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

File Reference No. 2023-ED300

Dear Ms. Salo:

RSM US LLP is pleased to provide feedback on the Financial Accounting Standards Board's (FASB or Board) proposed Accounting Standards Update (ASU), *Compensation—Stock Compensation (Topic 718): Scope Application of Profits Interest Awards* (proposed Update or proposal).

We support the Board's proposal that would add illustrative examples to Topic 718 to provide clarity on when the guidance in Topic 718 should be applied to profits interest or similar awards. We believe the proposed illustrative examples would help reduce the existing diversity in practice in determining whether a profits interest or similar award should be accounted for as a share-based payment arrangement (Topic 718) or similar to a cash bonus or profit-sharing arrangement (Topic 710, *Compensation – General*, or other Topics). However, as explained in more detail below, we encourage the Board to consider a future project to further enhance and address other aspects of the accounting for these type of awards, including clarification of recognition and measurement issues when equity-classified profits interest awards have a predetermined participation or distribution threshold. We believe a project that addresses and illustrates application of Topic 718's initial and subsequent measurement requirements to the types of awards described in our letter would benefit stakeholders and help reduce diversity in practice.

Our responses to the questions posed in the proposed Update are included in the remainder of this letter.

Responses to 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.

We agree that the proposed Update should apply to all reporting entities. While the issuance of profits interest awards may be more prevalent among private companies, as the Board noted, some public business entities (PBEs) have also issued these types of awards. As a result, we believe the application of the proposed guidance should be similar between PBEs and entities other than PBEs.

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 the illustrative example included in paragraphs 718-10-55-138 through 55-148 of the proposed Update is clear and operable. Case A and Case B present common scenarios we see in practice that we agree should be accounted for as share-based payment arrangements under Topic 718. We believe Cases C and D clearly demonstrate features (e.g., distributions upon an exit event based on an operating metric versus equity value of the entity) of certain profits interest awards that are more characteristic of bonus or profit-sharing arrangements that we agree are outside the scope of Topic 718.

Paragraph 718-10-15-3B of the proposed Update states that the proposed guidance would also apply to instruments that are similar to profits interest awards such as a share appreciation right or a phantom unit. As noted in paragraph BC6, these awards are often granted to employees located outside the United States. We believe it would be helpful to stakeholders if any final ASU issued by the Board included an example illustrating application of the proposed guidance to at least one of these other types of awards. Additionally, because a profit interest unit is not a defined term in US GAAP, we believe incorporating the common terms and characteristics of these awards (as detailed in paragraph BC5) in a final ASU would assist entities in determining the scope of similar awards to which the proposed guidance would apply.

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?

We agree with the proposed transition provisions that would allow entities the ability to either apply the proposed amendments retrospectively or prospectively. Although retrospective application would improve the comparability of information for each of the periods presented, the cost of applying that transition method can be costly and outweigh the benefits, particularly for entities other than PBEs, which are expected to be most impacted by the proposed Update.

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 generally defer to the preparers of financial statements regarding the time needed to implement the proposed Update, which would be a function of the number and different types of awards entities have issued that would be subject to the guidance in the proposed Update and the volume of other accounting standards updates that are applicable and currently being implemented by entities. Because entities other than PBEs often do not have the same level of resources and processes as PBEs, we believe they should be provided an additional year to adopt the proposed Update. We also believe early adoption should be permitted for all entities because we see no significant detriments by allowing entities to do so.

Other matters for the Board's consideration

We encourage the Board to consider a future project to further enhance and address other aspects of the accounting for profits interest and similar awards, including clarification of recognition and measurement issues when equity-classified awards have a predetermined participation or distribution threshold. Specifically, we believe the Board could help reduce diversity in practice if it provided examples addressing the timing and recognition of compensation cost for profits interest or similar awards subject to Topic 718 in the following scenarios:

- *Scenario One* - When an equity-classified profits interest or similar award has (1) a predetermined participation or distribution threshold equal to or greater than the fair value of the entity at the time of grant, (2) provides for vesting based on service and (3) allows the grantee to retain the award, subject to a fair value call, upon termination of service.
- *Scenario Two* - When an equity-classified profits interest or similar award has (1) a predetermined participation or distribution threshold equal to or greater than the fair value of the entity at the time of grant and (2) vests only upon the obtainment of certain specified cash returns to other investors while the grantee is providing services.

In addressing the recognition requirements of a profits interest or similar awards with a predetermined participation or distribution threshold, we recommend the Board consider and incorporate the following factors into the application guidance and illustrative examples:

a. Whether the return to investors is based on actual cash distributions (versus a hypothetical value calculation),
b. Whether there is a limited time for the specified investor return to be achieved (i.e., the awards have an expiration date or cannot be retained upon termination of service if the market condition has not been met), and
c. Whether the entity can demonstrate it is unlikely or impossible for such returns to be achieved without a liquidity event occurring.

The guidance in Topic 718 that requires a fair-value-based measurement method in accounting for share-based payment transactions, including the implementation guidance regarding the application of established principles of financial economic theory in estimating fair value, indicate that profits interest and similar awards should generally be valued considering the upside potential and not the immediate liquidity value of the awards. However, we have observed in practice that some entities inappropriately estimate the grant date fair value of these awards to be zero when the awards lack a current liquidity or intrinsic value at the date of grant. To clarify the measurement requirements of Topic 718, we encourage the Board to provide implementation guidance that illustrates how to apply the fair-value-based measurement principles of the standard to these type of awards.

We appreciate this opportunity to provide feedback on the proposed Update and would be pleased to respond to any questions the Board or its staff may have concerning our comments. Please direct any questions to Ginger Buechler at 612.455.9411 or Joseph Cascio at 212.372.1139.

Sincerely,

RSM US LLP

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