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July 10, 2023

Ms. Hillary H. Salo, Technical Director
Financial Accounting Standards Board
801 Main Avenue
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2023-ED300
Re: Proposed Accounting Standards Update, *Compensation — Stock Compensation (Topic 718): Scope Application of Profits Interest Awards*

Dear Ms. Salo:

Deloitte & Touche LLP is pleased to comment on the FASB's proposed Accounting Standards Update (ASU) *Compensation — Stock Compensation (Topic 718): Scope Application of Profits Interest Awards*.

We support the FASB's efforts to improve the accounting for profits interest and similar awards ("profits interest awards") by reducing diversity in practice in the determination of whether a profits interest award is subject to the guidance in ASC 718.

In our experience, profits interest awards represent legal-form equity, a description that is aligned with the discussion of the term "profits interest" in paragraph BC3 of the proposed ASU. We believe that a profits interest award that is legal-form equity is common and is the primary subject of the proposed ASU. Under the proposed ASU, an entity would be required to consider the key terms of the profits interest award, despite the legal form, to determine whether it should be accounted for as a profit-sharing arrangement or as equity within the scope of ASC 718. Accordingly, we recommend that the Board explicitly state that the objective of the scoping analysis is to determine whether a profits interest award that is legal-form equity substantively represents an equity instrument within the scope of ASC 718[1].

Furthermore, regarding the assessment of the scope of a profits interest award, each case in the proposed ASU considers whether the grantee can retain the economic rights conveyed by the profits interest award upon termination and whether those rights are based on the entity's residual net assets

[1] To assess the substance an entity would consider the key terms of the profits interest award to determine if the award is functioning consistently with an equity instrument or is more akin to a profit-sharing arrangement.

(e.g., whether the holders of profits interest awards participate on a pro rata, albeit subordinated, basis alongside other economic interest holders). We believe that these considerations are important in the determination of whether a profits interest award substantively represents equity because other economic interest holders often have similar economic rights. However, as noted in paragraph BC19 of the proposed ASU, the illustrative example is not all-inclusive. Therefore, we believe that entities will still have to use judgment and consider all facts and circumstances in evaluating whether to account for a profits interest award as a share-based payment arrangement or in a manner similar to how it accounts for a profit-sharing arrangement.

The appendix below contains our responses to the proposed ASU's questions for respondents as well as certain suggested improvements for the Board's consideration.

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We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Sean May at (415) 783-6930 or Aaron Shaw at (202) 220-2122.

Yours truly,

Deloitte & Touche LLP
cc: Kristin Bauer

Appendix
Deloitte & Touche LLP
Responses to Proposed ASU's Questions for Respondents

Question 1: Do you agree that the amendments in this proposed Update should apply to all reporting entities (including PBEs and entities other than PBEs)? Please explain why or why not.

Yes. We believe that all reporting entities (including PBEs and entities other than PBEs) should apply the proposed ASU's amendments.

Question 2: Is the proposed illustrative example included in paragraphs 718-10- 55-138 through 55-148 to determine whether a profits interest award should be accounted for in accordance with Topic 718 clear and operable? Please explain why or why not. Should the illustrative example include other considerations or exclude any considerations? If yes, please explain how you would change the proposed illustrative example.

We believe that the Board should consider making the following clarifications to the proposed ASU:

- ASC 718-10-15-3B notes that the cases illustrate the application of ASC 718-10-15-3 to profits interest awards. ASC 718-10-15-3 states (emphasis added):

  > The guidance in the Compensation—Stock Compensation Topic applies to all share-based payment transactions in which a grantor acquires goods or services to be used or consumed in the grantor's own operations or provides consideration payable to a customer by issuing (or offering to issue) *its shares*, share options, or *other equity instruments* or by *incurring liabilities* to an employee or a nonemployee that meet either of the following conditions:
  >
  > a. The amounts are based, at least in part, on the price of the entity's shares or other equity instruments. (The phrase at least in part is used because an award of share-based compensation may be indexed to both the price of an entity's shares and something else that is neither the price of the entity's shares nor a market, performance, or service condition.)
  >
  > b. The awards require or may require settlement by issuing the entity's equity shares or other equity instruments.

