

Summary of PCC Alternatives

Share-Based Payment Accounting Improvements

Appendix A to PCC Issue Summary No. 1

(Day 1 & 2, Topic 2)



Existing GAAP for Private Companies

Classification

- Entity determines classification of award (equity or liability)

Measurement

- Equity-Classified: allocate grant-date fair value over service period
- Liability-Classified: remeasured each reporting period to fair value or intrinsic value until settlement

PCC Alternative A

Classification

- All awards would be accounted for as liabilities (remeasured each reporting period)

Measurement

- Intrinsic Settlement Value:
 - Use of formula when there is no probable settlement amount
 - If there is no formula, use fair value

PCC Alternative B

Classification

- Entity would determine classification of award based on existing GAAP (equity or liability)

Measurement

- Equity-Classified: allocate grant-date fair value over service period (existing GAAP)
- Liability-Classified: intrinsic-settlement value (see measurement in Alternative A)

Characteristics of Private Company Awards

1

- What are the key terms that you usually see for share-based compensation in the private company space?

2

- Do you commonly see repurchase (i.e., puts/calls) features in awards to provide liquidity upon an exit event (e.g., death of an employee, termination, etc.)?
 - If yes, do the repurchase features usually include a formula to determine the value of the underlying share?
 - If no, why do you think private companies choose not to use formulas to determine the value of an underlying share?

3

- How do private companies classify (i.e., liability vs equity) and measure their awards today?

PCC Alternatives

4

- What comments or suggestions do you have for Alternative A?

5

- What comments or suggestions do you have for Alternative B?

6

- Do you think an alternative is needed for the awards without formula repurchase features? If so, what would you suggest?

7

- Assume that one of these alternatives were to be allowed, do you think the use of formula repurchase features would become more prevalent?

PCC Alternatives

8

- Would your clients elect either alternative? If so, which alternative (Alternative A or B) do you think they would elect?

9

- Besides classification and measurement, what other areas do you think private companies have difficulty with? What suggestion do you have?

10

- Do you think that the value arrived at today for share-based compensation is meaningful? If no, how should it be measured?

11

- Do you know any users of financial statements who would like to provide feedback on this accounting issue? If so, could you send us their contact information?

Settlement Intrinsic Value - Example

- 1/1/2015** PE acquires entity for 5 * 2014 Adj. EBITDA
 2014 Adj. EBITA = \$1 million
 PE intends to exit within 5-7 years
 One class of equity
- Option award assumptions
 Granted 100,000 options on 1/1/2015 with a \$50 exercise price
 Option fair value per share is \$50
 Cliff vest after 3 years of service, contractual term 10 years
 Entity has right to call shares at 3 * trailing EBITDA if employee terminates
 Employees cannot put the underlying shares
- 1/1/2020** Entity is sold at 8 * 2019 Adj. EBITDA
 Option fair value per share is \$480

	Adj. EBITDA	Per Share 3* EBITDA	Settlement Intrinsic Value	Annual Expense
12/31/2015	1,500,000	45	0	-
12/31/2016	2,000,000	60	10	7
12/31/2017	3,000,000	90	40	33
12/31/2018	4,500,000	135	85	45
12/31/2019	6,000,000	180	130	45
1/1/2020	N/A	N/A	430	300
				<u>430</u>