Ms. Susan M. Cosper  
Technical Director  
File Reference No. 2017-220  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116  

1 June 2017

Re: Proposed Accounting Standards Update, Compensation – Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting (File Reference No. 2017-220)

Dear Ms. Cosper:

We appreciate the opportunity to comment on the proposed Accounting Standards Update (ASU) issued by the Financial Accounting Standards Board (FASB or Board).

We support the FASB's objective to reduce the cost and complexity of accounting for nonemployee awards by aligning it with the accounting for employee share-based payments under Accounting Standards Codification (ASC or Codification) 718. We believe this proposal would contribute to that objective. However, to further reduce the cost and complexity of accounting for nonemployee awards, we recommend that the Board broaden the definition of an employee under ASC 718 to include (1) individuals who render services similar to those rendered by employees and are under the direct supervision of the grantor and (2) individuals who are employees of a reporting entity within a common control group.

We also have concerns about the proposed transition approach for Issue 1, which would require entities to use the grant date fair value calculated using ASC 718 to determine the cumulative-effect adjustment to retained earnings. This may create undue cost and complexity for an entity that may not have collected the requisite inputs to calculate an award's fair value as of the grant date using ASC 718. For this reason, we recommend that the FASB consider providing a transition practical expedient that would allow an entity to use the fair value as of the adoption date (rather than the grant date) using the same measurement that it used for the awards under ASC 505-50.

We agree with the proposal to allow entities to use the contractual term when valuing nonemployee awards. However, we believe that in some instances, as further discussed in Appendix A, the expected term may be a more appropriate input and should be permitted.

Appendix A of this letter contains our responses to selected questions in the proposal. In Appendix B, we provide additional feedback on other significant aspects of the proposal.

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We would be pleased to discuss our comments with the Board or its staff at your convenience.

Very truly yours,

Ernst & Young LLP
Appendix A — Responses to questions in the proposed ASU

We aren’t responding to Questions 2, 3, 5, 6, 7, 8 and 9 because we agree with the proposed guidance and the Board’s reasoning, as outlined in the Background Information and Basis for Conclusions. We have no further comments on those questions.

**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?

We agree that the proposed Update would reduce cost and complexity. However, to further reduce the cost and complexity of accounting for nonemployee awards, we recommend that the Board change the definition of an employee under ASC 718 in two ways.

First, we believe that the definition of an employee also should include individuals (e.g., independent contractors) who render services similar to those rendered by employees and are under the direct supervision of the grantor. We note that these individuals would meet the current definition of an employee in ASC 718 except for the requirement that they also meet the definition under the tax law. We understand that the Board considered and rejected aligning the definition of an employee with the definition in IFRS 2 Share-based Payment. However, we believe an amended definition would meet the Board’s objective by further simplifying the application of ASC 718 to an entity’s accounting for grants to these service providers.

Second, we believe the lack of guidance for awards to employees within a common control group causes undue complexity that should be eliminated. Specifically, we believe a grant to an employee of the reporting entity that is based on shares of any of the entities under common control with the reporting entity should be accounted for as an employee share-based payment arrangement in the reporting entity’s separate financial statements. Similarly, we believe that such grants also should be measured following ASC 718 in the separate financial statements of the subsidiary upon whose shares the awards are based.

For example, consider a common control group that consists of Parent, Subsidiary A and Subsidiary B. Parent directs Subsidiary A to issue options in Subsidiary A shares to employees of Subsidiary B. Under current practice, Subsidiary A measures these options at fair value under the guidance in ASC 820 in its separate financial statements, while Subsidiary B measures them at fair value under the guidance in either ASC 505-50 or ASC 815 in its separate financial statements. We believe both entities should measure those awards at fair value under ASC 718 in their separate financial statements. This would simplify the accounting for awards given to employees of a common control group in the separate financial statements of all entities involved because it would align the measurement of the awards in the separate subsidiary financial statements with the measurement of compensation cost in the consolidated financial statements.
**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?

In our experience, some entities issue awards to nonemployees that can’t be transferred (i.e., they are similar to employee awards). Therefore, we believe that entities that grant nonemployee share-based payments that contain restrictions that affect their fair value (e.g., the award can’t be transferred) should be required to use the expected term as an input for measuring the awards. If these entities are required to use the contractual term for these awards, the value of the awards (and the related costs) would be higher than the amount that would have been recorded for comparable employee awards.

Entities that do not have historical data to estimate an expected term should use the midpoint between the vesting date and the end of the contractual term as allowed by Securities and Exchange Commission Staff Accounting Bulletin Topic 14 or the practical expedient under ASU 2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*.

Entities that grant share-based payment awards without restrictions that reduce the awards’ value should be required to use the contractual term. The evaluation of whether the expected or contractual term is the appropriate input would be made award by award.

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

We are concerned that the proposed transition requirements are not clear and may add to the cost and complexity of adoption.

**Issue 1: Expanding the scope of Topic 718 to include share-based payment awards to nonemployees**

We believe the proposed transition requirements in ASC 718-10-65-11 should apply only to awards for which services have not been rendered or goods have not been delivered as of the adoption date. The proposed amendments and Basis for Conclusions state that “outstanding,” “unsettled” or “not settled” awards would be transitioned to the proposed guidance. In the proposed guidance, the terms appear to refer to nonemployee awards that have vested but have not been exercised. We believe this would be onerous and would not provide any substantial benefit to users of the financial statements.

We also believe that requiring entities to use the ASC 718 grant date fair value of an award in transition may be costly and inconsistent with the objectives of this proposal. The proposed transition provisions in ASC 718-10-65-11 would require an entity to use the ASC 718 grant date fair value when calculating the cumulative-effect adjustment to retained earnings. We believe this could be onerous because an entity may not have collected the requisite inputs to calculate the grant date fair value. In practice, the initial valuation is often performed at the end of the first reporting period after the grant date due to the requirement under ASC 505-50 to measure an award’s value at the date the related service is rendered or goods are delivered.
Because of these potential complexities, we recommend that the Board provide a practical expedient that would permit a modified retrospective adoption in ASC 718-10-65-11(b) as follows:

An entity shall apply the pending content that links to this paragraph on a modified retrospective basis for awards that are unvested as of the adoption date. An entity shall use the fair value estimate as of the adoption date that is used when applying the guidance in Subtopic 505-50 as the deemed grant date fair value for such unvested awards.

An entity shall apply the pending content that links to this paragraph on a prospective basis for awards that are issued or modified on or after the effective date.

**Issue 2: Aligning postvesting classification requirements**

We recommend that the Board specify in any final guidance on retrospective adoption the date that modification accounting should be applied. The proposed transition provisions in ASC 718-10-65-12(b) state that if nonemployee equity awards were reclassified as liabilities when performance was completed, the guidance on the modification of an award from liability classification to equity classification would apply. Further, an entity's valuation under ASC 505-50 may have been performed using the measurement guidance in ASC 820, which would require remeasurement of the award under ASC 718 using modification accounting.

Therefore, we recommend that the Board require a modified retrospective adoption and revise proposed paragraph ASC 718-10-65-12(b) to:

An entity shall apply the pending content that links to this paragraph on a modified retrospective basis through a cumulative-effect adjustment to retained earnings as of the beginning of the annual period in which the pending content that links to this paragraph is adopted. Upon adoption, an entity shall reevaluate the classification of nonemployee awards initially classified as liability as of the adoption date. If a liability-classified award would have remained equity classified because of the application of the pending content that links to this paragraph, the guidance on the modification of an award from liability classification to equity classification in paragraphs 718-20-55-135 through 55-138 shall be applied as of the adoption date. Those equity awards should be measured using fair value under Topic 718. For purposes of applying modification accounting at the date of adoption, an entity may elect a practical expedient to use the fair value that it used when applying the guidance in Topic 815.

We believe this transition method would reduce the cost and complexity of adopting the proposed guidance and would better meet the objectives of the simplification initiative for Issue 2.

