FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: August 17, 2020
Comments Due: October 1, 2020

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

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 718 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. 2020-200, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft until October 1, 2020. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing comments to director@fasb.org, File Reference No. 2020-200
- Sending a letter to "Technical Director, File Reference No. 2020-200, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

All comments received are part of the FASB's public file and are available at www.fasb.org.

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective. A copy of this Exposure Draft is available at www.fasb.org.

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FASB FINANCIAL ACCOUNTING STANDARDS BOARD®

Proposed Accounting Standards Update

Compensation—Stock Compensation (Topic 718)

Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards

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Summary and Questions for Respondents

Why Is the FASB Issuing This Proposed Accounting Standards Update (Update)?

The Private Company Council (PCC) is proposing amendments to the Codification in response to feedback from private company stakeholders indicating that determining the fair value of private company traditional stock-option awards (share-option awards) at grant date or upon a modification to an award is often costly and complex. This is primarily because private company equity shares often are not actively traded and, thus, observable market prices for those shares or similar shares do not exist. When determining the grant-date fair value of those awards, a valuation technique such as an option-pricing model is typically used. An option-pricing model requires various inputs, including the fair value of the equity shares underlying a share-option award (referred to as the current price input). During its research and outreach efforts leading to the amendments in this proposed Update, the PCC received feedback that the current price input is typically the most difficult input for private companies to estimate and substantiate to their auditors, primarily because of the lack of observable prices for private company equity shares.

The PCC decided that the concerns expressed about the cost and complexity encountered with determining the current price input in accordance with existing generally accepted accounting principles (GAAP) indicated that a change to that guidance for private companies was warranted. The *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (Guide) acknowledges two possibilities for recognition and measurement differences between private companies and public companies—an accounting alternative and a practical expedient. An accounting 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 the information provided by existing GAAP is deemed 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. Outreach indicated that information about share-option awards provided under existing GAAP is relevant, and thus it was determined that a practical expedient should be developed.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would affect all nonpublic entities (as defined in the Master Glossary of the Codification) that issue equity-classified share-option awards and elect the practical expedient in this proposed Update.

What Are the Main Provisions?

As a practical expedient, a nonpublic entity is allowed to determine the current price input of equity-classified share-option awards issued to both employees and nonemployees using a valuation method performed in accordance with specific regulations of the U.S. Department of the Treasury (Treasury Regulations). Among other things, those regulations provide acceptable valuation methodologies to comply with the "presumption of reasonableness" requirements of Section 409A of the U.S. Internal Revenue Code (Section 409A). Broadly, Section 409A has significant implications for share-option awards, whereby service providers such as employees may be subject to significant tax penalties if the awards are issued in the money (current price is greater than exercise price). Therefore, entities may already obtain valuations that are compliant with Section 409A in conjunction with the issuance of share-option awards to mitigate the risk that those penalties will be imposed on their service providers.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement for Private Company Stakeholders?

The measurement objective in Topic 718, Compensation—Stock Compensation, for share-option awards is fair value based, and the current price input is measured at fair value. This input is used in determining an award's fair value. The practical expedient in this proposed Update would allow a nonpublic entity to determine the current price of a share underlying an equity-classified share-option award using a valuation method performed in accordance with the presumption of reasonableness requirements of Section 409A. Those regulations allow for the use of any one of the following three methods to meet the presumption of reasonableness requirements:

1. A valuation determined by an independent appraisal within the 12 months preceding the grant date
2. A valuation based on a formula that, if used as part of a nonlapse restriction with respect to the share, would be considered the fair market value of the share
3. A valuation made reasonably and in good faith and evidenced by a written report that considers the relevant factors of the illiquid stock of a start-up corporation (as defined in the regulations).

The Treasury Regulations provide detailed requirements for the use of each of the three methods. The satisfaction of those requirements is necessary for an entity to avail itself of the presumption of reasonableness of the valuation for income tax purposes. Those requirements would similarly apply to nonpublic entities electing the practical expedient in this proposed Update.

Because of the requirements associated with, and limiting the availability of, the second and third methods listed above, it is expected that an independent appraisal will often be the method used by nonpublic entities electing the practical expedient in this proposed

Update. Section 409A has an objective of “fair market value,” which is similar to the fair-value-based objective in Topic 718.

Currently, some nonpublic entities may obtain separate external valuations to satisfy the requirements of both Topic 718 and Section 409A. Others may seek to use one formal valuation to serve multiple purposes, accepting the risk that the valuation may not satisfy all of the requirements of Topic 718 or of Section 409A. Providing the practical expedient in this proposed Update would align those requirements allowing those entities to obtain a single valuation to satisfy both requirements.

