June 5, 2017

Ms. Susan M. Cosper
Technical Director
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

File Reference No. 2017-220
Re: Proposed Accounting Standards Update, Improvements to Nonemployee Share-Based Payment Accounting

Dear Ms. Cosper:

Deloitte & Touche LLP is pleased to comment on the FASB’s proposed Accounting Standards Update (ASU) Improvements to Nonemployee Share-Based Payment Accounting.

We support the Board’s efforts under its simplification initiative to improve aspects of U.S. GAAP that are unnecessarily complex and costly. We believe that the proposed ASU would further that simplification objective and would reduce cost and complexity in financial reporting without adversely affecting the usefulness of the financial statements.

While we believe that most of the guidance on share-based payment arrangements with nonemployees should be aligned with that on such arrangements with employees, there could be significant differences between nonemployee awards and employee awards, particularly related to vesting conditions. Accordingly, we suggest that the Board provide additional clarification and implementation guidance to address those differences.

Appendix A to this letter contains our responses to the proposed ASU’s questions for respondents. Appendix B includes other significant comments for the Board’s consideration.
We appreciate the opportunity to comment on the proposed ASU. If you have any questions concerning our comments, please contact Sandie Kim at (415) 783-4848.

Yours truly,

Deloitte & Touche LLP

cc: Robert Uhl
Appendix A
Deloitte & Touche LLP
Responses to Questions for Respondents

**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?

Yes. Overall, we support the proposed amendments and believe that they will reduce cost and complexity while maintaining or improving the usefulness of the information provided to users of financial statements. We believe, generally, that because there are substantial similarities between nonemployee awards and employee awards, the accounting models should be similar and that most of the guidance in ASC 718 should be applied to nonemployee awards. However, given certain differences between employee awards and nonemployee awards, the final ASU should provide additional clarification and implementation guidance on (1) distinguishing between nonemployee service and performance conditions and (2) determining a nonemployee’s vesting period. Our recommendations are discussed in more detail in Appendix B.

**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?

Yes. We agree that the measurement of nonemployee share-based payments should be consistent with the fair-value-based measurement objective for employee awards.

**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?

Yes. We agree that the measurement date for equity-classified nonemployee awards should be the grant date. Under ASC 505-50, many nonemployee awards are remeasured each reporting period until the completion of performance. As noted in paragraph BC9 of the proposed ASU, this accounting was based on the view that “there is a fundamental difference between the relationship that employees and nonemployees have with the entity granting the awards.” However, we believe that the nature of an entity’s relationship with its nonemployees is not sufficiently different from that with its employees to warrant a different measurement date.

**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?

Yes. We agree that the contractual term of stock options and similar instruments issued to nonemployees should be used as an input for determining the fair-value-based
measurement of such awards. While some nonemployee awards may contain certain restrictions that are similar to those in employee awards (e.g., lack of transferability), we believe that the costs of determining an expected term for nonemployee awards outweigh the benefits of a more precise measurement (i.e., the use of the contractual term is more operable than determining an expected term).

**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?

Yes. We believe that the probability of achieving a performance condition should be taken into consideration in the determination of the appropriate cost to recognize for nonemployee awards. Under current guidance, an entity is required to measure any cost recognized on the basis of the “then-current lowest aggregate fair value” of the awards as of each reporting period until the performance condition is “known” (i.e., achieved). This could result in a scenario in which the lowest aggregate fair value is zero and no cost is recognized until the performance condition is achieved, even if the performance condition is expected to be met. We believe that such an accounting outcome does not reflect the economics of share-based payment transactions. The cost of nonemployee awards should be recognized when the related goods or services are provided and the awards are expected to vest, in a manner similar to the recognition of cost if the payment was made in cash.

However, we recommend that the Board clarify the distinction between nonemployee service and performance conditions, as described in Appendix B.

**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?

Yes. We believe that it is appropriate to continue applying the classification guidance in ASC 718 to nonemployee awards once the awards have vested, because doing so will simplify the application of existing U.S. GAAP to nonemployee share-based payments. We believe that the classification guidance for nonemployee awards should be consistent with that for employee awards.

However, as discussed in our October 17, 2016, response to the FASB’s Invitation to Comment, Agenda Consultation (File Reference No. 2016-290), we believe that the FASB should add to its agenda a broad project on distinguishing liabilities from equity. We believe that as part of such a project, the Board should consider aligning the classification guidance on both employee and nonemployee share-based payments with the classification guidance that applies to all other financial instruments.
**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?

We generally agree that the forfeiture guidance in ASC 718 should be the same for nonemployee and employee awards. However, because the accounting policy election related to forfeitures applies only to service conditions and not to performance conditions, it is important to clarify the distinction between them. In the absence of such clarification, the Board could consider not providing a policy election for nonemployee awards because in many circumstances it may be easier for an entity to estimate the probability of both service and performance conditions if it expects that nonemployees will fulfill their contractual requirements to provide the services or goods. However, in other circumstances, it could be challenging for an entity to estimate forfeitures, particularly in the absence of sufficient historical data. Therefore, our preference is for the Board to allow the accounting policy election related to forfeitures but to clarify the differences between service and performance conditions. Appendix B contains our recommendations.

In addition, because ASC 718-10-35-3 refers to an entity-wide accounting policy election for all share-based payment awards, we recommend that the Board clarify that the policy election can differ for employee and nonemployee awards. We recommend that a different policy election be permitted for employee and nonemployee awards given that in some circumstances, it may be easier to estimate forfeitures for employee awards than for nonemployee 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?

We generally agree that a nonpublic entity should use calculated value to determine the cost of its nonemployee awards, in a manner similar to its determination of the cost of its employee awards, when it is not practicable for the entity to estimate the volatility of its share price. However, we believe that references to ASC 250 and a change in accounting policy are confusing. ASC 718-10-30-20 states that when it is not practicable for an entity to estimate the volatility of its share price, the entity “shall” use calculated value, and it does not permit an accounting policy election. If it is practicable for an entity to estimate the volatility of its share price, the entity is precluded from using calculated value. Therefore, we believe that if a nonpublic entity concludes that it is not practicable to estimate the volatility of its share price, the use of calculated value should be required for both employee and nonemployee awards. We note, however, that calculated value is not commonly used in practice because it is typically practicable for a nonpublic entity to estimate the volatility of its share price (e.g., by evaluating the volatilities of comparable public entities).
**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?

Yes. We agree that nonpublic entities should be allowed to make a one-time policy election to switch from measuring liability-classified nonemployee awards at fair value to intrinsic value. However, we believe that the use of intrinsic value for nonemployee awards should be consistent with that for employee awards and recommend that the Board clarify whether nonemployee and employee awards must be treated consistently.

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

We agree with most of the transition requirements for the proposed amendments. However, an entity may not have determined the grant-date fair-value-based measurement of its equity-classified nonemployee awards if it was required under ASC 505-50 to remeasure the awards as of each reporting period until the completion of performance. Accordingly, an entity would be required to calculate such grant-date fair-value-based measurement upon adoption to determine the cumulative-effect adjustment to retained earnings. Allowing an entity to “fix” the measurement of its nonemployee awards on the adoption date rather than having it retrospectively calculate the grant-date fair-value-based measurement of its nonemployee awards would make implementation simpler and less costly. This transition would be similar to the approach applied when there is a modification that changes the classification of an award from a liability to equity.

**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?

No. We do not believe that an entity should be required to adjust the basis of an asset when applying the transition requirements, because the benefit of determining the adjustment would not outweigh the cost. Rather, all adjustments to the cost of nonemployee awards upon adoption should be recognized in retained earnings.

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

No. We believe that the current disclosure guidance in ASC 718 is sufficient given that ASC 718-10-50-2(g) requires separate disclosures for different types of awards “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 do not believe that entities will need a significant amount of time to adopt the proposed amendments because they would simplify the accounting for nonemployee share-based
payment transactions. Entities that issue share-based payments are already familiar with the requirements under ASC 718, which in many cases are less complex than those under ASC 505-50. However, since many nonpublic entities issue nonemployee awards, it may take those entities more time to determine the grant-date fair-value-based measurement of all outstanding nonemployee awards for calculating the cumulative-effect adjustment to retained earnings if such measurement was not previously calculated (because the awards were remeasured each reporting period).

If the FASB decides to permit different effective dates for public and private entities, we recommend that it not delineate on the basis of the definition of a public business entity but instead on the basis of whether the entity files financial statements with the SEC. Basing the effective date on the definition of a public business entity creates unnecessary complexity for public entities with equity method investees that do not file with the SEC but nevertheless are considered public business entities by the investor when it prepares its financial statements.
Nonemployee Vesting Conditions

The proposed ASU amends the definitions of “service condition” and “performance condition” to incorporate vesting conditions associated with nonemployee awards. However, because many nonemployee awards contain conditions that are different from those associated with employee awards, it may be difficult for an entity to determine whether they are service conditions or performance conditions. We note, however, that if an entity elects a policy to estimate forfeitures, the distinction may not be as relevant because the entity would assess the probability of meeting both types of vesting conditions.

Many nonemployee awards associated with rendering services do not include a service condition solely attributed to providing services over a distinct period. Rather, vesting may be conditioned on the performance of specific tasks and activities. In those circumstances, it may be difficult for an entity to determine whether the requirement to perform the tasks and activities is associated with a requirement to render services (which would be a service condition) or a requirement to achieve a specified performance target that is defined solely by “reference to the counterparty’s performance related to the grantor’s own operations (or activities)” (which would be a performance condition). The following examples illustrate vesting conditions that may make it difficult for an entity to assess the distinction:

- An entity grants an award to a distributor that is not a customer (i.e., it is a vendor) that vests if the distributor includes the entity’s products at a targeted number of the distributor’s locations.
- An entity grants an award to a marketing vendor that vests if the vendor promotes the entity’s products at a certain number of events and at specific types of events.
- An entity grants an award to a consulting vendor that vests if the project the vendor is working on is completed by a specific date.

While today an entity applies judgment under ASC 505-50 to determine which conditions are counterparty performance conditions and which are more akin to service-type conditions, it would be helpful for the Board to clarify the distinction in ASC 718 by adding implementation guidance and illustrations specific to nonemployee awards. Though an entity will still need to apply judgment, such clarification from the FASB should reduce potential diversity in practice and help to ensure that the guidance is consistently applied.

In addition, the proposed amendments to the definition of “service condition” include a nonemployee’s delivery of goods. Because a nonemployee’s delivery of goods is not a service, it may be confusing to apply the same term to both employee awards and nonemployee awards. The Board may therefore consider using a different term to describe vesting conditions associated with delivering goods. Such a term should be clearly defined so that the distinction between those vesting conditions and any performance conditions is apparent. For example, if an entity grants an award to a manufacturer that vests if the defects associated with the goods delivered are below a certain percentage, it may be difficult to assess whether the vesting condition is related to delivering goods or to a
performance condition. We note, however, that the nonemployee awards we see in practice are primarily related to services.

Further, many of the proposed amendments refer to “other conditions” in describing vesting conditions. For example, the term “other conditions” is used in the proposed amendments to the ASC master glossary’s definitions of “nonvested shares” and “restricted share.” Because “other conditions” could be interpreted as including market conditions (which are not vesting conditions) and is often used in practice to describe those conditions that would cause an award to be classified as a liability in accordance with ASC 718-10-25-13, we recommend that the Board use terms that encompass vesting conditions (i.e., “service conditions” and “performance conditions”).

**Nonemployee’s Vesting Period**

We believe that the Board’s use of the term “nonemployee’s vesting period” in the proposed ASU is confusing and should be clarified or revised. Proposed paragraph ASC 718-10-25-2B states that a nonemployee’s vesting period is “the period over which to recognize cost.” “Nonemployee’s vesting period,” which is used throughout the proposed ASU and not defined in the ASC master glossary, is generally coupled in the proposed ASU with a reference to an employee’s “requisite service period,” which is defined in the ASC master glossary. However, while the cost associated with employee awards is generally recognized ratably over the requisite service period, the cost associated with nonemployee awards may not be recognized ratably over a specific period. Rather, the cost of nonemployee awards is recognized “in the same period(s) and in the same manner as if the grantor had paid cash for the goods or services instead of paying with or using the equity instruments.” For example, the cost associated with consulting services may be recognized on a time-and-materials basis, which may not necessarily be ratable. Further, the cost associated with the purchase of goods would be recognized as the goods are delivered.

The proposed amendments to ASC 805 would further require an entity to determine the amount attributable to consideration transferred in a business combination by using a nonemployee’s vesting period rather than the amount recognized as cost in the acquirer’s postcombination financial statements. The proposed amendments to ASC 805-30-55-9 state that the nonemployee’s vesting period is “the period of time (specified or estimated) that a nonemployee delivers the promised good or renders the service.” However, we believe that the amount that should be attributed to precombination vesting (and therefore included as consideration transferred in a business combination) should be based on the proportion of total cost that is attributable to the precombination period, not the proportion of the total period.