We also recommend that the Board clarify what is intended by the term “unsettled” awards in the proposed guidance so it is clear which awards would need to be transitioned.
**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?

We do not believe entities should have to adjust the basis of an asset that includes capitalized compensation cost when applying the transition requirements because doing so would be difficult and would increase the cost and complexity of adoption.

For example, compensation cost that was capitalized initially may have been subsequently recognized in the income statement (e.g., capitalized into inventory and then sold, capitalized into an asset and depreciated or impaired) prior to the adoption date, which could make transitioning awards to their grant date fair value more complex. If the compensation cost was not recognized in the income statement as of the adoption date, revising this cost may change impairment or alter “lower of cost or market” assessments that were done (or would now need to be done), both of which might require the use of hindsight. In addition, retaining the current basis of assets upon transition would be consistent with the transition approach in ASU 2017-07, Compensation – Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.

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

We believe financial statement users are in the best position to comment on whether separate disclosures for nonemployee share-based payment transactions should be required. However, we believe the proposed changes to the disclosure requirement in ASC 718-10-50-2(g) are sufficient, as they would require separate disclosure “to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity’s use of share-based compensation.”

**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?

We believe preparers are in the best position to comment on the time necessary to adopt the proposed amendments. However, as discussed in our responses to Questions 10 and 11, we believe the Board should consider our proposal on the transition provisions when determining the effective dates of the standard. If the Board revises the modified retrospective transition methods as we recommend in our response to Question 10, adoption would be less complex, and the Board could consider this when setting the effective date.

Also, if early adoption is permitted and entities can adopt the proposed amendments before they adopt ASC 606, the proposal should address how to account for awards issued in accordance with ASC 605 because transactions involving equity instruments granted in conjunction with selling goods or services to customers as part of a contract are not included in the scope of ASC 718. We also do not believe that the adoption of the proposed amendments should be linked to the adoption of ASC 606 because the standards are unrelated.
Appendix B — Other comments about the proposal

Scope of ASC 718

We recommend amending the definitions of “share-based payment arrangement” and “share-based payment transactions” in the Master Glossary to state that these terms apply to awards issued to purchase goods or services used or consumed in the entity’s own operations. While the proposed amendments to ASC 718-10-15-3 and 15-4 clarify that ASC 718 applies only to awards issued in exchange for “goods or services used or consumed in a grantor’s own operations,” this language is not consistently used throughout the proposed guidance.

We also recommend bolding the terms “share-based payment arrangement” and “share-based payment transaction” in other topics and linking to the Master Glossary definitions. This will make it clear that the referenced awards are within the scope of ASC 718. This change would alleviate any potential gaps in scope for other references in the Codification to share-based payment arrangements and share-based payment transactions that don’t explicitly state that the purchased goods or services must be used or consumed in the entity’s own operations. For example, ASC 323-10-25-3 through 25-6 and ASC 505-10-25-3 do not refer explicitly to awards that are in the scope of ASC 718, link to the Master Glossary, or require that the grant must be for goods or services used or consumed in the investee’s own operations. Further, these paragraphs still refer only to grants to an investee’s employees; nonemployees are not mentioned. We had similar observations about other parts of the Codification.

We believe there is currently diversity in practice in accounting for transactions in which an entity issues equity to one party that invests cash and another party that contributes an asset, and each investment is contingent on the other. The proposed amendments to ASC 718-10-15-5(b) state that transactions involving equity instruments granted to a lender or an investor that provides financing to the issuer are outside the scope of ASC 718. We recommend that the Board expand this guidance to state that transactions in which an entity issues equity in exchange for both assets and funds should be evaluated using the criteria in ASC 810-10-40-6 to determine whether they should be considered a single financing transaction that is outside the scope of ASC 718.

We also recommend that the Board clarify whether transactions involving equity instruments granted in exchange for selling goods that are in the scope of ASC 610-20 would be outside the scope of ASC 718. The proposed amendments to ASC 718-10-15-5(c) state that transactions involving equity instruments an entity grants in exchange for selling goods or services to its customers are within the scope of the guidance in ASC 606 on consideration payable to a customer. However, when an entity grants equity instruments to a counterparty that is not a customer in exchange for nonfinancial assets, the transaction is in the scope of ASC 610-20.

