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Technical Director
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Proposed Accounting Standards Update: Compensation—Stock Compensation (Topic 718)

Improvements to Nonemployee Share-Based Payment Accounting

The Accounting Principles and Assurance Services Committee (the “Committee”) of the California Society of Certified Public Accountants (“CalCPA”) respectfully submits its comments on the referenced proposal. The California Society of CPA’s (“CalCPA”) Accounting Principles and Assurance Services Committee (the “Committee”) is the senior technical committee of CalCPA. CalCPA has approximately 43,500 members. The Committee consists of 55 members, of whom 45 percent are from local or regional firms, 32 percent are from large multi-office CPA firms, 12 percent are sole practitioners in public practice, 6 percent are in academia and 5 percent are in international firms. Members of the Committee are with CPA firms serving a large number of public and nonpublic business entities, as well as many non-business entities such as not-for-profits, pension plans and governmental organizations.

The Committee commends the Board for its proposed simplification of the accounting for nonemployee share based payments. It would not only achieve simplification, but remove a conceptual distinction without a substantive difference between employee and nonemployee awards. We have only one significant objection to the proposal, and it is explained in our responses to Question 4. We believe the difference in the proposed accounting for share based payments to employees and nonemployees is neither necessary nor appropriate and detracts from what is otherwise a very good simplification of accounting for nonemployee awards.

Question 1: Do you agree that the amendments in this proposed Update would result in a reduction (or potential reduction) of cost and complexity while maintaining or improving the usefulness of information provided to users of financial statements? If not, why?

The Committee agrees that the proposed amendments will reduce cost and complexity without compromising in any way the usefulness of information provided to users of financial statements.

Question 2: Should entities be required to measure nonemployee share-based payment transactions by estimating the fair value of the equity instruments they are obligated to issue? If not, why should there be a difference in the measurement objective for employee awards and nonemployee awards, and are there other alternatives that are more appropriate?

The Committee believes that measurement principles for share-based payment transactions should be the same for nonemployees as they are for employees, and accordingly fair value for awards to both groups should be measured the same way.
**Question 3:** Should the measurement date for equity-classified nonemployee awards be the grant date? If not, why should there be a difference in the measurement date for employee and nonemployee share-based payment awards, and what other alternatives are more appropriate?

The Committee believes that measurement principles for share-based payment transactions should be the same for nonemployees as they are for employees, and accordingly the grant date should be used in measuring awards to both groups.

**Question 4:** Should entities be required to use the contractual term of share options and similar instruments issued to nonemployees as an input to the measurement of those share-based payment awards? If not, what other alternatives are more appropriate?

The Committee believes that use of the contractual term for share options and similar instruments issued to nonemployees is inconsistent with the simplification objective of the proposed amendments because it would create a difference in the measurement of employee and nonemployee awards. It is not unusual for the contractual term of share options to be longer than the requisite service period, whether granted to an employee or nonemployee, and the Committee sees no merit in accounting for the same transactions differently. The Committee therefore, favors using the same input to the measurement of share-based payment awards to employees and nonemployees.

In today’s business environment, entities are increasing their use of nonemployee contractors for services historically performed by employees. Compensation practices, including stock compensation, often mirror those for employees. We believe the accounting for them should be the same.

The Board’s basis for its conclusion to use the contractual term was based to a substantial degree on the potential transferability of share options and similar awards for nonemployees. We fail to see why this should make a difference in the accounting. However, if it should, we point out that those awards often do have the same transferability restrictions as awards to employees, and some render the transferability issue moot by having forfeiture restrictions on the termination of service similar to those usually found in awards to employees. At a minimum, these should be accounted for in the same manner as awards to employees. But, since the transferability restrictions are not the same for all nonemployee awards, and some are similar to those in awards to employees, is any useful purpose served by treating any of these awards differently from employee awards? We do not think so.

