of AU-C Section 540A *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*

    c) Paragraphs 8 and A49 of AU-C Section 500A *Audit Evidence*

    d) Paragraphs 5 and 12 of AU-C Section 620 *Use of the Work of an Auditor's Specialist*.

38. A consulting firm (CFGI CL #20) expressed its view that it did not expect that audit cost savings would occur because private companies typically obtained valuations on an annual or quarterly basis and the gap between the valuation date and grant date was generally concluded to be immaterial by private companies and their auditors. The following comment illustrates that view:

> We do not believe that the practical expedient will save on costs for private companies associated with the current price input. We typically see private companies defaulting to an annual or quarterly valuation cadence to meet the requirements of ASC 718 and Section 409a. Regardless of cadence, the grant-date is rarely ever on a quarterly close date or annual close date. Private companies and their auditors generally conclude that the difference in the current price of the underlying share between the grant date and the valuation date, for U.S. Generally Accepted Accounting Principles ("US GAAP") purposes, is immaterial to the financial statements…

39. A CPA society (NYSCPA CL #04) indicated that "audit assessment should remain a necessary component of the valuation process." That respondent stated that the auditor's procedures performed over a Section 409A valuation were critical to ensuring its reasonableness because of the relatively uncommon occurrence of IRS audits:

> From our own experience and discussions with others, it is our assessment that compliance with Section 409A regulation is generally inadequate for private companies, primarily because the IRS rarely reviews Section 409A issues. It is not uncommon to encounter companies that issue options outside of the 12-month safe harbor period or not accounting for information after the previous valuation that may have significantly changed the value of the company. It is often left up to the auditors, who cannot fully rely on preparers and management, to review ASC 718 valuations to ensure that companies are

> complying closely with Section 409A regulations. The proposed Update may reduce or remove, rather than enhance, management and the auditors' commitment to reviewing such issues.

40. An industry group (TIC CL #07) supplemented their response with views of the Auditing Standards Board:

> TIC has discussed with Auditing Standards Board and they agree that any potential audit savings would likely be minimal. They also fear preparers and their auditors may incorrectly assume that this practical expedient permits them to base the accounting purely on the 409A valuation without consideration of the reasonableness of the assumptions and process used therein. However, the same level of audit evidence would be required to validate the estimated share price value as is required today.

Audit Costs Reduction Depends on Whether a Company Obtains Multiple Valuations

41. Several respondents' expectation of reduced audit costs was contingent upon the number of required valuations. That view is illustrated by the following comment from an audit practitioner (PM CL #21):

> Yes, we agree the practical expedient will allow for reduced costs, especially when entities obtain separate valuations for tax and financial reporting purposes. However, in situations, where a separate valuation is not obtained for financial reporting purposes, the cost savings may not be significant.

42. Of the several respondents that aligned with that view, three (TIC CL #07, ICPAS CL #14, and PM CL #21) expected a small cost reduction but did not expect that it would apply for many companies because they did not believe that many companies obtained multiple valuations.

Evaluating Tax Law and the Code Could Add Complexity

43. Some respondents observed that the proposed Update could increase audit costs. Three audit practitioners (KPMG CL #08, Deloitte CL #10, and EY CL#19) and a consulting firm (CG CL #24) noted that the threshold "grossly unreasonable" did not exist in GAAP and preparers and auditors would need to apply judgment to interpret it. Those practitioners highlighted that this could require interpretation of other sections of the U.S. Internal Revenue Code and may lead to diversity in practice. One of those respondents also observed that changes in tax law that affected the referenced paragraphs from Section 409A would result in corresponding changes in GAAP.

44. Two CPA societies (ICPAS CL #14 and CALCPA CL #23) and an audit practitioner (EY CL #19) stated that audit teams may need to engage tax specialists because application of the referenced paragraphs from Section 409A could require expert judgment.

45. Two CPA societies (NYSCPA CL # 04 and VSCPA CL #09) observed that several valuation methods are available under the practical expedient (that is, those allowed by the Section 409A "presumption of reasonableness" provisions). Those respondents indicated that the exercise of judgment to select the appropriate method could increase costs.