Other comments on ASC 718:

We recommend that the proposed amendments to ASC 718-20-35-1 and 718-30-35-2 not be included in any final guidance. They appear, in certain instances, to provide cost attribution guidance for nonemployee awards that is not in line with the intent of the proposed Update for nonemployee awards.
We also recommend the Board clarify the application of the proposed amendments to ASC 718-20-35-7. We do not believe that companies should be required to recognize compensation cost for the cancellation of awards, as would be required by the proposed amendments to ASC 718-20-35-7, if the promised good or service has not delivered (e.g., due to inadequate quality or timeliness of goods or services).

Lastly, ASC 718-10-35-14 has been amended to include nonemployees when an entity modifies or settles a fully vested, freestanding financial instrument after it becomes subject to other applicable US GAAP, by replacing the term “employee” with “grantee.” However, together with the proposed amendments, it now refers to current or former grantees. We believe the reference to “current or former” should be deleted because once a party receives a grant, it becomes a grantee and cannot become a former grantee.

Consequential amendments:

We believe the proposed amendment to ASC 260-10-45-29(b) for entities applying the treasury stock method to include the amount of unrecognized compensation cost for “future delivery of goods, or satisfaction of other conditions” in the assumed proceeds calculation would be a significant change in practice, and we recommend that the Board not include this amendment in the final guidance. The proposed amendment would contradict the guidance in ASC 260-10-45-32, which excludes issuances of performance-based stock options (and performance-based nonvested stock) from the computation of diluted earnings per share and the assumed proceeds calculation. That is, because the issuance of nonemployee awards is contingent upon delivery of goods or services (i.e., a condition other than time), the proposed guidance is not clear as to whether these awards would be included or excluded from the assumed proceeds calculation. Therefore, we recommend that the Board not include this provision in any final guidance. If the Board moves ahead with the amendment to ASC 260-10-45-29(b), conforming edits should be made to ASC 260-10-45-32, and we believe the Board should explain the reason for this change in the Basis for Conclusions.

We recommend that the Board amend ASC 323-10-25-3, 323-10-25-4 and 505-10-25-3, which refer to grants to employees of an equity method investee, to discuss the application of this guidance to nonemployee awards. Based on the proposed amendments to ASC 323-10-55-19, we believe the Board intended for this guidance to apply also to an investor’s grants of share-based payments to nonemployees that provide goods or services to be used in the investee’s own operations.

The guidance in ASC 470-20-30-26 discusses the accounting for arrangements that include a beneficial conversion option. This may be the case when an entity issues a convertible instrument in exchange for cash proceeds and, in a separate contract, the entity provides or receives goods or services from the same counterparty. Based on our discussions with the staff, we understand that the FASB proposed superseding this paragraph because ASC 606 would provide guidance on how to allocate elements of a contract between the equity/cash transaction and the good/services transaction when the issuer is providing the goods. However, when the issuer is receiving goods or services from another entity, there is no other guidance that describes whether (or how) to combine the issuance of equity for cash (when a beneficial conversion is indicated) with the receipt of goods. That is, ASC 606 only applies to fact patterns in which the issuer is selling goods or services to a customer; it does not apply when the entity is receiving goods or services. We recommend that the FASB keep this guidance and amend it to only apply to fact patterns in which the issuer is receiving goods or services.
Given that the cost attribution guidance is the primary difference between nonemployee and employee awards under the proposal, we believe that proposed amendments to Example 2 in ASC 805-30-55-17 should be revised to be consistent with the proposed examples in ASC 718. We believe the paragraph should only contemplate awards issued to employees and should state that “[T]he principles on accounting for employee awards, except for compensation cost attribution and certain inputs to valuation, are the same for nonemployee awards. Therefore, the guidance in these Cases may serve as implementation guidance for nonemployee awards, but the attribution to pre- and post-combination vesting likely would be different.”