GRANT THORNTON LLP
Grant Thornton Tower
171 N. Clark Street, Suite 200
Chicago, IL 60601-3370

D +1 312 856 0200
S linkd.in/grantthorntonus
twitter.com/grantthorntonus

October 1, 2020

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

Via Email to director@fasb.org

Re: File reference No. 2020-200

Dear Ms. Salo:

Grant Thornton LLP appreciates the opportunity to comment on proposed Accounting Standards Update (ASU), *Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards,* a proposal of the Private Company Council.

Some private entities might benefit from the proposed practical expedient, especially if they predictably grant awards at the same time of each year and obtain a Section 409A valuation as of or near that date. Our primary concern is the potential reliance upon valuations up to twelve months in age. The question is how to draw the line between a valuation remaining reasonable versus becoming 'grossly unreasonable' as defined in the Treasury Regulations ("Regulations") or otherwise no longer appropriate for accounting and auditing purposes. Timeliness of a valuation has always been important, and its usefulness diminishes over time.

The proposed amendments appear to be bringing Regulations into Topic 718; that is, allowing the income tax position taken for an award to drive the financial reporting. We see parallels to Topic 740 guidance on uncertain tax positions and how that guidance leads the preparer and auditor through the relevant evaluations and judgments. The proposed amendments, in contrast, do not provide guidance on evaluating and forming judgments.

Our responses to questions from the exposure draft are below.

Grant Thornton

Question 1: Is the practical expedient as drafted in this proposed Update operable? If not, please explain why.

On the surface the proposed guidance appears operable. As we considered further, we believe that unless a 409A valuation is quite recent, the operability may be in doubt. The particular concern is known or knowable events and circumstances since the date of a valuation and how to determine whether the valuation is stale. For example, in 2020 there continues to be substantial economic upheaval and uncertainty, with some entities seeing increased results (and presumably share value) while others have seen adverse consequences. Also, there may have been share issuances or redemptions at observable prices that could be overlooked.

The proposal does not include guidance as to whether or how an entity should form an assertion that the use of a valuation remains appropriate. For example, assume that underlying shares were valued at $10 in November 2019. A September 2020 share-option award uses $10 as the share price input to a Black-Scholes model in accordance with the practical expedient. Many would question whether $10 remains reasonable because it could be over- or understated, especially in light of the 2020 economic changes and uncertainties.

We believe that for the sake of operability, the proposed guidance should address known or knowable changes in value since the valuation was prepared, regardless of the extent to which the Regulations address the issue. 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.

The IRS challenges tax valuations and resolution can take a long time. The income tax exposure is addressed under the uncertain tax position guidance in Topic 740. Further, it seems the Topic 718 accounting itself would become a form of uncertain 'book' position. A question is how and when preparers and auditors would address this uncertain valuation issue. Topic 718 does not have guidance on estimating exposure, but instead leads to the binary outcome of error or no error. We believe the proposed guidance should also encompass this valuation uncertainty issue.

Also please see our response to Question 5 regarding structuring.

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.

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.

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.

We speculate that there would be minimal impact on audit costs because auditors nonetheless must become comfortable with the valuation itself and the related Topic 718 accounting. In the end, there might not be the cost savings sought by stakeholders.

As discussed at Question 4, the significant number of entities that today obtain a single valuation likely would have minimal savings, if any. Other entities that obtain two valuations (one for 409A and a separate one for Topic 718) might see cost savings if they obtain only one valuation going forward.

Question 4: Do you or your clients obtain separate valuations to satisfy GAAP requirements (Topic 718) and tax regulations (Section 409A)?

We see many private entities engage specialists to prepare single valuations for the dual-purpose of meeting both 409A and Topic 718 requirements. We see very few entities obtain two valuations.

Again, the age of a valuation in relation to the award date is more of an issue.

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

No. 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.

In either case, it seems undesirable that a grantor could choose to apply the practical expedient for a particular award based on whether an aging 409A valuation or a fresh valuation is beneficial in some manner.

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.

We defer to financial statement users to address this question.

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

We agree.

****

We would be pleased to discuss our comments with you. If you have any questions, please contact Sandy Heuer, Partner (sandy.heuer@us.gt.com), or Doug Reynolds, Managing Director (doug.reynolds@us.gt.com).

Sincerely,

/s/ Grant Thornton LLP