Staff Analysis of Issues 1 and 2 (Analysis of Costs and Benefits)

46. The PCC approved the practical expedient on the basis that it would reduce costs associated with determining the current price input used to calculate the grant-date fair value of an equity-classified share-option award. The PCC decided to pursue a practical expedient (as opposed to an accounting alternative) because it was broadly determined that share-based compensation information was relevant and useful to users of private company financial statements. Specifically, the PCC expected that the practical expedient would reduce costs in the following three ways:

    a) Nonpublic entities currently obtaining two independent valuations, one for GAAP and one for tax requirements, would be able to obtain just one to satisfy both purposes.

    b) Valuations by independent appraisal that satisfy Section 409A are valid for 12 months unless determined to be "grossly unreasonable." That could potentially reduce the number of valuations that a nonpublic entity would have to obtain.

    c) Documentation and audit procedures currently required in practice to substantiate the current price input should decrease.

47. Most comment letter respondents expressed views that were not consistent with the view that the practical expedient would result in pervasive cost savings. Therefore, the staff believes that the PCC's first step should be to consider whether the costs and benefits of the practical expedient warrant proceeding to a final Update. If the PCC wants to proceed to a final Update after considering comment letter feedback on costs and benefits, the PCC would then need to consider the remaining issues raised by comment letter respondents.

Potential Cost Savings (a)—Only One Valuation to Serve Both Tax and GAAP

48. Nearly all respondents indicated that companies obtain one valuation of the price of a share underlying a share option award and use that valuation for both tax and GAAP purposes.

49. Of the few respondents indicating that companies obtain multiple valuations, only one provided an explanation for that practice. That respondent observed that when a company grew and needed to prepare GAAP financial statements, its valuations became more robust than the valuations that were used in non-GAAP financial reporting and tax reporting. The staff believes that this is more a comment on (a) the robustness of a valuation that is driven by many possible factors that affect the complexity of valuing a growing company than on (b) substantiating the need for separate valuations. In other words, it seems like the more robust GAAP-compliant valuation could be used for Section 409A compliance purposes.

50. The staff believes that the PCC should consider whether the comment letter feedback received on cost savings associated with companies obtaining separate valuations is consistent with the PCC's expectations and should be used as a basis for providing the practical expedient.

Potential Cost Savings (b)—Fewer Valuations over the 12 Months Subsequent to the Valuation Date

51. A few respondents indicated that companies calculate new valuations for awards granted within 12 months of a valuation date either by obtaining a new valuation report or by adjusting the valuation obtained at the beginning of the 12-month period. Therefore, if the practical expedient could eliminate the need for some of those valuations or adjustments, it could save costs.

52. While a few respondents (different from those referred to in paragraph 51) identified reducing the number of valuations required in a 12-month window as the primary benefit of the practical expedient, those respondents also suggested that the Board provide more guidance about the types of events that would cause a valuation to become unusable in that period. Some respondents suggested that the current version of the practical expedient should be replaced with a version that did not reference Section 409A at all, and instead provided a 12-month trigger-based assessment.

53. Based on the comment letter feedback received, the staff believes that the PCC should consider whether the practical expedient in its current form (that is, without additional guidance on a 12-month trigger-based assessment) would reduce instances of companies obtaining or updating valuations within a 12-month period and, therefore, whether that type of cost savings should be used as a basis for the practical expedient.

54. The staff separately analyzed a practical expedient for a 12-month trigger-based assessment in paragraphs 106 through 113.

Potential Cost Savings (c)—Reduction in Documentation and Audit Procedures Required to Substantiate the Current Price Input

55. Most respondents indicated that audit costs would not be reduced by the practical expedient. Nearly all respondents with that view indicated that an auditor would audit a valuation obtained to comply with the practical expedient in the same way they would audit a valuation obtained to comply with current GAAP. Several respondents explained that the practical expedient would not relieve them of the requirement to comply with the AICPA's U.S. Auditing Standards. That feedback is consistent with the staff's previous outreach with members of the AICPA's Auditing Standards Board before the issuance of the Exposure Draft who were skeptical as to whether the standard on auditing estimates would be met if an auditor did not consider the methodologies and assumptions used by a valuation professional.

56. One respondent was unsure about whether audit costs would be saved overall but indicated that the requirement to audit valuations within a 12-month period only for material events could contribute to a reduction in audit costs. The staff notes that paragraph 1.409A-1(b)(5)(iv)(B)(2) of the Treasury Regulation Section referenced by the practical expedient does not mention material events. Rather, the paragraph that mentions material events is 1.409A-1(b)(5)(iv)(B)(1), and the PCC voted to exclude that paragraph from the practical expedient.

57. The staff notes that the "grossly unreasonable" notion that exists in the paragraph cited by the practical expedient could achieve a similar objective to the material events notion described by the respondent above. However, some respondents indicated that audit costs could *increase* if audit teams consult tax specialists to evaluate the "grossly unreasonable" threshold and other tax concepts.

58. The staff believes that the PCC should consider whether the comment letter feedback received on how auditing procedures would be affected by the practical expedient is consistent with the PCC's expectations and whether audit cost savings should be used as a basis for the practical expedient.

Effect of the Practical Expedient on Decision Usefulness

59. Most respondents stated that the practical expedient would not compromise decision usefulness. A common reason for that view was the similarity in measurement objectives between Topic 718 and Section 409A. That is, because the measurement objectives are similar, the practical expedient should result in measurements of share-based awards similar to those that would be arrived at under current GAAP. Some respondents indicated that measurements could differ in some limited circumstances. Based on those comments, the staff believes that there would be a similar measurement result in most cases.

Staff Recommendation

60. The staff believes that comment letter feedback indicates that the PCC should consider whether the current version of the practical expedient achieves its objective of lowering the cost and complexity of determining the fair value of private company traditional share-option awards. The staff also believes that the PCC should contemplate the pervasiveness of potential cost savings in its consideration of whether the practical expedient achieves its objective.

Issue 3: Scope

Background

61. The proposed Update limited the scope of the practical expedient to equity-classified share-option awards. Share-based payments may take the form of other types of awards such as restricted shares and may be accounted for as liabilities or equity depending on their terms.

62. The following question was included in the proposed Update to seek feedback on whether the scope of a final Update should include other types of equity-classified share-based payments:

> **Question 2:** The practical expedient in this proposed Update is applicable only for equity-classified share-option awards. Should the scope of the practical expedient in this proposed Update be expanded to include other equity-classified share-based compensation arrangements (for example, nonvested shares)? Please explain why or why not.

Summary of Comments

63. Twenty-two respondents commented on the scope of the proposed Update. Most respondents stated that the scope of the practical expedient should be expanded, some supported the scope as exposed, and one CPA society had mixed views regarding scope.

Include Additional Forms of Equity-Classified Share-Based Payments

64. Many respondents indicated that equity-classified share-based payments other than share options should be included in the scope of the practical expedient.

65. Some of those respondents (practitioners, CPA societies, and a consultant) noted that the shares that underlie share options are often also granted as restricted shares or nonvested shares. They asserted that it would be reasonable to use the same Section 409A valuation to value the same shares. The following comment illustrates that view (KPMG CL #08):

> We believe the Board should expand the scope of the practical expedient to include nonvested share awards (also, in practice, referred to at times as "restricted share awards"), as the share price value that is developed under the 409A valuation to value share option awards also likely would be used to value nonvested share awards, if both were granted on the same grant date. Further, we do not see a distinction between the valuation method for the share price input for a share option, and the valuation method for a nonvested share award, as it is usually the same underlying common stock.

Further to that point, another respondent (CALCPA CL #23) stated that share options exercised early are similar in substance to a nonvested share:

> There is little if any practical difference between a nonvested share that results from early exercise of a stock option and a nonvested share that is originally issued as a share in exchange for cash consideration. Under the proposed ASU, the practical expedient would apply to the former but not the latter. It is not clear to us that such implications of the narrowed scope are meaningful.

66. Some respondents (practitioners, a state society, and an industry group) supported the inclusion of other equity-classified share-based awards to reduce the potential for similar compensation arrangements to be measured inconsistently. An audit practitioner (RSM CL #16) warned that explicitly excluding other equity-classified awards could increase costs because some nonpublic entities currently use a Section 409A valuation to measure those awards.

67. A practitioner (GT CL #17) and a CPA Society (ICPAS CL #14) recommended expanding the scope of the practical expedient because of the prevalence of other types of share-based payments, such as nonvested shares. The following comment illustrates that view (GT CL #17):

> In our experience, private entities most often grant unvested share awards or forms of profits interests and least often grant share-options. We would support expanding the scope to other private entity equity-classified awards if the operationality issues discussed at Question 1 are resolved.

68. A CPA society (CTCPA CL #12) commented that expanding the scope to include other equity classified awards would simplify financial reporting and tax compliance for private companies.

Include Liability-Classified Share-Based Payments

69. The proposed Update did not ask whether the scope of the practical expedient should include liability-classified share-based payments. However, some respondents stated that liability-classified awards should be included in the scope.

