



May 4, 2017

Financial Accounting Standards Board
401 Merritt Seven
PO Box 5116
Norwalk, CT 06856-5116
Attn: Technical Director

Re: File Reference 2017-220, Proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

Dear Technical Director:

Thank you for the opportunity to comment on the Proposed Accounting Standards Update—*Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting* (the “Proposed ASU”).

We welcome the efforts of the Financial Accounting Standard Board (“FASB” or “Board”) to simplify the accounting for nonemployee share-based payment transactions. In general, we are supportive of the vast majority of the proposed amendments to Accounting Standards Codification (“ASC”) Topics 718 and 505. We believe that these amendments will improve the accounting for nonemployee share-based payments and enhance consistency between the recognition and measurement of employee and nonemployee awards.

In the following letter, we have focused our feedback to just several areas where we believe the Proposed ASU should be clarified or amended.

Thank you very much for taking our comments into consideration. If you have any questions or require further information regarding the contents of this letter, please contact Scott Ehrlich, President and Managing Director of Mind the GAAP, at +1 (773) 732-0654 or by email at sehrlich@mindthegaap.com.

1. Limitation of the Accounting Policy Election in ASC 718-10-35-8 and ASC 718-20-55-32 to Employee Awards

Many entities – especially smaller, nonpublic companies – will grant nonemployee share-based payment awards to service providers. Often, these awards contain graded vesting conditions. For instance, an early-stage biotech company might grant a medical advisor 10,000 equity-classified share-based payment awards that vest monthly over a three-year period. In substance, the biotech is “paying” for a medical advisor’s services over the period of time that such services are being rendered.

Under current ASC guidelines, we understand that when an entity grants awards with graded vesting to nonemployees, the entity must separately measure each tranche of the award.¹ Using the example in previous paragraph, this means that the biotech company would have to make:

- 36 separate fair value measurements for the graded vested award at issuance,
- Another 36 measurements one month later (35 interim and one final measurement for the tranche that vested),
- 35 measurements one month thereafter (34 interim and one final measurement for the second tranche to vest)
- Etc.

We believe that this accounting is extremely onerous for preparers – particularly smaller, nonpublic companies.

Had the biotech company granted a similar award to an employee, the biotech could have elected an accounting policy under ASC 718-10-35-8 and ASC 718-20-55-32 to, in substance, account for the share-based payment award as a single accounting unit. That is, the biotech could have measured the fair value of the entire award using a single weighted-average term, and attribute that value on a straight-line basis over a three-year period.

¹ ASC 505-50-30-11 states in part: “The issuer shall measure the fair value of the equity instruments in these transactions using the stock price and other measurement assumptions as of the earlier of the following dates, referred to as the measurement date: (a) The date at which a commitment for performance by the counterparty to earn the equity instruments is reached (a performance commitment) or (b) The date at which the counterparty’s performance is complete.” In our experience, it’s extremely rare to have a performance commitment date that precedes the date at which the counterparty’s performance is complete. Hence, most entities will measure nonemployee share-based payment awards based on the guidance in ASC 505-50-30-11(b). Furthermore, ASC 505-50-30-15 concludes by stating that “the elimination of any obligation on the part of the counterparty to earn the equity instruments” results in a measurement date being reached. Thus, for awards containing graded vesting, the elimination of the counterparty’s obligation (resulting in earning a portion of a share-based payment awards) occurs at each tranche’s vesting date. As a result, a final measurement date is established for each tranche of a graded vesting award as that tranche vests. Prior to a tranche vesting, an entity will make interim measurements of the value of that tranche, and will continue to do so under ASC 505-50-30 until that tranche vests.

We were hoping that the Proposed ASU would afford the same accounting policy election outlined in ASC 718-10-35-8 to nonemployee awards. Instead, though, the Proposed ASU clarifies that this accounting policy election would remain available only to employee share-based payment awards (through the insertion of the word "Employee" in the header to this paragraph).

We would request that the Board reconsider its decision and permit nonpublic companies, if not all entities, the ability to elect a policy for nonemployee awards containing graded vesting to:

- **Measure, as of the date of grant, the entire award as a single accounting unit and**
- **Attribute the value of the award on a straight-line basis over the requisite service period for the entire award (that is, over the requisite service period of the last separately vesting portion of the award, acknowledging that the amount of compensation cost recognized at any date must at least equal the portion of the grant-date value of the award that is vested at that date)**

We recognize that our request may not be consistent with certain principles included in the Proposed ASU. For example, ASC 718-10-25-2C states that "*an asset or expense be recognized (or previous recognition reversed) 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*". This is consistent with the current guidance in ASC 505-50-25-4, which results essentially results in separate attribution and measurement for each tranche of a nonemployee award with graded vesting.

