

Equity Compensation Valuation

IRC 409A, ASC 718 and IFRS 2

COMPLEXITY REQUIRES EXPERIENCE

Equity, option, and derivative valuations depend on a number of variables. *How was the price of the underlying enterprise determined? How will pricing and value be determined going forward?* These analyses often require complex formulas and key data/assumptions which unfortunately can lead to controversy or dispute.

Other questions to ask include:

- Is your board or tax advisor concerned that the IRS would interpret the data differently and derive a different value for the options?
- Did an independent third-party expert determine the fair value (as required by FASB ASC 718 and IFRS 2) and fair market value (as required by IRC 409A) of the common equity or was a "market price" or "recent" transaction price used?
- Was the value determined using a Black Scholes option pricing model or a binomial lattice model? How were the inputs derived for the model?
- When valuing common equity, have you properly considered the rights and restrictions of the securities senior to the common, such as the preferred equity tranches and debt?
- How can your company benefit from an analysis performed for compliance purposes?

One must keep in mind that the IRS has increased the penalty for reliance on a faulty valuation analysis. The person and firm that provides an analysis that plays a material role in a tax filing, personal or corporate, is considered an unsigned tax preparer. If the IRS determines the work relied upon by the filer was not performed properly, the person and firm can be cited and charged. Remember, the IRS has hindsight on its side if it decides to audit your reports.

MANAGING A SHARE-BASED COMPENSATION STRATEGY

FASB ASC 718 and IFS 2 establish standards for the accounting of share-based compensation and transaction strategies. Whether you are starting to develop and integrate a share-based strategy into your company's plan or have an existing strategy, a defensible, well-contemplated valuation is essential for the proper outcome and execution.