70. Two audit practitioners (BDO CL #06 and EY CL #19) and a CPA society (CALCPA CL #23) recommended expanding the scope to include liability-classified awards. One of those audit practitioners (BDO CL # 06) provided the following three points in support of expanding the scope to liability-classified awards:

    a) Companies often use the annual Section 409A valuation for valuing liability-classified awards.

    b) Private companies may only remeasure liability-classified awards annually because they often do not prepare interim period financial statements.

    c) If the Board did not expand the scope to liability-classified awards, it should provide guidance for a modification that results in an award being reclassified from equity to a liability. That audit practitioner was unsure whether the practical expedient would need to be unwound upon such a modification.

71. An independent consultant (CVP CL #01) and an audit practitioner (Baker Tilly CL # 22) noted that companies may experience additional cost savings if liability-classified awards are included in the scope. Those respondents asserted that after the initial valuation of a liability-classified award, subsequent valuations are often billed at a substantial discount.

72. A consulting firm (CG CL #24) questioned the rationale for excluding liability-classified awards based on companies not obtaining valuations at each quarterly reporting date, noting the following:

> While entities typically would not obtain Section 409(A) valuations at each reporting date, many entities do <u>obtain</u> at least one valuation per year, which generally can be used for tax purposes for a twelve-month period. Thus, many entities do have a valid Section 409(A) valuation <u>available</u> at each reporting date.

73. A CPA society and a consulting firm (CALCPA CL #23 and CG CL #24) recommended that the scope should also include liability-classified stock-indexed financial instruments in the scope of Topic 480 and Subtopic 815-40. Both of those respondents indicated that *that* scope expansion could be undertaken as a separate project.

74. Three audit practitioners (PwC CL #05, BDO CL #06, and Baker Tilly CL #22) and a consulting firm (CG CL #24) recommended removing from the basis for conclusions the reference to the practical expedient available to private companies to measure liability-classified awards at intrinsic value. Those respondents indicated that *that* expedient still requires companies to determine the fair value of the share underlying an option and does not reduce the cost of determining the current price input.

Limit the Scope to Equity-Classified Share-Options

75. Some respondents agreed with the scope in the proposed Update (only equity-classified share-option awards). Those respondents provided several reasons for their view.

76. A CPA society (NYSSCPA CL #04) and an audit practitioner (PwC CL #05) stated that nonvested shares do not require valuations for tax purposes until vesting and therefore a Section 409A valuation would not be required at the grant date. Those respondents reasoned that the practical expedient would either not apply or not be elected in that situation because no Section 409A valuation would be obtained at the grant date.

77. An audit practitioner (PM CL #21), a consulting firm (CFGI CL #20), and a CPA society (VSCPA CL #09) stated that using a Section 409A valuation for other share-based compensation arrangements could be a substantial change to the current fair value accounting because of the complexity of Topic 718.

78. An audit practitioner (PwC CL #05) recommended that the scope of the practical expedient explicitly exclude awards that are not legally in the form of share-options but accounted for as share-options due to their substance, such as non-recourse notes.

79. An industry group (IMA CL #18) asserted that the applicability of the practical expedient to other arrangements would be infrequent and of little value to most private companies.

80. An audit practitioner (Deloitte CL #10) did not support the proposed practical expedient and consequently did not support expanding its scope.

Issues for PCC Consideration

81. If the PCC decides to proceed to a final Accounting Standards Update, the staff believes that, based on feedback received, the PCC should reconsider whether the scope should be expanded to other equity-classified share awards, liability-classified awards, or both.

Issue 4: References to Section 409A

Background

82. The two primary ways in which an entity may claim to the IRS that the fair value of a share underlying a share-option was determined using a reasonable application of a reasonable valuation method for purposes of Section 409A are by (a) considering facts and circumstances as of the valuation date (referred to in this memo as the Facts and Circumstances Method) or (b) meeting a rebuttable presumption of reasonableness.

83. At its December 2019 meeting, the PCC discussed the valuation procedures in Section 409A and decided that the practical expedient should only reference those procedures meeting the rebuttable presumption of reasonableness in paragraph 1.409A-1(b)(5)(iv)(B)(2) of Section 409A.

84. Section 409A states that using any of the following three specified valuation methods will qualify for the presumption of reasonableness:

    a) A valuation by an independent appraisal (that is, a valuation specialist) within the preceding 12 months (referred to as the independent appraisal method)

    b) A valuation based on a formula that, if used as part of a nonlapse restriction with respect to the stock, would be the fair market value of the stock (referred to as the formula-based method)

    c) A valuation made reasonably and in good faith and evidenced by a written report that considers the relevant factors of illiquid stock of a start-up corporation (referred to as the start-up method).[3]

Summary of Comments

85. Five respondents commented on the paragraphs from Section 409A referenced in the proposed Update. Two of those respondents recommended that a final Update reference fewer paragraphs from Section 409A and three respondents recommended referencing additional paragraphs.