However, the accounting policy election in ASC 718-10-35-8 and ASC 718-20-55-32 is already a deviation from certain overarching principles of ASC 718, and the Board permitted an exception to those principles based on cost/benefit trade-offs.² We are simply asking the Board to consider extending that same accommodation to nonemployee awards. Desirably, we would request the Board to expand the accounting policy election in ASC 718-10-35-8 and ASC 718-20-55-32 to all nonemployee awards containing graded vesting. If the Board is uncomfortable doing so, then we would secondarily request that Board at least permit the accounting policies elections in ASC 718-10-35-8 and ASC 718-20-55-32 to be applied by nonpublic companies, who would be disproportionately affected by the burdensome process of having to separately measure and attribute each tranche of a nonemployee award with graded vesting. In our experience, nonpublic companies often have fewer technical

² See B172 of Statement of Financial Accounting Standards No. 123 (revised 2004), which states in part: "In reconsidering the proposed accounting for awards with graded vesting, the Board acknowledged that accounting for them as in substance multiple awards, each with its own requisite service period, is more complicated than accounting for them as a single award. The Board generally agreed with respondents that requiring the multiple-award method for all awards with graded vesting would be an unnecessary refinement. Accordingly, the Board decided to continue to provide a choice of attribution provisions for awards with graded-vesting schedules based only on service conditions."

accounting resources relative to public companies, and nonpublic companies will more frequently engage nonemployees to provide services that otherwise would be provided by employees at most public companies.

2. Potentially Unclear or Conflicting Language in the Summary Section of the Proposed ASU

Starting on Page 2 of the Proposed ASU, there is a table reflecting "Current GAAP" and a "Summary of Proposed Amendments".

- The first row of this table – related to the 'Overall Measurement Objective' – states that under the proposed ASU, "Nonemployee share-based payment transactions within the scope of Topic 718 would be measured by estimating the fair value of the equity instruments that an entity is obligated to issue when the good has been delivered or the service has been rendered and any other conditions necessary to earn the right to benefit from the instruments have been satisfied."
- However, the second row of this table, under the heading 'Measurement Date', indicates that "Equity-classified nonemployee share-based payment awards would be measured at the grant date."

We were slightly confused by the interaction of these two statements. Our interpretation is that equity-classified nonemployee awards would be measured as of the grant date, but based on assumptions as to the fair value of the equity instrument as and when the related good or service has been delivered by the award recipient. We're not sure if our understanding is correct. If so, the combinations of these statements would seem to contradict ASC 718-10-30-10A, which requires that the contractual term (and not the date a good has been delivered or a service has been rendered) be used as an input to a valuation model in valuing a nonemployee option award.

In the final ASU, we would ask that the Board carefully consider the language included in the Summary section of the ASU and to try to better clarify (a) the principles of the amendments and (b) the changes from existing generally accepted accounting principles.

3. Practical Expedient for Nonpublic Entities to Substitute Calculated Values for Expected Volatilities When Measuring Share Options Issued to Nonemployees

We do not favor the calculated value method. Instead, we believe that nonpublic companies can and should use observable data from a select group of similar publicly traded peer companies as a surrogate for estimating their own volatilities. For this reason, we are not in favor of extending the calculated value practical expedient when measuring nonemployee awards granted by nonpublic companies.

4. Basis Adjustments to Assets that Include Share-Based Payment Costs in Transition

We believe that it would be operationally challenging for entities, in transition, to adjust the basis of an asset that includes share-based payment costs. Therefore, we believe that asset basis adjustments should only be recognized on a prospective basis from the effective date of the new standard.

5. Separate Disclosures for Nonemployee Share-Based Payment Transactions

We support separate disclosures for nonemployee versus employee share-based payment awards. We think separate disclosures would provide decision-useful information to users of the financial statements, including information about:

- The relative number of awards granted to employee and nonemployee recipients, and
- Any distinctions in the terms and conditions between awards granted to employee and nonemployee recipients.