The PCC decided that the practical expedient in this proposed Update should not be available for liability-classified awards, primarily because those awards are required to be remeasured at the end of each reporting period. It is not expected that nonpublic entities would obtain valuations that satisfy the presumption of reasonableness requirements of Section 409A at each reporting date. Additionally, private companies are already afforded a practical expedient for liability-classified awards whereby those awards may be remeasured based on intrinsic value.

Nonpublic entities would be allowed to apply the practical expedient in this proposed Update on an award-by-award basis, primarily because the measurement objectives of Topic 718 and those of Section 409A are similar.

What Are the Transition Requirements and When Would the Amendments Be Effective?

The practical expedient in this proposed Update would be effective prospectively for all qualifying awards granted or modified during fiscal years beginning on or after the effective date and interim periods within the following years consistent with the Guide. The effective date will be determined after the PCC considers stakeholder feedback on this proposed Update. Early application would be permitted.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

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

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.

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)?

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

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.

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

Amendments to the *FASB Accounting Standards Codification*®

Introduction

1. The Accounting Standards Codification is amended as described in paragraphs 2 and 3. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>.

Amendments to Subtopic 718-10

2. Add paragraph 718-10-30-20C and its related heading, with a link to transition paragraph 718-10-65-16, as follows:

Compensation—Stock Compensation—Overall

Initial Measurement

<u>**> Nonpublic Entity—Practical Expedient for Current Price**</u>

<u>**718-10-30-20C** As a practical expedient and on an award-by-award basis, a **nonpublic entity** may use a valuation performed in accordance with Treasury Regulation Section 1.409A-1(b)(5)(iv)(B)(2) to determine the current price of its underlying share (see paragraph 718-10-55-21(c)) for purposes of determining the fair value of a **share option** at **grant date** or upon a **modification** that is classified as equity in accordance with paragraphs 718-10-25-6 through 25-18. This practical expedient may not be used for other forms of **share-based payment arrangements** such as **nonvested shares**.</u>

3. Add paragraph 718-10-65-16 and its related heading as follows:

Transition and Open Effective Date Information

<u>**> Transition Related to Accounting Standards Update No. 2020-XX, *Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards***</u>

<u>**718-10-65-16** The following represents the transition and effective date information related to Accounting Standards Update No. 2020-XX, *Compensation—Stock Compensation (Topic 718): Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards:*</u>

a. The pending content that links to this paragraph shall be effective for fiscal years beginning on or after December 15, 202X, and interim periods within fiscal years beginning after December 15, 202X **[interim will be one year after annual effective date consistent with the Guide]**.
b. An entity shall apply the pending content that links to this paragraph prospectively.
c. Early application is allowed.

The amendments in this proposed Update were approved for publication by 6 members of the Financial Accounting Standards Board. Ms. Botosan voted against publication of the amendments. Her alternative view is set out at the end of the basis for conclusions.

Members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Christine A. Botosan
Gary R. Buesser
Susan M. Cosper
Marsha L. Hunt
R. Harold Schroeder

Background Information, Basis for Conclusions, and Alternative View

Introduction

BC1. The following summarizes the PCC's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for endorsing the PCC's conclusions when needed to supplement the PCC's considerations. Individual PCC members and Board members gave greater weight to some factors than to others.

BC2. On December 11, 2018, the PCC added Issue No. 2018-01, *Practical Expedient to Measure Grant-Date Fair Value of Equity-Classified Share-Based Awards,* to its technical agenda. The PCC added this Issue in response to feedback from private company stakeholders indicating that determining the fair value of private company share-option awards (traditional stock-option awards) is often costly and complex. This is primarily because private company equity shares often are not actively traded and, thus, observable market prices for those shares or similar shares do not exist. When determining the fair value of those awards, a valuation technique such as an option-pricing model is typically used. An option-pricing model requires various inputs, including the fair value of the equity shares underlying a share-option award (referred to as the current price input). The PCC received feedback that the current price input is typically the most difficult input for private companies to estimate and substantiate to their auditors, primarily because of the lack of observable prices for private company equity shares.

BC3. On December 16, 2019, the PCC decided to provide a practical expedient, whereby a nonpublic entity is allowed to determine the current price input of equity-classified share-option awards issued to both employees and nonemployees using a valuation method performed in accordance with specific Treasury Regulations. Among other things, those regulations provide acceptable valuation methodologies to comply with the "presumption of reasonableness" requirements of Section 409A. Broadly, Section 409A has significant implications for share-option awards, whereby service providers, such as employees, may be subject to significant tax penalties if the awards are issued in the money (current price is greater than exercise price). Therefore, entities may already obtain valuations that are compliant with the presumption of reasonableness requirements of Section 409A in conjunction with the issuance of share-option awards to mitigate the risk that those penalties will be imposed on their service providers.

