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December 13, 2021

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

File Reference No. 2021-005, Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions

Dear Ms. Salo:

The California Society of CPA's ("CalCPA") Accounting Principles and Assurance Services Committee (the "Committee") is the senior technical committee of CalCPA. CalCPA has approximately 42,600 members. The Committee consists of 55 members, of whom 44 percent are from local or regional firms, 31 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia, 5 percent are in international firms, and 2 percent are members in business industry. 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.

## General Perspectives

The Committee is writing to share its views on the Financial Accounting Standards Board's ("FASB" or "the Board") proposed accounting standards update ("ASU"), File Reference No. 2021-005. We appreciate the Board's standard-setting proposal and the opportunity to provide our perspectives on the proposed standard.

While the majority of the Committee agrees with the proposed ASU, the Committee believes that the FASB should undertake a separate, broader project to evaluate the reasonableness and appropriateness of existing fair value measurement guidance pertaining to sale or use restrictions. In this regard, the Committee believes that the FASB should evaluate more broadly, whether existing fair value measurement guidance regarding sale or use restrictions creates inappropriate disparities between economic fair value and accounting fair value that detract from, or compromise, decision useful information to existing and potential investors, lenders, and other creditors.

In addition to similar questions raised by Messrs. Cannon, Jones, and Kroeker pertaining to the fair value measurement of equity securities, Committee members note that the reasonableness of fair value measurements for gifts-in-kind ("GIK") has also been raised by regulators, including the California Attorney General's office. Specifically, when valuing GIK, entities are required to make hypothetical assumptions about the principal (or most advantageous) market for the GIK. However, existing measurement guidance may result in valuations that are not reflective of an asset's actual marketability and use (*e.g.* as a result of donor-imposed restrictions). While the FASB responded to these concerns by amending presentation and disclosure guidance (*i.e.*, Accounting Standards Update No. 2020-07), the Committee reiterates our related recommendation that a separate project be undertaken to evaluate and consider the reasonableness and appropriateness of existing fair value measurement guidance pertaining to sale or use restrictions.

## Specific Question Responses

***Question 1—Restriction Type: Do you agree with the Board's decision on scope to include all contractual restrictions that prohibit the sale of an equity security? Please explain why or why not.***

The Committee agrees with the Board's decision on scope to include all contractual restrictions that prohibit the sale of an equity security. We do not believe that there is a reasonable basis for limiting one type of contractual restriction from another for accounting purposes given the economic similarities between the contractual restrictions and the principles at issue in the proposed ASU.

However, for the reasons described in part above, the Committee believes a separate project should be undertaken to evaluate and consider whether existing fair value measurement guidance pertaining to sale or use restrictions is appropriate and fulfills the objectives of financial reporting under GAAP as set forth in the FASB's Statement of Financial Accounting Concepts No. 8.

***Question 2—Measurement: Do you agree with the Board's decision that a contractual restriction prohibiting the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, should not be considered in measuring fair value? Alternatively, should the Board amend the guidance in Topic 820 (or elsewhere in GAAP) such that contractual sale restrictions would be required to be considered in determining fair value?***

The majority of Committee members agreed with the Board's decision that a contractual restriction prohibiting the sale of an equity security is not considered part of the unit of account of the equity security and, therefore, should not be considered in measuring fair value. However, a substantial minority did not. Those in the minority shared concerns similar to Messrs. Cannon, Jones, and Kroeker, including concerns that resulting disparities between economic fair value and accounting fair value could detract from, or compromise, decision useful information to existing and potential investors, lenders, and other creditors. In acknowledgement of these minority member concerns, it should also be noted that certain members in the majority cited the consistency of the proposed accounting guidance with existing fair value measurement concepts under ASC 820 as the primary basis for their conclusion and not the underlying reasonableness of the fair value measurement concepts applicable to sale or use restrictions. This latter group of Committee members believe the Board should amend the guidance in Topic 820 (or elsewhere in GAAP) such that contractual sale and use restrictions would be required to be considered in determining fair value.

***Question 3—Entity Type: Should all types of entities use the same unit of account when measuring the fair value of an equity security subject to a contractual sale restriction, or should***

***certain types of entities (for example, investment companies, broker dealers, and pension plan financial statements) have a different unit of account? Please explain your response.***
The Committee agrees that all types of entities should use the same unit of account when measuring the fair value of an equity security subject to a contractual sale restriction. In this regard, the Committee does not believe that a reasonable basis exists to limit the requirements under the proposal to specific industries (*e.g.*, investment companies, broker-dealers) and doing so would negatively impact the comparability of financial reporting under GAAP.

***Question 4—Disclosures: Would qualitative or quantitative disclosures (for example, describing the nature of a contractual sale restriction on an equity security and the related amount recognized on the balance sheet) help users in understanding the effects of a contractual restriction on the sale of an equity security held by a reporting entity? Please explain why or why not. For reporting entities, what costs would be incurred to disclose that information?***
The Committee believes that qualitative or quantitative disclosures (for example, describing the nature of a contractual sale restriction on an equity security and the related amount recognized on the balance sheet) are necessary to help users in understanding the effects of a contractual restriction on the sale of an equity security held by a reporting entity. The Committee also believes that a description of the valuation techniques and inputs used to arrive at a fair value measure under Topic 820 should clearly reflect that contractual restrictions are not considered in determining the fair value of equity securities. The Committee believes that such disclosures are not cost prohibitive and can be embedded in an entity's existing disclosure processes for other restricted assets (*e.g.*, restricted cash).

***Question 5—Transition: Do you agree with the transition guidance in this proposed Update? Please explain why or why not.***
The majority of the Committee agrees with prospective transition guidance proposed with respect to entities that are not investment companies. However, the Committee generally disagrees with the industry specific transition guidance proposed. In this regard, members believe the proposed transition guidance applicable to such entities would: (i) inappropriately permit different bases of accounting for similar assets, (ii) facilitate ongoing diversity in practice, and (iii) create irregular earnings volatility across similar asset types for those entities.

***Question 6—Implementation: How much time would be necessary to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities? Please explain your response.***
The Committee does not believe significant time would be necessary to implement the proposed amendments. In this regard, the Committee recognizes that the impact of the proposed guidance would likely result in less fair value complexity (e.g., eliminating fair value adjustments pertaining to restrictions). Moreover, incremental disclosures required in connection with contractual restrictions are not likely to result in significant costs or time burdens.
The Committee also believes that private companies should be provided an additional year's time to allow for requisite education requirements and to allow for implementation examples in practice by public business entities to emerge. However, the Committee believes it reasonable and

appropriate to allow entities other than public business entities to early adopt the proposed amendments

***Question 7—Clarity and Operability: Do you agree that the proposed amendments and, in particular, the definition of a restricted security provide the necessary clarity to resolve existing diversity in practice? Please explain why or why not. Are the proposed amendments operable and auditable? If not, which proposed amendment or amendments pose operability or auditability issues and why?***
With the above noted exception pertaining to the proposed transition guidance, the Committee generally believes that the proposed amendments and, in particular, the definition of a restricted security provide the necessary clarity to resolve the existing diversity in practice. The Committee also believes that the proposed amendments are operable and auditable. In this regard, the Committee believes: (i) the definition of a restricted security reasonably distinguishes such securities from equity securities with contractual restrictions, (ii) the proposed accounting treatment clarifies existing fair value measurement concepts and guidance, and (iii) reduces the complexity of fair value measurements for entities previously making adjustments to its fair value measurements for equity securities with contractual obligations.

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

Sincerely,

Paul J. Peterson, Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants