



July 2, 2017

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

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

Dear Ms. Cospers:

The Financial Reporting Committee (FRC or Committee) of the Institute of Management Accountants (IMA) is writing to share its views on the Financial Accounting Standards Board's (Board) Exposure Draft (ED) of the Proposed Accounting Standards Update, *Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*.

The IMA is a global association representing over 90,000 accountants and finance team professionals. Our members work inside organizations of various sizes, industries and types, including manufacturing and services, public and private enterprises, not-for-profit organizations, academic institutions, government entities and multinational corporations. The FRC is the financial reporting technical committee of the IMA. The committee includes preparers of financial statements for some of the largest companies in the world, representatives from the world's largest accounting firms, valuation experts, accounting consultants, academics and analysts. The FRC reviews and responds to research studies, statements, pronouncements, pending legislation, proposals and other documents issued by domestic and international agencies and organizations. Additional information on the FRC can be found at [www.imanet.org](http://www.imanet.org) (About IMA, Advocacy, Financial Reporting Committee).

The Committee is supportive of the Board's simplification initiatives related to nonemployee share-based payment accounting. We believe that the ED generally simplifies the accounting for nonemployee share-based payments by moving most aspects of accounting to a model similar to that for employee share-based compensation. For the reasons stated in BC10 and BC11, we agree that the reason for a different model for nonemployees is no longer applicable.

With that said, we want to comment on the following aspects of the ED where additional simplification could be appropriate.

**Contractual term as an input to measure the value of options and similar instruments issued to nonemployees (Question for Respondents #4)**

Notwithstanding the Board's rationale in BC12, we believe entities should have the flexibility to use estimates of the expected term where the entity believes that the expected term is a more relevant input and there is data to develop such estimates. Some nonemployee awards do have transfer restrictions. Additionally, there may still be a need to estimate when the contractual term is not defined as a fixed date. For example, the contractual term for many awards is defined as the shorter of 90 days after completion of service for the entity, or 10 years. Unless the Board intends for an entity that grants such



an award to use the longest contractual term, it would seem that the entity should be required to estimate the duration of the service as usually this would be shorter than the maximum contractual term of the award. If the Board intends that reporting entity use the contractual term, even if that is longer than the expected service period plus the period of time to exercise following the completion of the service period, we believe the Board should make that clear.

While it could sometimes be simpler to use the contractual term for nonemployee awards in lieu of developing an estimate, on the other hand, this simplification benefit could be partially or fully negated by the additional complexities that result from (a) developing valuation inputs of volatility, which can be a relatively complex estimate, and the risk-free interest and dividend rates that are different from those used for employee awards; and (b) the ongoing need to determine if a particular individual qualifies as an employee (or common law employee) of the entity.

### **“As if cash were paid” attribution method for nonemployee awards**

The ED highlights that the “as if cash were paid” method results in a difference between employee and nonemployee awards in attribution. In some instances, such differences could be relatively minor. In other cases, for example, for certain performance and service awards, the difference could be significant. To illustrate, a performance award with multiple tranches of equal number of shares that vest over consecutive periods would be recognized using the accelerated method if it is an employee award, and most likely straight-line if it is a non-employee award. A service award with progressively increasing number of shares vesting in consecutive periods would be recognized straight-line if it is an employee award, and likely in a manner proportionate to the number of shares in each tranche if it is a nonemployee award. We expect this difference in attribution methods would also limit the extent of simplification the ED allows for some entities. We recommend giving entities the ability to use the attribution methods available for (and consistent with) similar employee awards if progress towards vesting is best characterized as passage of time.

### **Determining whether an award is a service or a performance award**

In some cases, entities may find it challenging to determine whether a particular vesting condition in a share-based payment award to a nonemployee is a service condition (e.g., the grantee is required to provide services over a vesting period) or a performance condition (i.e., a performance target that pertains to “the performance of the counterparty, if such performance ... solely relates to the grantor’s own operations (or activities)”). We recommend that the Board consider providing implementation guidance, possibly in the form of case examples, which clarifies the distinction between a service condition and a performance condition for nonemployee share-based payments.

### **Replacement awards in a business combination**

We believe the framework proposed in the ED may not always lead to a reasonable outcome, and further, is inconsistent with the “as if cash were paid” attribution method for nonemployee awards. Specifically, the proposed guidance in paragraphs 805-30-55-8 and 55-9 requires entities to determine the pre-combination portion of the award based on the ratio of the nonemployee’s pre-combination vesting period to the greater of the total applicable period or the original applicable period of the award (i.e., on the basis of passage of time). This attribution may be inconsistent with the pattern of goods or



services delivery for performance awards to nonemployees. As an example, assume a nonemployee contracted to deliver to the entity 100 units of an inventory item over a 12-month period in exchange for stock options that cliff vest with the final delivered unit, and at the time the entity was acquired, 6 months into the delivery period, had delivered 90 units. The acquiree would have recognized 90% of the grant-date fair value of the options under the “as if cash were paid” method. However, in determining the post-combination accounting, the acquirer would only be able to attribute 50% (6 months/12 months based on the passage of time) of the pre-acquisition value of the acquiree options to the pre-acquisition period. Thus, the acquirer would recognize the remaining value of the replacement award (50%) as the cost of the remaining 10 units of inventory, which is clearly disproportionate to the value of those units. We do not believe this approach results in a reasonable accounting outcome.

### **Transition provisions**

We believe applying the modified retrospective method to all awards unsettled as of the effective date as required by paragraph 718-10-65-11 (and other transition paragraphs) may be difficult for entities, as it would require re-measuring all such awards as of the grant (and/or modification, as applicable) date. We believe many entities may not have readily available information about fair values of nonemployee awards that may date back multiple years because such fair values were not required to be determined contemporaneously. An alternative could be to allow prospective application that would affect any shares not yet fully vested as of the initial application date, and that could be measured as of that date. We also want to encourage the Board to allow the early adoption alternative.

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We support the approaches taken by the Board in the ED as related to the matters addressed in Questions for Respondents #2, 3, 5 through 9, 11 and 12. We do not anticipate the adoption of the final ASU will require significant time for most entities, and nonpublic entities may be able to complete the adoption in the same timeframe as public entities.

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

Sincerely,

A handwritten signature in blue ink that reads "N. Schroeder".

Nancy J. Schroeder, CPA  
Chair, Financial Reporting Committee  
Institute of Management Accountants  
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