  We recommend that in each case in the illustrative example, the entity base its evaluation on whether the profits interest award substantively represents the entity's "shares" or "other equity instruments," rather than on the applicability of ASC 718-10-15-3(a) and ASC 718-10-15-3(b), when assessing whether a profits interest award is within the scope of ASC 718 or is subject to other GAAP. Each case in the illustrative example focuses on ASC 718-10-15-3(a) and ASC 718-10-15-3(b). However, ASC 718-10-15-3(a) and 15-3(b) provide guidance on determining whether a *liability incurred* by the entity is within the scope of ASC 718. It is unclear how these portions of the paragraph apply to profits interest awards because, as stated in the body of this letter, entities assess whether the facts and circumstances support that the profits interest award, which is legal-form equity, substantively represents the entity's "shares" or "other equity instruments" under ASC 718 rather than whether the entity incurred a liability to the grantee that is within the scope of ASC 718. We believe that this change would not require the Board to significantly change the cases presented in the proposed ASU and could be accomplished by removing references to ASC 718-10-15-3(a) and ASC 718-10-15-3(b) and focusing on the judgments indicating that the profits interest award substantively represents the entity's "shares" or "other equity instruments" in accordance with ASC 718-10-15-3.

- In Case B in the proposed ASU's illustrative example, the Board concludes that the Class B units are within the scope of ASC 718 because, if these units are settled through an exit event, the grantee can "participate in the residual net assets of Entity X." Because the entity is evaluating whether the profits interest awards, which represent legal-form equity, represent the entity's equity or are more akin to a profit-sharing arrangement, we recommend that the conclusion clarify that the Class B units represent the entity's equity shares because such units *vest* upon an exit event that entitles the grantee to the right to X's residual net assets regardless of whether the grantee's employment is continued. In our view, if the units are vested upon an exit event, the grantee is entitled either to receive a cash settlement at that point or to retain the Class B units and the perpetual rights to X's residual net assets after the exit event and upon voluntary termination. These key terms are aligned with those for the holders of Class A units. We also believe that this conclusion is aligned with the assumption in Case B and clarifies why the Class B units represent equity of the entity rather than a profit-sharing arrangement.

- The assumptions for Case C and Case D state that the "Class B units do not entitle the grantee to receive equity of Entity X." We believe that this statement should be removed from these two cases. As discussed above, profits interest awards generally represent legal-form equity. Therefore, an entity is evaluating whether, despite the legal form, the profits interest award substantively represents the entity's equity and therefore should be within the scope of ASC 718. If this statement is removed, the analysis would be based on an evaluation of the key terms of the profits interest award in relation to Class A units rather than on a legal-form analysis.

Question 3: An entity would be required to apply the proposed amendments either (a) retrospectively to all prior periods presented in the financial statements or (b) prospectively to awards granted or modified on or after the effective date with an associated disclosure that describes the nature of and reason for the change in accounting principle. Do you agree with the proposed transition provisions? If not, why not, and what basis would be more appropriate and why?

Yes. We agree with the proposed transition provisions.

Question 4: Regarding the effective date, how much time would be needed to implement the proposed amendments? Should the amount of time needed to implement the proposed amendments by entities other than PBEs be different from the amount of time needed by PBEs? Should early adoption be permitted? Please explain your response.

We believe that entities would be ready to implement the proposed amendments as soon as preparers could produce the necessary information to comply with them and establish relevant internal controls over any new processes. Therefore, we defer to the views of financial statement preparers, in particular those at entities other than PBEs. We also believe that early adoption should be permitted when determining whether a profits interest or similar award is within the scope of ASC 718.