



AICPA releases draft chapters of updated “cheap stock” guide

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At a glance

The AICPA released a working draft of two revised chapters of the Valuation of Privately-Held Company Equity Securities Issued as Compensation Guide. This non-authoritative guidance provides both accounting and valuation considerations relevant to stock-based compensation awards granted by privately-held entities when there are secondary market transactions in their shares.

What happened?

On June 23, the Financial Reporting Executive Committee (FinREC) of the AICPA released for public comment a [working draft](#) of two updated chapters (Chapter 8 and Chapter 9) from the AICPA *Valuation of Privately-Held Company Equity Securities Issued as Compensation Guide* (the Guide), which is sometimes referred to as the “Cheap Stock Guide.” The Guide provides non-authoritative interpretive guidance and illustrations related to the accounting for, valuation of, and disclosures related to privately-held company equity securities issued as compensation.

There has been significant growth in the breadth and volume of secondary market transactions (i.e., third parties buying and selling common stock of the company directly from each other) since the prior update of the Guide in 2013. The AICPA working draft addresses the evolution of these transactions and their impact on privately-held company stock valuations and accounting. The updated guidance aims to better articulate the principles of ASC 820, *Fair Value Measurement*, and ASC 718, *Compensation—Stock Compensation*.

The proposed update to Chapter 8, *Inferring Value from Transactions in a Private Company’s Securities*, addresses valuation considerations when there have been secondary market transactions. The updated chapter provides a framework for calibrating a company’s estimated valuation of its equity securities underlying awards of stock-based compensation to marketplace transactions in the company’s securities. The revisions more clearly describe the fair value principles under ASC 820, which prioritizes the use of observable transaction prices, including considerations regarding the unit of account, the principal market, market participants, other elements to the transactions, calibration, adjustments for timing differences, adjustments for company developments, and how to weigh various factors in assessing the relevance of the secondary market transaction prices. In most cases, privately-held company valuations will need to consider the value indicated by the transaction prices in the secondary market and place a significant degree of weight on those transactions.

The proposed update to Chapter 9, *Selected Accounting and Disclosure Matters* (previously Chapter 14), focuses on the accounting for share-based payments when employees or other service providers participate in secondary market transactions or repurchases made by the company. The draft chapter:

- Clarifies that the guidance in ASC 718 applies equally to purchases of (1) equity awards (such as stock options) and (2) equity securities obtained by the award holders upon the settlement of the awards, and therefore, the purchase of equity securities from an employee or other service provider could be within the scope of ASC 718 even if the company is not the purchasing party,
- Reiterates that an entity will need to analyze all purchases from grantees (including those made by related parties or economic interest holders) to determine if there is a compensatory element, and
- Includes a new illustrative example of the framework and disclosures for stock-based compensation awards for potential SEC registrants.

While we believe the updated guidance is broadly consistent with existing best practice in accounting and valuation assessments in the context of privately-held company equity securities, it is possible that the updated guidance may be viewed as a change in practice for some entities and could have implications for financial reporting valuations of privately-held company common stock underlying stock-based compensation awards.

What's next?

Comments on the draft chapters are due by September 20, 2024, and we expect the chapters to be finalized in 2025. Although the updated chapters may not be finalized until 2025, the content of the Guide is interpretive guidance relative to existing authoritative literature and will not have a definitive effective date. Therefore, we believe impacted companies should consider the guidance in the draft chapters for any future valuations and secondary market transactions.

Other chapters of the Guide are expected to be updated, although no timeline has been established.

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