BC4. On February 12, 2020, the Board endorsed the PCC's decisions, leading to the issuance of the practical expedient in this proposed Update.

Scope

BC5. The PCC decided that the scope of this proposed Update should be consistent with the scope of other practical expedients such as that provided for estimating expected term. Therefore, the practical expedient in this proposed Update includes all nonpublic entities as defined in the Master Glossary (second definition). At this stage, the Board has not considered whether the proposed practical expedient may be appropriate for other entities. However, those entities are less likely to experience the same level of difficulty in determining the current price input because it is more likely that those entities would have observable market prices for their shares.

BC6. The practical expedient in this proposed Update can be applied only to equity-classified share-option awards. A share option is a traditional stock-option award and is defined in the Master Glossary. The PCC decided that the practical expedient in this proposed Update should not be available for liability-classified awards, primarily because those awards are required to be remeasured at the end of each reporting period. It is not expected that nonpublic entities would obtain valuations that satisfy the presumption of reasonableness requirements of Section 409A at each reporting date. Additionally, nonpublic entities are already afforded a practical expedient for liability-classified awards whereby awards may be remeasured on the basis of intrinsic value.

BC7. Equity-classified share-option awards granted to employees and nonemployees are within the scope of this proposed Update. The PCC did not believe that there was a reason to exclude awards issued to nonemployees from the scope of the practical expedient because (a) the accounting for share-based awards issued to employees and nonemployees was aligned by FASB Accounting Standards Update No. 2018-07, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*, and (b) the proposed practical expedient references specific valuation procedures in Section 409A, which has an underlying measurement objective (fair market value) that is essentially the same as the fair-value-based objective in Topic 718.

BC8. The PCC decided that the expedient could be applied on an award-by-award basis. Although a policy election for all qualifying awards would promote consistency, the PCC concluded that it would be illogical to disallow a nonpublic entity from using a valuation method that was otherwise compliant with Topic 718 for certain individual awards.

Background Information

BC9. Topic 718 provides guidance on accounting for share-based compensation awards such as share-option awards, which are classified as either liabilities or equity. Equity-classified share-based compensation awards are initially measured at fair value at the grant date (referred to as grant-date fair value) and are not subsequently remeasured unless they are modified and meet certain requirements. If an observable market price is not available for a share-based compensation award, the fair value of those awards is estimated using a valuation technique that would be used for determining amounts at which instruments with the similar characteristics would be exchanged. Liability-classified awards are remeasured at the end of each reporting period.

BC10. For share-option awards, a lattice model (for example, a binomial model) and a closed-form model (for example, the Black-Scholes-Merton model) are option-pricing models used for estimating fair value that are accepted under Topic 718. The PCC learned that the Black-Scholes-Merton model is the most commonly used model by nonpublic entities because that model is generally considered to be the least complex for determining a reasonable estimate of fair value if the terms of the option allow it. That model requires all of the following inputs for measuring the fair value of share-option awards:

a. Exercise price
b. Expected term
c. Expected volatility of the price of the share underlying the share-option award for the award's expected term
d. Expected dividends on the share underlying the share-option award for the award's expected term
e. The risk-free interest rate for the expected term
f. The current share price.

BC11. Private company stakeholders indicated that the inputs to the Black-Scholes-Merton model vary in degree of difficulty to estimate. Specifically, they noted that the risk-free interest rate, exercise price, and expected dividend rate are generally easy to obtain. However, those stakeholders indicated that the expected share price volatility, expected term, and current share price can be costly to estimate.

BC12. Topic 718 already provides nonpublic entities with practical expedients for estimating expected share price volatility and expected term. However, no practical expedient currently exists for estimating the current price. The current price input is often considered the most costly and complex input to determine and audit for nonpublic entities, primarily because an active market for those entities' shares rarely exists. Therefore, readily determinable market prices normally do not exist for nonpublic entity shares. Although the current price input is discussed above in the context of the Black-Scholes-Merton model, other valuation models, such as lattice models, also may require the current share price input.

BC13. Since 2013, the PCC has discussed the accounting for share-based compensation on several occasions, and extensive outreach has been performed with all stakeholder types. The objectives of the outreach were to determine whether (a) share-based compensation information in the financial statements is decision-useful for users of private company financial statements and (b) the accounting for share-based compensation could be simplified for private companies. Broadly, it was determined that share-based compensation information is relevant and decision useful. Therefore, under the Guide, any option provided to nonpublic entities to simplify the guidance would have to achieve a result similar to existing GAAP. Consequently, a practical expedient (as opposed to an accounting alternative) is warranted.