Reference Fewer Paragraphs from Section 409A

86. The two respondents who recommended referencing fewer paragraphs from Section 409A focused their comments on the references to paragraphs 1.409A-1(b)(5)(iv)(B)(2)(ii) and (iii). An audit practitioner (RSM CL #16) stated:

> While paragraph BC20 makes clear the expectation that most nonpublic entities would use a valuation determined by an independent appraisal to determine the current price of a share underlying a share-option award, and that other methods provided under the rebuttable presumption of reasonableness requirements of Section 409A will be limited in use, we are concerned that providing the practical expedient and introducing these other valuation methods may generate confusion about whether an independent appraisal is necessary and the extent to which companies can take advantage of the other methods.

A CPA society (NYSSCPA CL #04) commented on the appropriateness of the formula-based and start-up valuation methods, noting:

> A comparison of these descriptions with AICPA Statement on Standards for Valuation Services (SSVS) No. 1 and other valuation standards such as Uniform Standards of Professional Appraisal Practice (USPAP) Standards 9 and 10 raises questions on whether the last two “valuation” methods prescribed by Section 409A qualify as acceptable valuation methods. It would appear that the results of these two methods would fall well short of the fair-value-based requirements of ASC 718.

[3] Use of the formula-based and start-up methods are limited by other factors detailed in Section 409A.

Reference More Paragraphs from Section 409A

87. Two CPA societies (NYSSCPA CL #04 and ICPAS CL #14) and an audit practitioner (PwC CL #05) recommended that the practical expedient include a reference to paragraph 1.409A-1(b)(5)(iv)(B)(1). That is, that the practical expedient reference the *Facts and Circumstances Method*. However, each of those respondents had a different rationale for their view.

88. One of those respondents (NYSSCPA CL #04) recommended referencing the *Facts and Circumstances Method* because that paragraph details certain facts and circumstances that should be evaluated to assess the reasonableness of a valuation. That respondent indicated that "misapplication of Section 409A prescribed methods under certain facts and circumstances can lead to exceptionally unreasonable values."

89. Another of those respondents (PwC CL #05) recommended referencing the *Facts and Circumstances Method* because that paragraph explains when a valuation performed within 12 months of the grant date would not be considered reasonable. That respondent stated:

> Without this additional reference, a key aspect of the reasonableness of the valuation is missing, namely that "the use of a value previously calculated under a valuation method is not reasonable as of a later date if such calculation fails to reflect information available after the date of the calculation that may materially affect the value of the corporation."

90. The last of those respondents (ICPAS CL #14) recommended referencing the *Facts and Circumstances Method* because it would allow private companies, such as venture capital and private equity-backed companies that use internal valuations, to apply the practical expedient.

Issues for PCC Consideration

91. Based on the comment letter feedback received regarding the references to Section 409A, if the PCC decides to proceed to a final Accounting Standards Update, the staff believes that the PCC should reconsider the references to Section 409A. In particular, the staff recommends that the PCC reconsider:

    a) How to track and consider the effects of future changes to Section 409A on the practical expedient given that specific references to that Section would be codified.

    b) Whether it is necessary to reference the formula-based (1.409A-1(b)(5)(iv)(B)(2)(ii)) and start-up (1.409A-1(b)(5)(iv)(B)(2)(iii)) methods. Some respondents stated concerns about referencing those methods, and it was the PCC's expectation that most nonpublic entities would not have elected either of those methods, opting instead for the independent appraisal method.

    c) Whether to include a reference to the facts and circumstances method (1.409A-1(b)(5)(iv)(B)(1)) as some respondents indicated that it would improve the auditability of the practical expedient and encourage the practical expedient to be applied more broadly.

Issue 5: Award-by-Award Basis

Background

92. At its December 2019 meeting, the PCC decided that the practical expedient could be elected on an award-by-award basis primarily because the measurement objectives of Topic 718 and Section 409A are similar. The following question was included in the proposed Update to obtain feedback on the ability to elect the practical expedient on an award-by-award basis:

> **Question 5:** Do you agree with allowing the proposed practical expedient to be elected on an award-by-award basis?

