



September 30, 2020

VIA Email

Technical Director
File Reference No. 2020-200
Financial Accounting Standards Board
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RE: *Proposed Accounting Standards Update: Compensation—Stock Compensation (Topic 718), Determining the Current Price of an Underlying Share for Equity-Classified Share-Option Awards*

Introduction

The National Venture Capital Association (NVCA) represents the vast majority of American venture capital under management.¹ Venture capital funds (VCF) invest across the spectrum of company stages of development, typically from early stage startup through IPO or acquisition.

NVCA supports the Private Company Council and its goal of ensuring that the Financial Accounting Standard Board's (FASB) accounting rules are relevant for private as well as publicly traded companies. The inclusion of key employees in the equity upside of private companies is a bedrock of the entrepreneurial ecosystem of which venture capital is a part. Therefore, the accounting treatment of equity option grants has an impact on most companies that receive venture capital investments.

Our comments on all financial reporting matters are informed by the active involvement of NVCA's CFO Task Force, comprised of member firms' Chief Financial Officers and Administrative Partners who are responsible for the financial reporting within the venture

¹Venture capitalists are committed to funding America's most innovative entrepreneurs, working closely with them to transform breakthrough ideas into emerging growth companies that drive U.S. job creation and economic growth. As the voice of the U.S. venture capital community, the National Venture Capital Association (NVCA) empowers its members and the entrepreneurs they fund by advocating for policies that encourage innovation and reward long-term investment. As the venture community's preeminent trade association, NVCA serves as the definitive resource for venture capital data and unites members through a full range of professional services. For more information about the NVCA, please visit www.nvca.org.

industry. Most task force members are CPAs, and many have practiced accounting with leading national firms. In addition, many task force members have had significant operating experience as CFOs of both private and public companies. They provide insights into the value of information in private company (hereinafter “PC”) financial statements and are frequently involved in accounting decisions of private operating companies.

CFOs of venture funds interact with thousands of private companies as users of their financial statements. They also advise VCF “deal partners” who often serve on PC boards of directors and have the primary responsibility to oversee a fund’s investment in a PC investee.

General Comment

NVCA supports the Private Company Council’s Proposal. We see the proposed change in accounting for private companies as meeting the FASB’s criteria for a “practical expedient.” It would be cost effective and, we believe it is consistent with, and will achieve the same accounting and reporting objective as, the current Topic 718 requirements. For the reasons stated in the FASB’s Release, it is both costly and duplicative for early-stage and smaller PCs to separately estimate the fair value of equity shares underlying a share-option award for tax and accounting purposes. We expect venture-backed PCs to adopt the provisions outlined in the Proposal.

From an investor perspective, use of the practical expedient will allow investee companies to save resources that can be more appropriately applied to other tasks which we believe will enhance company growth, expand employment as companies grow, and achieve better alignment among early-stage company stakeholders. We do not anticipate a loss of decision-useful information for investors.

Specific Responses

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

Yes. We believe that venture-backed private companies will adopt this practical expedient and that the means by which the valuation is determined will be auditable.

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.*

Yes. We think that all types of equity-based compensation should be treated similarly. As further amplified in our response to Question 6, below, it is critical to investors that any PC action that has the potential to dilute investors’ share of equity should be fully disclosed. Similarly, since nonvested shares, warrants, restricted shares, or management incentive units, for example, are just as significant as vested option grants to investors, we think they should receive the same accounting treatment as vested options. Therefore, we think Topic 718 should make the

practical expedient available for any equity-based compensation program that is subject to the broad coverage of Section 409A.

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.*

Yes. The goal is the same for the valuation requirements of IRC 409A and Topic 718 -- an objective estimate of fair value of an underlying equity instrument by a trained individual using the best available information. In current practice, outside experts are retained to evaluate similar metrics using the same valuation tool kit for both valuations. Therefore, companies will save money on outside experts.

Furthermore, the finite resources of PC financial staff are needed to oversee and support both valuations and to reconcile any significant differences between the fair values estimated in either approach. Significant staff time savings would also result from use of the practical expedient.

Elimination of the requirement to obtain a separate Topic 718 valuation may well cause auditors to evaluate the 409A valuation in more detail. However, this work should require less auditor time and significantly less PC employee time than the current requirements, which in many cases are duplicative and can require extensive reconciliation processes. Therefore, both audit fees and PC finance staff time should be reduced if the 409A valuation is proper and, if auditors evaluate the 409A valuation work, and the provider of those services efficiently.

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

Yes. 409A valuations must occur at every stage of company development and must be done regularly to satisfy ongoing IRS requirements. Consequently, all private companies that issue stock options to employees incur the cost to obtain valuations that meet the IRS standards from their very beginnings through -- and in some cases well beyond -- an exit event.

Audited GAAP financial statements are often not required in the earliest days of a private company. However, as the company grows and matures, audited GAAP financial statements are required by later stage investors, banks, and other financing sources. In many cases, this necessitates valuation work beyond the 409A valuation report. In some cases, a separate experts' report, or substantial supplemental work to analyze market data in addition to that included in the 409A, is required for audited financials.

We acknowledge that, as private companies nearing the "exit" stage, particularly through a public stock offering, the value and savings from use of the practical expedient may diminish. However, this would not reduce the cost effectiveness of the practical expedient during the many years that lead up to an exit event.

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

Yes. However, the practical expedient should presumptively apply so long as its basic criteria are met. In other words, while preparers may decline to use the practical expedient with respect to every award, valuations based IRC 409A should not require a facts and circumstances justification for its application.

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.*

No. Valuations of most venture-backed PCs include a number of inputs that require judgment. As users of PC financial statements, we find the analysis required by IRC 409A to establish fair value equally useful to that required by Topic 718.

As a practical matter, VCFs obtain more timely information from 409A valuations. Since deal partners serve on the boards of private companies and have a fiduciary duty to ensure that 409A valuations are IRS-compliant, they review these valuations throughout the year as grants are approved. Therefore, VCFs currently receive regular and reliable information from the 409A valuation process, which, because of its timeliness is often more decision useful than the annual analysis done for Topic 718 compliance.

Furthermore, adoption of the practical expedient will not change the important information in the notes to the financial statements regarding the dilutive effect of equity option grants. As long-term investors, our focus is not primarily on the compensation expense of periodic stock option grants, but on the potential dilutive effect of such grants. Therefore, VCFs focus on the potential dilution in the entire stock options pool, not the effect of individual grants made in a single reporting period. The practical expedient would not change the requirement to provide this key information in PC financial statements, and it should not.

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

Yes.

Sincerely,

A handwritten signature in black ink that reads "Bobby Franklin". The signature is written in a cursive, slightly slanted style.

Bobby Franklin
President and CEO