ILLINOIS **CPA** SOCIETY

August 14, 2015

Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2015-270

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update, Compensation-Stock Compensation—*Improvements to Employee Share-Based Payment Accounting*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual views of the members or the organizations with which they are affiliated. The organization and operating procedures of the Committee are outlined in Appendix A to this letter.

We are supportive of the Board's efforts to reduce complexity in accounting standards, particularly related to the guidance on accounting for share-based payment transactions. Overall, we believe that the Board's proposed guidance will go a long way toward reducing cost and complexity associated with accounting for share based payment awards while maintaining the usefulness of the information provided to financial statement users.

However, as described in more detail below, we believe that the proposal to recognize all excess tax benefits and tax deficiencies in the income statement could create complexity and could potentially provide less useful information to financial statement users over time. Additionally, a majority of the Committee believes that the guidance on contingent repurchase features could be further simplified to address current diversity in practice.

Our responses to the proposal's Questions for Respondents follow.

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?*

   We believe that, overall, the proposed amendments will reduce cost and complexity while maintaining or improving the usefulness of information provided to users of financial statements. As described in our responses to Questions 2 and 7 below, we believe that the Board should reduce cost and complexity by requiring entities to recognize excess tax benefits and tax deficiencies as a component of equity, and a majority of the Committee believes that the Board should consider eliminating diversity in practice related to repurchase features contingent on an employee's voluntary termination.

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 do not believe that excess tax benefits and tax deficiencies associated with share based payment awards should be recognized in the income statement. We note that the Board expressed a view in the Basis for Conclusions of FASB Statement 123(R), *Share-Based Payment*, that a share based payment award is associated with two distinct transactions: (1) the entity grants awards to a group of employees in exchange for services (i.e. a compensation arrangement) and (2) the employees acquire equity in the entity by exercising options or by vesting in shares (i.e. an equity transaction). We have not identified any discussion in the proposed ASU about why the Board believes this view is no longer appropriate.

Therefore, we do not believe it is appropriate to require entities to account for the tax effects of share based payment awards as if they are associated with a single compensation transaction. If the Board believes that simplification is imperative, we suggest that it reconsider an approach whereby entities would recognize all excess tax benefits and tax deficiencies as a component of equity.

We realize that the risk of this approach is that an entity's net income might be overstated in a period in which a tax deficiency is realized. However, we believe this risk is mitigated by the facts that (1) many entities have sufficient excess tax benefits in equity to offset most tax deficiencies and (2) over a long period of time excess tax benefits and tax deficiencies are likely to offset. This latter point is consistent with the original rationale for permitting excess tax benefits realized in prior periods to offset a tax deficiency realized in the current period. Other than conservatism, which we do not view as an appropriate basis for accounting standard setting, it is unclear why this rationale would not also apply to tax deficiencies, such that their realization might result in a cumulative tax effect debit within additional paid-in capital that would be offset by excess tax benefits realized in future periods. We believe this approach would be consistent with the Basis for Conclusions of Statement 123(R) and achieve the objective of the Board's simplification initiative.

Regardless of the Board's decision on this topic, we believe that an entity should not delay recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable. Such a requirement to delay recognition is inconsistent with the general requirement in ASC 740, *Income Taxes*, that an entity should recognize a deferred tax asset and then determine whether a valuation allowance is required. The current approach requires an entity to track excess tax benefits that are not realizable through a reduction to taxes payable, which increases complexity beyond whatever benefit is derived by deferring recognition of the deferred tax asset.

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?*

If the Board proceeds with its proposal regarding recognition of excess tax benefits and tax deficiencies, then we agree with classifying the effect on tax cash flows related to excess tax benefits as an operating activity on the statement of cash flows. However, as stated above, we believe that an employee's option exercise or share vesting is an equity transaction and ought to be accounted for as such, including classifying the effect on tax cash flows related to excess tax benefits as a financing activity.

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?*

We agree that entities should be permitted to make an accounting policy election either to account for forfeitures when they occur or to estimate forfeitures. We believe that permitting this election will reduce complexity, particularly for entities that do not have a history of issuing share based payment awards, without impairing the usefulness of information provided to financial statement users.

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 majority of the Committee believes the proposed expansion of the exception to liability classification related to the amount withheld for employees' taxes is appropriate because the purpose of withholding is to satisfy the employee's tax obligation, regardless of whether it is at the statutory minimum, maximum, or somewhere in between. The withholding does not change the nature of the award, and current guidance in this area is unnecessarily complicated. The majority acknowledges that an entity's decision to permit this form of net settlement is voluntary, and that certain entities have the ability to provide other means for employees to settle tax withholding requirements upon exercise, such as broker-assisted cashless exercise. However, the majority believes that for certain entities, including those whose stock is not readily convertible to cash, such other means might be limited, and that the proposed expansion simplifies and improves the accounting for these entities.

Other members of the Committee believe the Board should not expand the exception to accounting for cash-settled awards as liabilities and note that the complexity the Board is attempting to solve was not caused by complicated accounting standards, but was created by companies. Companies could require employees to use broker-assisted exercise, which would allow each employee to determine the amount of cash needed to meet tax withholding (or other) requirements and would remove the risk that a company could be required to record additional compensation cost for withholding too many shares. Those Committee members believe the Board should modify the consequences of withholding too many shares. Requiring a company to remeasure compensation cost on the entire award for withholding too many shares is overly draconian. An approach consistent with the approach the Emerging Issues Task Force took on Issue 87-6C, *Use of Stock Option Shares to Cover Tax Withholding*, under which a company recognized compensation cost for the excess shares withheld, is preferable to the current approach.