Summary of Comments

93. Twenty-two respondents commented on the applicability of the practical expedient. Most of those respondents agreed that the practical expedient should apply on an award-by-award basis, some respondents supported broader applicability, and one respondent was unsure of the best approach.

Award-by-Award Basis

94. Most of the respondents who supported application of the practical expedient on an award-by-award basis did not elaborate on their view, several agreed with the Board's basis that the measurement objectives of Topic 718 and Section 409A are similar, and one CPA society (FICPA CL #02) expected that award-by-award application would encourage broader adoption of the practical expedient.

Broader Applicability

95. Most of the respondents who did not support application of the practical expedient on an award-by-award basis recommended application through an entity-wide policy election. A CPA society (CALCPA CL #23) and a consulting firm (CG CL #24) recommended application on a measurement-date-by-measurement-date basis. Another CPA society (CTCPA CL #12) did not provide a specific alternative—only disagreement with the award-by-award basis.

96. The respondents who recommended an entity-wide policy election (BDO CL #06, GT CL #17, and IMA CL #18) all cited concern about a company's ability to manipulate earnings through an award-by-award application of the practical expedient. The following comment illustrates that view:

> We believe applying the practical expedient should be a policy election for all awards in scope. Continuing from our response to Question 1, we are concerned about structuring. The expedient might be elected more often in a rising market and less often in a declining market. For example, assume that a grantor has a 409A valuation prepared in January and it still meets the 'reasonableness' requirements in September when share-options are awarded. The grantor might elect the practical expedient for this award if the grantor knows or expects that the value of the shares has risen since the valuation was prepared. In this circumstance—all else equal as to inputs to a model—the option value would be lower than if the higher current share value were used. The result is lower compensation cost and perhaps a baked-in benefit to the grantee. In contrast, if the grantor knows or expects in

> September that the value of the shares has declined since January, it might not elect the expedient to use the January valuation and instead obtain a fresh valuation yielding lower compensation cost. (GT CL #17)

97. The respondents who recommended application on a measurement-date-by-measurement-date basis (CALCPA CL #23 and CG CL #24) stated that it would be unreasonable for entities to use different values to measure awards with the same measurement date. The following comment illustrates that view:

> If an entity concludes that the use of the practical expedient is appropriate at a particular measurement date, it should generally continue to use the practical expedient and apply the same stock price until either the underlying Section 409(A) valuation is no longer within the period of its acceptability to the IRS, or until the entity otherwise concludes that fair value of its stock should be determined using other methods. (CG CL #24)

Issue for PCC Consideration

98. If the PCC decides to proceed to a final Accounting Standards Update, the staff believes that the PCC should discuss whether to maintain application on an award-by-award basis. The staff highlights that respondents that expressed concern with award-by-award application cited potential earnings manipulation as the basis of their concerns.

Issue 6: Transition Requirements

Background

99. The PCC decided that the practical expedient should be applied on a prospective basis. A retrospective or modified retrospective transition would require that a nonpublic entity remeasure the grant-date fair value of its existing awards using the current price input determined by a valuation method that satisfies Section 409A and the PCC expected that valuations performed for compliance with Topic 718 would be more robust than valuations performed for compliance with Section 409A.

100. The following question was included in the proposed Update to obtain feedback on transition requirements:

> **Question 7:** Do you agree with the proposed prospective transition requirements? If not, please explain why.

Summary of Comments Received

101. Twenty-two respondents commented on the proposed transition requirements. All those respondents agreed with prospective application. However, two audit practitioners (PwC CL #05 and RSM CL #16) disagreed with the statement supporting the proposed transition method that valuation

methods that are compliant with Topic 718 are more robust than valuation methods compliant with Section 409A.

Staff Recommendation

102. If the PCC decides to proceed to a final Accounting Standards Update, the staff recommends that the PCC retain the proposed transition method given the broad support for that method in comment letters.

Issue 7: Other Approaches Suggested

Background

103. The objective of the practical expedient was to reduce the cost of determining the current price input while achieving the measurement objective of Topic 718. Some respondents commented broadly on other ways the PCC could possibly accomplish that objective.

Summary of Comments

104. Several respondents suggested an approach that would allow a company to use a valuation for 12 months subject to a trigger-based assessment of events after the valuation date.

105. An industry group suggested an approach that would allow a company to assume that the current price of a share underlying a share option is equal to the strike price—an approach previously considered by the PCC.

