Kevane Grant Thornton

Audit

Expedient

Entities

ASU 2021-07 offers private company practical expedient

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The amendments in ASU 2021-07 offer nonpublic entities a practical expedient to use when determining the "current price input" of an equity-classified sharebased payment award issued to employees and nonemployees. The current price input is used when calculating the award's fair value.

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Background

Equity-classified share-based payment awards, such as share options, are initially measured at the grant-date fair value and typically are not subsequently remeasured. The most common valuation technique used by nonpublic entities to estimate the grant-date fair value of share options is the Black-Scholes-Merton model. This option-pricing model requires various inputs, including the fair value of the equity shares underlying the option, which is called the current price input. If an observable market price for the current price input is not available, which is usually the case with nonpublic entities, the fair value of the share underlying the award is estimated.

Private company stakeholders told the FASB's Private Company Council that private company equity shares are usually not actively traded and therefore lack an observable market price. As a result, the current price input is typically complex and costly to estimate.

Unit of account and disclosure

The practical expedient in ASU 2021-07 allows a nonpublic entity to determine the current price input of a share option using the "reasonable application of a reasonable valuation method," which is determined as of the award's measurement date, taking into consideration the following factors:

1. the value of the nonpublic entity's tangible and intangible assets
2. the present value of the entity's anticipated future cash flows
3. the market value of stock or equity interests in similar entities engaged in substantially similar trades or businesses
4. recent arm's-length transactions involving the sale or transfer of the entity's stock or equity interests

5. other relevant factors, such as control premiums or discounts for lack of marketability
6. the entity's consistent use of a particular valuation method to determine the value of stock or assets for other purposes

Finally, the amendments state that the "reasonable application of a reasonable valuation method" cannot utilize a value calculated more than 12 months earlier than the measurement date, and that the value utilized must be updated for all subsequent information material to the value of the entity.

The amendments specifically acknowledge that a valuation performed in accordance with Treasury Regulation §1.409A-1(b)(5)(iv)(B) would comprise the "reasonable application of a reasonable valuation method.

Grant Thornton insight

It is important to keep in mind that the practical expedient does not change the fair-value measurement objective for the current price input of the option pricing model, nor does it affect existing audit requirements around management's judgments and estimates.

Unit of account and disclosure

The practical expedient may be elected on a measurement date–by–measurement date basis, meaning a nonpublic entity must apply the amendments to all share-based payment awards with the same underlying share and the same measurement date. Nonpublic entities must also disclose their use of the practical expedient.

Effective date and transition

Entities may early apply the practical expedient, including in an interim period, for any financial statements that have not yet been issued or made available for issuance as of October 25, 2021, which is the date when the ASU was issued.

Otherwise, the practical expedient may be applied prospectively for all equity-classified awards granted or modified during fiscal years beginning after December 15, 2021 and during interim periods within fiscal years beginning after December 15, 2022.

Source: *Grant Thornton Insight October 28, 2021*

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