6. *Should the cash paid by an employer to the taxing authorities when directly withholding the 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?*

   We agree that the cash paid by an employer to the taxing authorities when directly withholding the shares for tax-withholding purposes should be classified as a financing activity on the statement of cash flows, since it is associated with a share issuance. However, we believe such classification is inconsistent with the presumption underlying the proposed expansion of the exception to liability classification related to the amount withheld for employee taxes, which is that the withholding is *not* a share repurchase. We believe the Board should consider whether this inconsistency might be misleading to financial statement users.

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?*

   While we agree that the proposal to disregard whether the contingency is within the employee's control would reduce complexity, we believe that an entity's ability to assess the probability of events within the employee's control is limited to the extent that it could be rare that any such contingency would be deemed probable until it occurs. In certain Committee members' experience, repurchase features in awards issued by closely held entities are often contingent on an employee's termination, voluntary or otherwise. Some view an employer call option on vested awards that will be exercised upon an employee's voluntary termination as akin to a put option that could be exercised before the employee has been exposed to the risks and rewards of share ownership for more than six months, therefore requiring awards with such features to be classified as liabilities. Under this view, the put option would be deemed exercised on the employee's termination date.

The majority of the Committee believes that if, in the Board's view, an employee's ability to voluntarily terminate employment and cause the company to exercise a call option is not akin to a put option held by the employee, then the Board could further reduce complexity, and promote consistent classification among entities, by providing entities the ability to disregard contingencies based on an employee's voluntary termination.

Other Committee members do not believe the Board should revise its guidance on repurchase features. Those members note that a company could include a requirement in the award document that an employee hold shares acquired through exercise of an option or vesting of restricted stock for at least six months prior to exercising a put option. As with the tax withholding issue, those members believe the Board is trying to fix an issue that is not the result of a complicated accounting standard, but has been created by companies who, for whatever reason, are unwilling to require the employee to hold shares for a minimum period.

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?*

   We believe the expected term practical expedient is appropriate, particularly in situations where an entity issues few awards and lacks sufficient experience to reasonably estimate employee exercise behavior. Given the existing "simplified method" expedient available to public entities, it is unclear whether there would be significant incremental benefit and/or unintended consequences to expanding the scope of the proposed expedient. Therefore we believe this expedient should be limited to nonpublic entities.

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?*

   A majority of the Committee believes that nonpublic entities should be allowed to make a one-time election to switch from fair value to intrinsic value as the measurement basis for liability-classified awards, on the basis that it is consistent with the objective of the Board's Simplification Initiative and is responsive to feedback from the Private Company Council.

   We do not believe the Board should consider making the measurement basis an ongoing election, as it is unclear in what circumstances it would be preferable to switch from fair value to intrinsic value, and the ongoing ability to elect the measurement basis could permit "strategic" elections in periods when the resulting income statement effect is favorable.

   Other Committee members disagree with the Board's proposal as they do not believe the fact that nonpublic entities "were not aware of that option" (as stated in the Summary of the proposed ASU) is a sufficient reason to permit the granting of an exception now.

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

    We believe the transition requirements for each area are appropriate.

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?*

We believe the amount of time necessary to adopt the proposed amendments could vary significantly among entities based on their resources and volume of share based payment transactions. We recommend that entities other than public business entities be given additional time to implement the proposed amendments, and that all entities be provided the option to early adopt.

We appreciate the opportunity to offer our comments.

Sincerely,

Scott G. Lehman, CPA
Chair, Accounting Principles Committee

Ryan Brady, CPA
Vice Chair, Accounting Principles Committee

APPENDIX A

ACCOUNTING PRINCIPLES COMMITTEE
ORGANIZATION AND OPERATING PROCEDURES
2015-2016

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to fully study and discuss exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:

Large: (national & regional)

Ryan Brady, CPA (Vice Chair)	Grant Thornton LLP
John Hepp, CPA	Grant Thornton LLP
David Jamiolkowski, CPA	Baker Tilly Virchow Krause, LLP
William Keirse, CPA	Ernst & Young LLP
Scott Lehman, CPA (Chair)	Crowe Horwath LLP
Reid Mitchell, CPA	Wipfli LLP
Elizabeth Prossnitz, CPA	BDO USA LLP

Medium: (more than 40 professionals)

Timothy Bellazzini, CPA	Sikich LLP
Michael Kidd, CPA	Mowery & Schoenfeld LLC
Matthew Mitzen, CPA	Frost Ruttenberg & Rothlatt PC
Krunal Shah, CPA	Mitchell & Titus LLP
Jeffery Watson, CPA	Miller Cooper & Company Ltd

Small: (less than 40 professionals)

Peggy Brady, CPA	Selden Fox, Ltd.
Marvin Hoffman, CPA	Bronswick, Reicin, Pollack, Ltd.
Brian Kot, CPA	Cray Kaiser Ltd CPAs
Joshua Lance, CPA	Joshua Lance CPA, LLC

Industry:

Rose Cammarata, CPA	CME Group Inc.
Anand Dalal, CPA	Toji Trading Group LLC
Ashlee Earl, CPA	Seaway Bank and Trust Company
Jeffrey Ellis, CPA	FTI Consulting, Inc.
Farah Hollenbeck, CPA	Abbvie
Marianne Lorenz, CPA	AGL Resources Inc.
Michael Maffei, CPA	GATX Corporation
Ying McEwen, CPA	Case New Holland
Anthony Peters, CPA	McDonald's Corporation
Martin Ross, CPA	Riveron Consulting LP
Amanda Rzepka, CPA	Jet Support Services, Inc.
Richard Tarapchak, CPA	National Material

Staff Representative:

Gayle Floresca, CPA	Illinois CPA Society