Twelve-Month Trigger-Based Assessment of Events after the Valuation Date

106. A consulting firm (SRR CL #15) suggested a practical expedient that would mirror the 12-month period for use of a valuation that is not "grossly unreasonable" afforded by Section 409A as follows:

> As we see it, eliminating the requirement for multiple valuations within a year for a nonpublic entity can be a real and meaningful cost reduction for nonpublic entities, provided they are not grossly unreasonable due to changes in the business during that period as outlined in BC21, item (b).
>
> Thus, FASB could achieve the same outcome through a practical expedient that simply provides for the share price input to be prepared within the 12 months preceding the grant date rather than as of the grant date specifically, subject to an interim trigger-based assessment that an up-to-12-month-old valuation would not have been materially different as of the grant date.

107. An audit practitioner (EY CL #19) provided a similar suggestion. That respondent stated:

> We believe that this would allow all nonpublic companies to take advantage of the primary benefit of the proposed expedient, which is the ability to use a valuation for a 12-

> month period, regardless of whether the company obtains a valuation performed in accordance with Section 409A.
>
> In addition, we believe that ASC 718 should include examples of significant events or transactions that may lead to a material change in the valuation that would require an updated valuation to be obtained or performed (e.g., an imminent merger or acquisition, disposal of a significant business, a financing transaction, launch of a significant product).

However, that respondent further stated that the 12-month period of presumed reasonableness afforded by Section 409A for valuations that are not "grossly unreasonable" may not apply in many circumstances because:

> …companies that issue awards throughout a 12-month period often do so in periods leading up to an initial public offering (IPO), a financing transaction or another event that significantly affects the fair value of the company.

108. A consulting firm (CFGI CL #20) requested that FASB provide guidance to help companies evaluate the changes in a company's business between the valuation date and the grant date. That respondent stated the following:

> We believe that the PCC, in building upon industry practice, should work closely with accounting specialists and valuation specialists to provide guidance to private companies on interpolation that can be used to support the grant-date fair value between valuation dates. If private companies can maintain, in their own control, an effective method for interpolating fair values, while ensuring they are considering changes in the macro and micro economics of the valuations, companies would then start to save on costs from third party valuations and time incurred with supporting the grant-date fair value to audit firms.

109. Two audit practitioners (GT CL #17 and Baker Tilly CL #22) did not advocate for a different practical expedient but still recommend that guidance be provided for assessing changes in value within the 12 months after the valuation date. One of those respondents provided the following suggestions for assessing such changes:

> Suggestions include considering observable share transactions in the same or similar securities of the grantor, significant improvements or declines in operating performance, achieving or missing key entity milestones, and material acquisitions or dispositions, as well as enumerating relevant indicators, such as those in Topic 350 and 360 impairment tests. Those indicators focus on potential impairments (that is, negative events) and these Topic 718 indicators would need to cover negative and positive changes. Also, this guidance could provide a path akin to a qualitative rollforward to conclude that a 409A valuation is not grossly unreasonable for awards granted later in its twelve-month lifespan. There likely are other qualitative means to achieve this objective. (GT CL #17)

Issues for PCC Consideration

110. The staff believes there are two paths for providing additional guidance about assessing changes in a 12-month period after a valuation date:

a) Add a reference to paragraph 1.409A-1(b)(5)(iv)(B)(1)

b) Develop guidance for a 12-month trigger-based assessment of a valuation's appropriateness (do not reference Section 409A at all)

Path 1: Add a Reference to Paragraph 1.409A-1(b)(5)(iv)(B)(1)

111. Paragraph 1.409A-1(b)(5)(iv)(B)(1) already provides the following guidance about factors to consider when evaluating a valuation completed in the 12 months after the valuation date:

> Similarly, the use of a value previously calculated under a valuation method is not reasonable as of a later date if such calculation fails to reflect information available after the date of the calculation that may materially affect the value of the corporation (for example, the resolution of material litigation or the issuance of a patent) or the value was calculated with respect to a date that is more than 12 months earlier than the date for which the valuation is being used.

112. The PCC previously decided not to reference 1.409A-1(b)(5)(iv)(B)(1) because it did not believe the valuation method described by that paragraph (the facts and circumstances method) would save costs.

Path 2: Develop a 12-Month Trigger-Based Assessment of a Valuation's Appropriateness

113. Another potential path is to pursue a new version of a practical expedient that does not reference Section 409A at all, and instead, only provides guidance for evaluating the appropriateness of a valuation within 12-months of a valuation date (as some respondents recommended). The staff notes the following potential benefits to that approach:

a) Any changes to a version of a practical expedient that does not reference Section 409A would be subject to FASB's due process, whereas changes to Section 409A are not subject to FASB's due process.

b) The current version of the practical expedient introduces the possibility that the outcome of an IRS audit could result in an error in a private company's financial statements, whereas a practical expedient that does not reference Section 409A avoids that outcome.

114. However, Path 2 would require the staff to perform additional research and outreach before forming a recommendation because the resulting guidance could apply by analogy (through reference to paragraph 105-10-05-2) in other Topics that require fair value measurement such as:

a) Topic 350 Intangibles—Goodwill and Other

b) Topic 805 Business Combinations

c) Topic 815 Derivatives and Hedging

d) Topic 842 Leases

Assume That Current Price* Is *Equal to Strike Price

115. An industry group (TIC CL #07) indicated that a version of the practical expedient previously considered in 2018 by the PCC in which a company would be allowed to assume that its current price input was equal to the strike price of an award would result in more cost savings than the current version. Specifically, that respondent stated:

That group had suggested that in the event a private company has made a good faith determination that a share-based award is not in-the-money, then for purposes of calculating the fair value of the awards issued, the company can assume the fair value of the underlying share is equal to the strike price.

TIC believes that the initial proposed expedient noted above would have been further reaching and resulted in additional savings from both an accounting and auditing perspective than that proposed in this ED.

Staff Recommendation

116. The staff notes that a practical expedient that would assume that the current price of a share underlying a share-option award is equal to the exercise price set forth in the share-option contract was already considered and extensively debated by the Board and the PCC and ultimately rejected before deciding to pursue the version of the practical expedient that was exposed for public comment. Consequently, the staff recommends that the PCC not reconsider that version of a practical expedient for determining the current price of an underlying share.

Issue 8: Other Noteworthy Comments

Summary of Comments

Clarifications

117. An audit practitioner (KPMG CL #08) indicated that a reader might interpret the practical expedient to require that for every grant of awards (that is, on an award-by-award basis) the company is required to obtain a valuation under the Treasury Regulations. That respondent recommended clarifying that *applying the practical expedient* and not *obtaining a valuation* is elected on an award-by-award basis.

118. Two respondents (CALCPA CL #23 and CG CL #24) recommended that the Board clarify that a valuation performed in accordance with Treasury Regulation Section 1.409A-1(b)(5)(iv)(B)(2) can only be used during the period it meets the IRS requirements.

119. One audit practitioner (EY CL #19) recommended that the Board clarify that early adoption was permitted in an interim period.

Disclosures

120. An industry group (TIC CL #07) and a consulting firm (SRR CL #15) stated that companies should be required to disclose their use of the practical expedient.

Non-Public Entities That Become Public Entities

121. An audit practitioner (EY CL #19) stated its expectation that SEC Staff Accounting Bulletin Topic 14.B (SAB 14.B) would likely be applied by analogy for the practical expedient. SAB 14.B provides guidance on the transition to fair-value measures by nonpublic entities that become public entities. The respondent expected that, like the practical expedients available for calculating volatility and measuring

liability-classified awards at intrinsic value, companies would not need to remeasure awards that were initially measured under the practical expedient upon becoming public companies. The respondent recommend that the Board clarify its intent if it had concerns with that approach.

122. A consulting firm (CG CL #24) indicated that the practical expedient would be applied by many of its private clients, including those contemplating going public in the future, and that it was aware of diverse views as to whether the practical expedient could be applied in a company's initial registration statement. The consulting firm stated that even if that application was not permitted, many companies would probably conclude that revision was unnecessary. Like the audit practitioner, the consulting firm also recommended that the Board clarify its views on this point.

Extend the Practical Expedient to Public Entities with Limited or No Trading Activity

123. One respondent (Baker Tilly CL #22) recommend extending the scope of the practical expedient to public entities whose stock has limited or no trading activity.

Uncertainty About the Outcome of an IRS Audit

124. An audit practitioner (GT CL #17) and a consulting firm (CG CL #24) stated that accounting under the practical expedient could result in uncertainty in the fair value of an award that could eventually be resolved by an IRS audit. Those respondents recommended that the FASB provide guidance on how to address that uncertainty similar to the guidance on uncertain tax positions in Topic 740.

Issues for PCC Consideration

125. If the PCC decides to pursue a final Accounting Standards Update based on the current version of the practical expedient, the staff believes that the PCC should consider whether any of the issues in this section require amendments to the practical expedient.