June 5, 2017

Technical Director
director@fasb.org
File Reference No. 2017-220

Via Email

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

Dear Technical Director,

I am writing on behalf of the National Association of Stock Plan Professionals to comment on the proposed Accounting Standards Update (ASU) to include awards issued to nonemployees under the scope of Topic 718. The National Association of Stock Plan Professionals (NASPP) is a professional association representing over 6,000 members. Our members are directly involved in the design, oversight, and administration of stock compensation programs and include stock plan administrators; human resource professionals; corporate secretaries; financial and accounting professionals; securities, tax, and benefits attorneys; and compensation consultants. Our membership includes corporate issuers of all sizes, from all regions of the United States, and in a wide spectrum of industries.

Overall, we are very supportive of the proposal to include nonemployees under the scope of Topic 718. We believe that this will simplify accounting for awards issued to nonemployees, will be welcomed by our members, and will better represent the economics of these transactions. We have a few concerns, however:

- In addition to including awards to nonemployees under the scope of ASC 718, we also encourage the Board to expand the definition of “employee” to align with that of IFRS 2.
- We are concerned that the requirement to use the contractual term as an input in calculating the fair value of options issued to nonemployees does not reflect the economics of the arrangement. Based on our research, which we describe below, most options granted to nonemployees are not transferable and are subject to vesting and forfeiture conditions that are similar or identical as the options companies grant to employees. Thus, in most cases, nonemployees will exercise the options they hold before expiration of the contractual term.
- We are concerned that the transition requirements may be onerous for some companies and are unnecessarily complex.
We respectfully submit the following comments.

**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, we agree. We believe that this better reflects the economics of the arrangement and is more intuitive for users of the financial statements. In addition, the current method of accounting for awards issued to nonemployees is very burdensome for preparers of financial statements. Aligning the treatment of nonemployee awards with that of awards granted to employees will alleviate much of this burden.

We also urge the Board to reconsider aligning the definition of “employee” in ASC 718 with IFRS 2. We note that sometimes contractors fulfill a role that is equivalent to that of an employee, performing services that are similar to those performed by an employee, serving a single client (the granting corporation), performing work at the direction of the granting corporation. Where this is the case, the equity awards granted to them are typically identical to the awards issued to employees. The standard, as proposed in the exposure draft, however, would differentiate the accounting treatment of these awards in some areas (e.g., valuation, attribution of expense). We feel that both users and preparers of financial statements would be better served if these individuals are considered employees.

**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 cost of equity awards issued to nonemployees should be equal to the fair value of the 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 awards issued to nonemployees should be the grant 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?**

No, we do not believe entities should be required to use the contractual term as an input in determining the fair value of options and similar instruments. We understand that the Board included this requirement because it was felt that options issued to nonemployees are transferable and subject to different terms and conditions than options issued to employees. This is not our experience, however. Based on our research, most awards issued to nonemployees are subject to vesting and forfeiture provisions that are similar or identical to the awards entities issue to their employees. We also find that the overwhelming majority of entities that issue awards to nonemployees provide that those awards are nontransferable.

We see no compelling argument for stipulating that, in all circumstances, the contractual term must be used to value options (and similar instruments) issued to nonemployees. In the majority of cases, this would significantly overvalue the awards. Moreover, even where options are transferable, we note that use of the contractual term is already required by virtue of the fact that it is not reasonable to assume that option holders will exercise earlier than the contractual term.

We believe it is appropriate for the standard to permit entities to use an expected term that is less than contractual term for options (or similar instruments) granted to nonemployees. If the Board feels it is necessary to stipulate use of contractual term, we encourage the board to limit this requirement to options that are fully transferable.

Below is a summary of research we performed in May 2017. These data were collected via a survey in which 399 of our members participated. All survey respondents are companies that currently have an equity compensation program. Eighty-five of the respondents indicated that they currently grant stock options to consultants, contractors, or other nonemployees (other than outside directors) or have done so in the past. We asked these 85 respondents to provide us with more information about the stock options they grant (or have granted in the past) to nonemployees (other than outside directors). The following two charts illustrate their responses.
As you can see, for the majority of respondents (74%), options granted to nonemployees have substantially the same terms as options granted to employees. In addition, 98% of respondents indicate that options granted to nonemployees are not transferable.

**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 agree that performance awards issued to nonemployees should consider the probability that the performance condition will be achieved in determining the appropriate periods of recognition.

**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 agree that the classification guidance in Topic 718 for awards that have vested is appropriate for awards issued to nonemployees.

**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?**

Yes, we agree that the forfeiture guidance in Topic 718 is appropriate for awards issued to nonemployees. We believe it would be confusing for users of the financial statements if forfeitures of nonemployee awards are accounted for differently than forfeitures of awards issued to employees.

**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?**

Yes, we agree that the practical expedient for nonpublic entities to substitute calculated values for expected volatilities when measuring options and similar instruments is appropriate for awards issued to employees.

**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, this election should be allowed.
Question 10: Are the transition requirements for the proposed amendments appropriate? If not, what transition approach is more appropriate?

Overall, we think the modified retrospective approach with a cumulative-effect adjustment to retained earnings is the appropriate method to transition to the updated standard.

We are concerned, however, that it will be necessary for entities to use the grant date fair value of awards, particularly stock options and similar instruments, to determine the amount of the cumulative adjustment. In some cases, many years may have elapsed since the awards were granted. Because the exposure draft requires the cumulative adjustment to include all unsettled awards, options and similar instruments that are subject to adjustment may have been granted close to nine years ago (most entities specify a ten-year contractual term for options and similar instruments).

Under the current standard, there is no requirement to determine the grant date fair value of awards issued to nonemployees; we expect that many entities will have no record of this value, or even, in the case of options and similar instruments, the inputs necessary to determine this fair value. We recommend allowing entities to choose to determine the cumulative adjustment using the current fair value of awards in the event that they do not know the grant date fair value.

We also are concerned about the requirement to record a cumulative adjustment for all unsettled awards. In some cases, awards are not settled until many years after they have vested. Stock options and similar instruments are not settled until exercise, which, as we note above, frequently can occur up to ten years after grant. Likewise, full value awards can also include deferred settlement features, although this is less common. Requiring a cumulative adjustment for vested but unsettled awards increases the complexity of the transition and does not provide any relief to entities (once equity awards vest, the cost associated with them has been fully recorded).

We recommend requiring a cumulative adjustment only for unvested awards.

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 have no comment on this question.

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

We do not believe separate disclosures are necessary for awards issued to nonemployees.
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 defer to preparers of financial statements with respect to the amount of needed to adopt the amendments, although we would be happy to research this among our members if the Board requires additional input on it. We note that the amount of time necessary to adopt the proposed amendments will depend upon whether the Board decides to adjust the transition requirements as we have suggested in response to question #11. If these changes are not adopted, we expect that more time will be necessary to adopt the amendments.

We do not think it is necessary to provide nonpublic entities with a longer period of time in which to adopt the amendments and we encourage the Board to permit early adoption.

Thank you for considering our comments. The NASPP would welcome the opportunity to meet with members of the FASB staff to further discuss our comments, to respond to questions, and to provide additional information. At the staff’s convenience, we would be happy to come to Norwalk to meet with you on this matter. If you have any questions regarding this letter, please do not hesitate to contact me at (510) 493-7599 or bbaksa@naspp.com.

Sincerely,

Barbara A. Baksa, CEP
Executive Director