In addition, the proposed ASU’s discussion of the terms “requisite service period,” “explicit service period,” “implicit service period,” and “derived service period” is confined to employee awards. While those terms generally apply to employee awards more so than nonemployee awards because the attribution guidance for the latter is different, the terms might be relevant for those nonemployee awards that are similar to employee awards. We recommend that the Board incorporate some of the discussion in paragraph BC8 into the implementation guidance to ASC 718. The guidance in ASC 718-10-55-78 and 55-79 on changes in estimate might also be relevant for nonemployee awards.
Implementation Guidance and Illustrations

As discussed above, there could be significant differences between nonemployee awards and employee awards, particularly related to vesting conditions. Accordingly, it would be helpful if the Board could provide implementation guidance and illustrations that apply specifically to nonemployee awards, particularly in connection with distinguishing between service and performance conditions. While many of the illustrations in ASC 505-50 may not be relevant in light of the proposed amendments (e.g., determining the measurement date), they would be useful as a starting point for developing guidance.

While the proposed ASU acknowledges that many of the examples in ASC 718 that pertain to employee awards might also apply to nonemployee awards, we believe that it can be difficult to distinguish which parts of the examples are applicable and which are not. The Board might consider adding a single paragraph (rather than discussing the differences in each example) that precedes the examples indicating that while the examples are written in the context of employee awards, they may also apply to nonemployee awards other than those associated with (1) attribution of cost and (2) use of contractual term instead of expected term in valuing nonemployee stock options and similar instruments.

In addition, it is not clear why certain examples related to employee awards would not apply to nonemployee awards, including:

- Example 8 in ASC 718-10-55-131, which discusses book value plans.
- Example 8 in ASC 718-20-55-71 through 55-75, which discusses a share award granted by a nonpublic entity.

Further, it is not clear why Example 4 in ASC 718-20-55-47A through 55-50 (which discusses an increase in expected term because of a performance condition that affects transferability) would also apply to nonemployee awards given that the proposed amendments would require the use of contractual term as an input for nonemployee stock options and similar instruments.

Earnings per Share

The proposed amendments to ASC 260 would incorporate terms associated with nonemployee awards in the calculation of earnings per share. However, it is not clear how certain vesting conditions related to nonemployee awards would be treated under the “contingently issuable shares” guidance in ASC 260-10-45-48 through 45-57. ASC 260-10-45-32 specifies that while vesting conditions associated with the “mere passage of time” are not considered contingently issuable shares, performance-based awards are. That is, time-related contingencies are distinct from contingencies requiring specific achievement. For employee awards, service conditions would be considered time-related contingencies. However, as discussed above, given the nature of many nonemployee awards that require the performance of specific tasks and activities, it is not clear whether certain vesting conditions would cause a nonemployee award to be considered contingently issuable shares. We recommend that the Board (1) clarify the distinction between nonemployee service and performance conditions and (2) provide examples illustrating whether certain awards are treated as contingently issuable shares.
Classification

We support the proposed amendments to the classification guidance in ASC 718 to incorporate nonemployee awards. However, we recommend that the Board make all the classification guidance consistent for employee and nonemployee awards. Specifically, ASC 718-10-25-18 through 25-19A refer only to employees, but entities may have withholding obligations for certain nonemployee awards. We recommend that the Board extend to nonemployee awards the exception to liability classification for net settlement provisions associated with statutory tax withholding requirements.

Consideration Payable to a Customer

The proposed amendments to ASC 606-10-32-25 include equity instruments granted in conjunction with selling goods or services as consideration payable to a customer. Accordingly, ASC 718 would not address those share-based payment transactions. However, while the guidance on consideration payable to a customer in ASC 606-10-32-25 through 32-27 addresses how to account for such consideration, that guidance does not address the measurement of share-based payments (including the measurement date). While ASC 606-10-32-21 through 32-23 could be applied by analogy, that guidance addresses only noncash consideration received from a customer. Accordingly, we believe that ASC 606 should also be amended in such a way that the guidance on noncash consideration received from a customer would also apply to noncash consideration paid to a customer.

