CalCPA

1800 Gateway Drive, Ste 200
San Mateo CA 94404-4072
(800) 922-5272
www.calcpa.org

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Technical Director
Director@fasb.org

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Proposed Accounting Standards Update: Compensation—Stock Compensation (Topic 718) *Improvements to Employee Share-Based Payment Accounting*

The Accounting Principles and Assurance Services Committee (the "Committee") of the California Society of Certified Public Accountants ("CalCPA") respectfully submits its comments on the referenced proposal. The Committee is the senior technical committee of CalCPA. CalCPA has approximately 43,000 members. The Committee consists of 57 members, of whom 43 percent are from local or regional CPA firms, 30 percent are from large multi-office CPA firms, 13 percent are sole practitioners in public practice, 9 percent are in academia and 5 percent are in international CPA firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

Question 1: Do you agree that the proposed amendments result in a reduction (or potential reduction) of cost and complexity while maintaining or improving the usefulness of information provided to users of financial statements? If not, why?

The Committee agrees that the changes in the proposed ASU will reduce cost and complexity in accounting for share-based payment transactions. By better aligning accounting with income tax requirements, we do not believe the information will be any less useful to users of financial statements.

Question 2: Should excess tax benefits and tax deficiencies be recognized in the income statement? If not, why, and are there other alternatives that are more appropriate? Should an entity delay recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable? If yes, why?

We agree that excess tax benefits and deficiencies should be recognized in the income statement. Such accounting achieves a closer alignment of the accounting for share-based payment transactions and the tax consequences of those transactions. We do not believe an entity should defer recognition of an excess tax benefit until it is realized through a reduction of income taxes payable; we see no reason why they should be accounted any differently than any other item affecting financial statement and tax income differently. Further, deferring recognition until realized through a reduction of income taxes payable would require continuation of some of the same complex recordkeeping that the Board is trying to mitigate.

Question 3: Should the effect on tax cash flows related to excess tax benefits be classified as an operating activity on the statement of cash flows? If not, what classification is more appropriate and why?

The Committee believes that the effect on cash flows related to excess tax benefits should be classified as an operating activity in the statement of cash flows. This corresponds with the classification of the share-based compensation expense to which it relates.

Question 4: Should entities be permitted to make an accounting policy election either to account for forfeitures when they occur or to estimate forfeitures? If not, why?

The Committee agrees with the proposal that an entity be permitted to make an accounting policy election to recognize forfeitures as they occur. The need to estimate forfeitures and adjust estimates to actual experience can be cumbersome, and yields little if any benefit. Further, for newer entities or entities without a meaningful history of forfeitures, the estimation process is fraught with difficulty and potential error.

Question 5: Is the proposed expansion of the exception to liability classification related to the amount withheld for employee's taxes appropriate? If not, is there another exception that is more appropriate and why?

The Committee agrees with the proposed expansion of the exception to the liability classification related to the amount withheld for employee taxes. The existing requirements fail to recognize the realities of complying with income tax regulations, and they were unnecessarily and excessively stringent. The proposed amendment will correct this.

The proposed amendment to paragraph 718-10-25-18 refers to the employee's maximum statutory rate. This is ambiguous on two scores. First, is the rate referred to the rate applicable to the specific employee, for example, based on earnings at the employer, or the maximum rate that could be applicable to the employee. We believe it should be the latter; an employer may not know what the employee's actual tax situation is. Second, the rate used should disregard the potential deductibility of state income taxes; many employees find it difficult to get any benefit from state income taxes paid because of alternative minimum tax. Adding a phrase "regardless of the employee's actual tax rate" would clarify both issues.

Question 6: Should the cash paid by an employer to the taxing authorities when directly withholding shares for tax-withholding purposes be classified as a financing activity on the statement of cash flows? If not, what classification is more appropriate and why?

The Committee agrees with the Board's proposal to classify cash paid to taxing authorities when withholding shares for tax withholding be classified as a financing activity in the statement of cash flows.

Question 7: When assessing the classification of an award with a repurchase feature that can only be exercised on the occurrence of a contingent event, should a contingent event within the employee's control be assessed in the same manner as a contingent event outside the employee's control? If not, why should there be a difference in the assessment?

The current requirements to determine whether an award with a repurchase provision that can only be exercised dependent on a contingent event is currently one of the more arcane exercises in accounting for share-based compensation. We agree with the Board's proposal to remove employee's control as a factor in the accounting determination.

Question 8: Is the practical expedient for nonpublic entities to estimate the expected term of all awards with performance conditions that affect vesting or service conditions appropriate? If not, are there other practical expedients that are more appropriate and why? Should the expedient be limited to nonpublic entities?

The Committee agrees with the proposed practical expedient for estimating the term of an award. The Committee observes that the reason for a practical expedient is because the entity lacks adequate history to enable it to estimate a term. Some public entities, most often newly public entities experience the same issue - lack of meaningful history. The Committee would support making a practical expedient available to them for a limited specific period of time after their shares become publicly traded.

Question 9: Should nonpublic entities be allowed to make a one-time election to switch from measuring liability-classified awards at fair value to intrinsic value? If not, why? While not proposed, should the Board consider making the ability to elect intrinsic value an ongoing election alternative for nonpublic entities?

The Committee is in favor of permitting entities to switch from measuring liability classified awards from fair value to intrinsic value accounting, on the basis that it is practical relief. The Committee is not in favor of making use of intrinsic value an ongoing election; in the future, the accounting alternative under a one-time election should be clear and an ongoing availability of an election should be unnecessary.

Question 10: Are the transition requirements for each area appropriate? If not, what transition approach is more appropriate?

The Committee generally agrees with the transition provisions.

However, the Committee would favor permitting non-public entities to implement the amendments retrospectively. Some of these entities do not prepare GAAP financial statements, and it makes little sense to have to consider the effects of superseded accounting principles for periods before the effective date in the transition provisions. Others may prefer to restate prior to when they first become public to achieve a consistent presentation for all periods.

Question 11: How much time will be necessary to adopt the amendments in this proposed Update? Should the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?

Adoption of the proposed amendments should result in time savings by all affected entities. The Committee has not attempted to quantify the savings. The Committee believes savings will be more dependent on the features and number of share-based awards in each entity than whether they are public or non-public.

Issue 9: Eliminating the Indefinite Deferral in Topic 718, paragraphs 718-10-35-12 and13:

The Committee agrees with the Board's decision to eliminate the guidance that was indefinitely deferred in Topic 718.

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We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any questions or require additional information.

Sincerely,

A.J. Major III

A.J. Major III
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants