

September 1, 2020

FASB PROPOSES ACCOUNTING STANDARDS UPDATE SIMPLIFYING THE VALUATION OF STOCK OPTIONS FOR NONPUBLIC COMPANIES

The Financial Accounting Standards Board (FASB) on August 17, 2020 released a proposed Accounting Standards Update (ASU) that would simplify the valuation of equity-classified stock options and stock-settled stock appreciation rights (SARs) for nonpublic companies by allowing them to use the safe harbor valuation methods prescribed in Internal Revenue Code (IRC) Section 409A to determine the stock price at the date of grant, which is one of the inputs for an option pricing model. Once effective, the proposed ASU would be applied prospectively on an award-by-award basis to equity-classified stock options or stock-settled SARs granted to or modified for employees and nonemployees. The proposed ASU is subject to a comment period that ends on October 1, 2020, after which time the FASB will determine an effective date.

The proposed ASU would establish a “practical expedient” that would allow nonpublic companies to use any of the following three valuation safe harbors described in regulations under IRC Section 409A to determine the stock price at the date of grant, which is an input for an option pricing model:

- A valuation determined by an independent appraisal within the 12 months preceding the grant date
- A valuation based on a formula that, if used as part of a non-lapse restriction with respect to the shares, would be considered the fair market value of the shares
- A valuation made reasonably and in good faith that is evidenced by a written report that considers the relevant factors with respect to the illiquid stock of a start-up corporation, as defined in the regulations

A practical expedient is defined by the FASB as a more cost-effective way of achieving the same or a similar accounting or reporting objective. The FASB believes an independent appraisal will be the valuation technique most often used by nonpublic companies.

The proposed ASU is in response to concerns expressed by the Private Company Council (PCC) about the cost and complexity of determining the fair value of the stock price at grant, which is typically the most difficult input for nonpublic companies to estimate and substantiate due to the lack of observable market prices. The

proposed practical expedient would complement existing practical expedients extended to nonpublic companies for estimating expected term and expected stock price volatility.

Interestingly, the proposed ASU applies only to equity-classified stock options and stock-settled SARs granted to or modified for employees and nonemployees. It does not apply to liability-classified awards such as cash-settled SARs, or to other equity-classified awards such as restricted stock or performance shares. With respect to the latter, the FASB has requested comments as to whether the practical expedient in the proposed ASU should be extended to other equity-classified awards.

General questions about this summary can be addressed to Thomas M. Haines in our Chicago office at 312-332-0910 or by email at thomas.haines@fwcook.com. Specific questions should be referred to the company's professional accountants. Copies of this summary and other published materials are available on our website at www.fwcook.com. A complete summary of Topic 718 can be found [here](#).