In addition, the proposed amendments to the ASC master glossary definition of "cash consideration" refer to the guidance in ASC 718 that describes how the cost of equity instruments should be recognized (in the same period(s) and in the same manner as if the entity had paid cash). Because equity instruments issued as sales incentives to customers would not be within the scope of ASC 718 under the proposed amendments, we believe that the definition should not include reference to how the cost of nonemployee awards would be recognized under ASC 718.

Debt With Conversion and Other Options

The proposed amendments would include employee awards in the guidance on beneficial conversion features in ASC 470-20 (currently such guidance applies only to nonemployee awards). In addition, the proposed amendments would change the measurement date for the intrinsic value, if any, of a beneficial conversion option from that under ASC 505-50 to the grant date under ASC 718. We believe that such proposed amendments would have unintended consequences.

While in practice we do not commonly see convertible debt issued to employees, some entities issue fixed-price puttable shares that have similar economic characteristics. Such instruments are commonly accounted for as tandem awards, in a manner similar to that described in ASC 718-10-55-120 through 55-130. That is, a liability is recognized on the basis of the fixed put price, and an equity-classified call option is recognized on the basis of the fair-value-based measurement of the stock option with an exercise price equal to the fixed put price. We believe that all employee awards should be excluded from the scope of
the guidance in ASC 470-20 and, instead, should continue to be accounted for under the provisions of ASC 718 (unless modified when the grantee is no longer an employee or a vendor).

We also believe that the accounting and classification of nonemployee awards should be based on the provisions of ASC 718 and not those of ASC 470-20 (unless modified when the grantee is no longer an employee or a vendor). Under current guidance in ASC 470-20, the measurement of any beneficial conversion option at intrinsic value is determined on the measurement date under ASC 505-50. That measurement date is typically the date performance is complete, which is generally when the associated nonemployee award vests (given that reaching a performance commitment date is not common). At the time performance is complete and the nonemployee award vests, such an award becomes subject to other U.S. GAAP (e.g., ASC 815) in accordance with ASC 815-10-55-49 and ASC 815-10-55-51 through 55-53. We believe that if the postvesting guidance for nonemployee awards is aligned with that for employee awards, the guidance for tandem awards in ASC 718 should likewise apply to nonemployee awards. For convertible debt, any equity-classified conversion option would be recognized at a fair-value-based measurement on the grant date, not at intrinsic value.

Because the current guidance in ASC 470-20 applies to nonemployee convertible debt instruments when the instruments are typically no longer within the scope of ASC 505-50 (on the measurement date, which is typically the vesting date), we believe that the guidance in ASC 470-20 should apply only if awards that are originally within the scope of ASC 718 are no longer within the scope of that guidance. This would occur if an award is modified when a grantee is no longer an employee or a vendor (unless the modification is made solely to reflect an equity restructuring and meets certain conditions) under the proposed amendments to ASC 718-10-35-9 through 35-14. Once an award is no longer subject to the provisions of ASC 718, we believe that other U.S. GAAP (e.g., ASC 815 or ASC 470-20) should apply if the award is convertible debt. However, the measurement of any beneficial conversion option should take place on the modification date and not the original grant date since a modification is treated as an exchange of the original award for a new award in accordance with ASC 718-20-35-3.

Other Comments

- We recommend that ASC 718-740-25-3 not be amended because disqualifying dispositions would typically apply only to employee awards.
- We recommend that the Board remove or revise the proposed amendments to ASC 815-10-55-43 and 55-46 that add the term “share-based payment transactions” because that term is defined in the ASC master glossary by reference to the reporting entity’s shares, whereas the guidance in ASC 815 applies to awards that are indexed to an unrelated entity’s shares.
- Paragraph BC8 of the proposed ASU provides helpful guidance on how the attribution of costs associated with nonemployee awards may be similar to that of employee awards. We recommend that this be moved to ASC 718-10-55 as implementation guidance. In addition, we recommend that the Board remove or revise the last two sentences of this paragraph because even if an award of nonemployee stock options and similar instruments has a graded vesting schedule, the valuation of the entire
award would be based on the contractual term (versus the expected term, which could vary for each tranche when associated with employee awards).

- Paragraph BC12 of the proposed ASU states that “nonemployee options typically do not have the same restrictions on transfer after vesting.” However, we have observed in practice that some nonemployee warrants do have transfer restrictions after vesting. Therefore, we recommend that the Board remove this sentence.