BC14. Specifically, the Guide acknowledges two possibilities for recognition and measurement differences between private companies and public companies—an accounting alternative and a practical expedient. An accounting 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 the information provided by existing GAAP is deemed 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.

BC15. Between 2014 and mid-2019, the PCC considered the following alternatives to reduce the cost of accounting for share-based compensation (note some alternatives had a scope broader than just share-option awards):

a. Use the last observable transaction price of the share underlying a share-option award as the current price input
b. Determine share-based compensation cost as the difference between the last observable transaction price of the share underlying a share-option award and the exercise price, and update that calculation when there is an observable transaction through the award's settlement date
c. Classify all awards as liabilities and measure them at intrinsic settlement value—which would be a new concept in GAAP
d. Measure grant-date fair value of an award by determining the fair value of the services received as a proxy for the fair value of the equity-classified awards granted
e. Use the intrinsic value of the award at the grant date to determine total compensation cost to be recognized over the expected term
f. Use the exercise price of an equity-classified share-option award as the current price input for purposes of determining grant-date fair value.

BC16. Those alternatives were rejected for various reasons, including, but not limited to:

a. The relevance of share-based compensation information would be compromised.
b. The alternative represented an accounting alternative as opposed to a practical expedient.
c. There were operationality concerns.

BC17. In September 2019, the PCC decided to pursue a practical expedient that would allow a nonpublic entity to use a valuation performed in accordance with Section 409A to determine its current price input for purposes of determining the fair value of an equity-classified share-option award.

BC18. Section 409A regulates taxation of nonqualified deferred compensation and applies to many share-based compensation arrangements. Share-option awards may be considered nonqualified deferred compensation plans for tax purposes subject to Section 409A. While Section 409A does not discuss share-option awards in detail, the Treasury Regulations provide a robust description of the awards subject to Section 409A and the acceptable valuation procedures for those awards. To avoid having service providers subject to significant penalties under Section 409A, the exercise price of a share-option award should be set at or above the fair market value of the underlying share as of the grant date. Section 409A states that an entity with stock that "is not readily tradable on an established securities market" may avoid being subject to Section 409A by obtaining or performing a valuation based on the "reasonable application of a reasonable valuation method."

BC19. Under Section 409A, the two primary ways in which an entity may demonstrate to the U.S. Internal Revenue Service (IRS) that the fair value of a share underlying a share-option award was determined using a reasonable application of a valuation method are by (a) considering certain facts and circumstances as of the valuation date (the "facts and circumstances method") or (b) meeting a rebuttable presumption of reasonableness. The PCC decided that only valuation methods meeting the rebuttable presumption of reasonableness should be allowable under the practical expedient in this proposed Update. This is because the PCC believes that applying the facts and circumstances method is similar to what practice requires to comply with Topic 718 and, thus, would not reduce costs. Broadly, the following three methods are acceptable under the rebuttable presumption of reasonableness requirements of Section 409A to determine the fair market value of a share:

a. A valuation determined by an independent appraisal within the 12 months preceding the grant date
b. A valuation based on a formula that, if used as part of a nonlapse restriction with respect to the share, would be considered the fair market value of the share
c. A valuation made reasonably and in good faith and evidenced by a written report that considers the relevant factors of the illiquid stock of a start-up corporation (as defined in the regulations).

Treasury Regulations provide a number of conditions that must be satisfied with respect to each of those methods. For example, the regulations define the necessary qualifications for an independent appraiser performing the valuation referenced in the first method. In addition, entities must satisfy specific other attributes in order to avail themselves of the second and third methods (the third method applies only for eligible start-up corporations). The satisfaction of those requirements would also be required for any company electing the practical expedient.

BC20. It is expected 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. Outreach indicates that an independent appraisal is the most common method used by nonpublic entities to meet the rebuttable presumption of reasonableness of Section 409A for tax purposes. The other methods are subject to restrictions, which results in those methods being used much less frequently.

Basis for Conclusions

BC21. In December 2019, the PCC approved the practical expedient in this proposed Update on the basis that it would reduce costs associated with determining the current price input associated with a share-option award. In February 2020, the Board endorsed the PCC's decision on the basis of the following:

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." This could potentially reduce the number of valuations that a nonpublic entity would have to obtain.

BC22. In addition to the cost savings expected by the Board, the PCC believes that with the alignment of the practical expedient requirements in this proposed Update with those for the presumption of reasonableness provisions of Section 409A, documentation and audit procedures currently required in practice to substantiate the current price input should decrease.

