Accounting for Non-Employee RSUs

A question was posted on an equity-compensation Yahoo Group:

"My accountants are asking me...why aren't I marking-to-market my new non-employee RSUs, when I mark to market their options? Anyone have some paragraph number I can tell them to go and read, please?"

The assumption was that because the equity database being used for accounting didn't perform mark-to-market accruals for non-employee RSUs, it wasn't required.

Non-employee RSUs should be marked to market. And even if the equity database you are using might not support this, that doesn't mean it's not required. But the good news is that accounting for non-employee RSUs is much easier than non-employee options! (At the time of the post mentioned above, we had recently created a custom Excel spreadsheet report for a client for non-employee RSUs, so we knew the required calculations already.)

Why are they easier? Well, simply because while stock options require that you recalculate a Black-Scholes fair value (or some other option-pricing model) at the end of each reporting period, RSUs simply use the fair market value at the end of the period. So, yes they are relatively easy to handle with a custom Excel Spreadsheet or a quick Access query.

Remember that unlike employee options/RSUs, non-employee grants use the vest date as the measurement date and are revalued each reporting period until they vest. However, since this article was originally published, the Financial Accounting Standards Board (FASB) released some proposed accounting guidance in March 2017 that will simplify the accounting for non-employee grants and eliminate this mark to market valuation. See our Accounting Update-March 2017 and SOS Comment Letter to the FASB for more details.

A few pointers on the basics behind the calculations:

- In general, the FIN 28 (or "Multiple" or "accelerated attribution") approach whereby each vesting tranche is expensed from the grant date is used for non-employee grants. This was explicitly required by Emerging Issues Task Force (EITF) 96-18 (now referred to as FASB ASC Topic 505-50), which contains the rules for accounting for non-employee grants (subject to the pending guidance referenced above).

- For the prior market value, use the market value in effect on the Report Begin Date minus 1 day. (The easiest way to do this is to have a "report parameter" for prior market value that you input when the report is run. This will be the same value for all the grants.)

- For the current market value, use the market value in effect on the Report End Date. (Again, have a "report parameter" for current market value that you input when the report is run. This will be the same value for all the grants.)

- For any vested tranches, determine WHEN they vested.
  - If they vested before the report period began, use the market value from the vest date for prior market value AND for the current market value. (No additional expense will be booked.)
  - If they vested during the report period, use the prior market value input at report run time for prior market value AND pull in the vest date market value for the current market value.

If your company uses the market price at the end of the reporting period (month end or quarter end), due to the sheer volume of valuations (especially if you have monthly or quarterly vesting schedules), be sure to assess what the market value was on the actual vest date and determine if there is a material/significant difference that needs to be accounted for (Expense will be trued up to final market value used on either the vest date or month end/quarter end date)

  - If they vest after the report period ends, use the inputs for both prior and current market values, since the value hasn't yet been "finalized". (Expense will be trued up to the most recent market value, but will true up again next reporting period.)

- To arrive at current period expense, always subtract prior expense (prior elapsed service period * prior market value * shares) from to date expense (to date elapsed service period * current market value * shares). This will automatically true up your expense in the current period, correcting up, or down, for fluctuations in the market price and for the continuing progress of the vest schedule.

- If your company has elected an accounting policy to continue to estimate awards expected to vest, don't forget about estimated forfeiture rates. Be sure to "haircut" your accrual of expense by your estimated forfeiture rate. (Luckily you may find the forfeiture rate already in the report you use as a basis for your calculations).

In summary, non-employee RSUs can be a bit of a hassle, but once you automate your calculations, they shouldn't cause you more than a few minutes of effort each quarter from here on out.

Questions or comments? Please email us at xtra@sos-team.com

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This article was originally published March 2011 and updated in September 2017.