**Question 5:** Should nonemployee share-based payment awards containing performance conditions consider the probability that the performance condition will be met in determining the appropriate period(s) of recognition? If not, why should there be a difference in the accounting for employee and nonemployee share-based payment awards with performance conditions, and what other alternatives are more appropriate?

The Committee believes that measurement principles for share-based payment transactions should be the same for nonemployees as they are for employees, and accordingly consideration of performance conditions should be the same for both groups.
**Question 6:** Is the application of the classification guidance in Topic 718 to nonemployee share-based payment awards that have vested and for which the nonemployee is no longer providing goods or services appropriate? If not, why should there be a difference in the postvesting classification assessment for employee and nonemployee share-based payment awards?

The Committee believes that measurement principles for share-based payment transactions should be the same for nonemployees as they are for employees, and accordingly there should be no difference in the post vesting classification assessment for employee and nonemployee share-based payment awards.

**Question 7:** Is the application of forfeiture guidance in Topic 718 to nonemployee share-based payment awards appropriate? If not, why should there be a difference in accounting for forfeitures for employee and nonemployee share-based payment awards?

The Committee believes that measurement principles for share-based payment transactions should be the same for nonemployees as they are for employees, and accordingly there should be no difference in the forfeiture guidance for employee and nonemployee share-based payment awards.

**Question 8:** Is the practical expedient for nonpublic entities to substitute calculated values for expected volatilities when measuring share options and similar instruments issued to nonemployees appropriate? If not, why should there be a difference in the application of practical expedients for employee and nonemployee share-based payment awards?

The Committee believes that measurement principles for share-based payment transactions should be the same for nonemployees as they are for employees, and accordingly the practical expedient should be the same for employee and nonemployee share-based payment awards.

**Question 9:** Should nonpublic entities be allowed to make a one-time election to switch from measuring liability-classified nonemployee share-based payment awards at fair value to intrinsic value? If not, why should there be a difference in accounting policy elections for employee and nonemployee share-based payment awards?

The Committee believes that nonpublic entities be allowed to make a one-time election to switch from measuring liability-classified nonemployee share-based payment awards at fair value to intrinsic value. There should be no difference in accounting policy elections for employee and nonemployee share-based payment awards.

**Question 10:** Are the transition requirements for the proposed amendments appropriate? If not, what transition approach is more appropriate?

The Committee believes that the transition requirements are appropriate and are consistent with the simplification objectives of the proposed amendments. However, there is one exception to this; please see our response to Question 11.
**Question 11:** Should the Board require an entity to adjust the basis of an asset that includes share-based payment costs when applying the transition requirements? If not, what transition approach is more appropriate?

The Committee believes it would be reasonable to allow entities a choice as to whether or not to adjust the basis of an asset that includes share-based payment costs when applying the transition requirements. We recommend that the Board amend the proposal to permit this. The calculations can be difficult, particularly if involves inventory which may or may not still be on hand or long-lived fixed assets, and requiring entities to do those calculations is counter to the simplification objective of the proposed amendments.

**Question 12:** Should the Board require separate disclosures for nonemployee share-based payment transactions?

The Committee believes that disclosure provisions in current GAAP are adequate and that the Board should not require separate disclosure for nonemployee share-based payment transactions.

**Question 13:** How much time will be necessary to adopt the proposed amendments? Should the amount of time needed to apply the proposed amendments by entities other than public entities be different from the amount of time needed by public entities?

The Committee believes that the time to transition to the proposed amendments would not be substantial, particularly if our recommendation in Question 11 is adopted. The amount of time should not vary substantially for public entities and entities other than public entities. After transition, the proposed standards will generally provide time-savings for entities making share based awards to nonemployees.

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We thank you for the opportunity to comment on this matter. We would be glad to discuss our opinions with you further should you have any question or require additional information.

Sincerely,

Matthew J. Lombardi
Chair
Accounting Principles and Assurance Services Committee
California Society of Certified Public Accountants