Effective Date and Transition

BC23. The PCC decided that the practical expedient in this proposed Update 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. The PCC learned through outreach that valuation methods that are compliant with Topic 718 are generally more robust than those performed or obtained to satisfy Section 409A. Therefore, any previous valuation that was compliant with Topic 718 likely would satisfy Section 409A and, thus, would not require remeasurement. In addition, because the Section 409A and Topic 718 measurement objectives are essentially the same (fair value based), the benefits of any required remeasurement likely would not justify the related costs.

BC24. The PCC also decided that the practical expedient in this proposed Update should be applied prospectively for all qualifying awards granted or modified during fiscal years beginning on or after the effective date and interim periods within the following years consistent with the Guide and that early adoption should be permitted. The effective date will be determined after the PCC and the Board consider stakeholder feedback on this proposed Update.

Effect on User Relevance and Cost under the Private Company Decision-Making Framework

BC25. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. The Guide augments the existing conceptual framework for financial reporting to provide additional considerations in making user-relevance and cost-benefit evaluations for nonpublic entities. The PCC's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC26. The PCC believes that the practical expedient in this proposed Update, if elected, would continue to provide decision-useful information to the users of private company financial statements, while reducing the cost and complexity associated with determining the current price input into an option pricing model. Because the measurement objectives of Topic 718 and Section 409A are generally aligned, it is expected that the current price value determined using a valuation method satisfying the presumption of reasonableness requirements of Section 409A will be consistent with the value that would have been determined using a valuation method that is compliant with Topic 718. Both the Board and the PCC believe that costs would be reduced for nonpublic entities for the reasons in paragraph BC21. In addition, the PCC believes that documentation and audit procedures needed to substantiate the current price input should decrease under the practical expedient in this proposed Update.

Alternative View

BC27. Ms. Botosan supports alternatives for private companies within GAAP when there is an opportunity to reduce cost and complexity for private companies while at least maintaining the usefulness of information for typical users of private company financial statements. In this instance, however, Ms. Botosan disagrees with the issuance of the practical expedient in this proposed Update because, in her opinion, the proposed amendment will yield insufficient cost savings to justify creating another optional public-private difference within GAAP.

BC28. Entities estimate the fair value of a share to determine the exercise price of a share option and to estimate the value of the option. Arriving at a sufficiently reliable estimate of the fair value of the underlying share is not done simply for accounting purposes but to satisfy the issuer's and the recipient's need for reliable information regarding the exercise price and value of the option exchanged for goods or services. A sufficiently reliable estimate of the fair value of the underlying share is necessary for this determination. This economic motivation and the extent of effort the parties deem necessary to arrive at a sufficiently reliable estimate of the fair value of the underlying share should be unaffected by the practical expedient in this proposed Update.

BC29. In addition, the measurement philosophy in Section 409A and in GAAP is essentially the same. The three specified valuation methods that qualify for the presumption of reasonableness in Section 409A also are not precluded by existing GAAP. Not surprisingly, therefore, the staff learned during extensive outreach that it is common for preparers to obtain one valuation for both GAAP and tax purposes. Thus, Ms. Botosan believes that the practical expedient will merely serve to codify widespread existing practice that is already clearly acceptable under GAAP. For these reasons, Ms. Botosan believes that the practical expedient should not and will not have a significant impact on the valuation processes and procedures presently applied by private companies.

BC30. In addition, Ms. Botosan believes that, based on feedback from stakeholders, audit costs also are unlikely to be significantly reduced as a result of the proposed practical expedient. Representatives of the American Institute of Certified Public Accountants

(AICPA), the AICPA Auditing Standards Board, and the AICPA Technical Issues Committee with whom the staff spoke indicated that application of the practical expedient would not provide a "safe harbor" from the need for auditors to undertake appropriate audit procedures to assess inputs and assumptions used in estimating the value of a share underlying a share option. Ms. Botosan is concerned that confusion on this point could prove detrimental to the auditors of private companies. In addition, during its outreach with private company auditors, the staff learned that because share-based compensation is often immaterial for private company clients, limited audit procedures are already performed and, consequently, the expected reduction in audit costs similarly would be limited.

BC31. Finally, if excess costs exist in the financial reporting system because of uneconomic audit procedures applied to the estimate of the fair value of the underlying share in a share option, Ms. Botosan believes that it would be more fitting for those responsible for establishing audit requirements and setting expectations of auditors to address the concern.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would not require improvements to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). Any stakeholders who believe that improvements to the Taxonomy are required should provide their comments and suggested improvements at xbrled@fasb.org.