

June 5, 2017

Susan Cospers, Technical Director
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk CT 06856-5166

Re: File Reference No. 2017-220

Dear Ms. Cospers,

Thank you and the FASB Board for the opportunity to provide public comment to the FASB's Exposure Draft, *Compensation- Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*.

Stock & Option Solutions, Inc. or SOS as we are more commonly known is a leading stock administration staffing, consulting and outsourcing firm within the equity compensation marketplace. We provide temporary stock plan staffing, expert project resources, and total outsourcing solutions to both publicly traded and privately held entities. We support the Board's proposal to simplify and improve the accounting for non-employee share-based awards and align such awards with employee share-based awards under ASC 718. However, there are some clarifications needed to further streamline the proposed guidance so that there is no diversity in practice or misinterpretation. Below are our responses to the questions the Board requested feedback from respondents along with some additional comments and recommendations for consideration.

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?*

Response: Yes, we agree the proposed update would result in a reduction of cost and complexity while maintaining or improving the usefulness of information provided on an entity's equity grants to its non-employees. We do recommend the Board clarify the glossary term "employee" and either revise the term to "grantee" which could include the entity's W-2 employees, non-employee Board of Directors and non-employee consultants. OR the exception under ASC 718-10-20 that is permitted for an entity's non-employee Board of Directors to receive "employee treatment" should also apply to other non-employee consultants who provide service to the entity. The definition should also make a clear distinction that equity awards granted to customers are outside the scope of ASC 718 and subject to other U.S. GAAP. We believe these revisions would further streamline the guidance and provide clarity that all equity awards granted to employees and non-employees providing goods or services to the entity are virtually treated the same.

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?*

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Response: Yes, we agree companies should be required to estimate the fair value of the equity instruments they are obligated to issue. This same requirement is applied to equity awards granted to employees for similar work being performed.

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?*

Response: Yes, we agree the measurement date for equity-classified non-employee awards should be the grant date. The same requirement is applied to equity awards granted to employees for similar work being performed.

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?*

Response: No, entities should not be required to use the contractual term of options issued to non-employees. As mentioned above, an exception in ASC 718 was made to treat non-employee Board of Directors members like employees, when such individuals are non-employee consultants providing services to the entity and receiving compensation via Form 1099-MISC. Other non-employee consultants providing services to the entity should be treated no differently.

The SEC Staff issued guidance under Staff Accounting Bulletin (SAB) No. 107/110 (now SAB Topic 14.D.2) expressing the use of the contractual term vs. the expected term for non-employee equity awards primarily due to the transferability of stock options. Per the SEC SAB Guidance: "FASB ASC paragraph 718-10-55-29 states... "The fair value of a traded (or transferable) share option is based on its contractual term because rarely is it economically advantageous to exercise, rather than sell, a transferable share option before the end of its contractual term. Employee share options generally differ from transferable [or tradable] share options in that employees cannot sell (or hedge) their share options — they can only exercise them; because of this, employees generally exercise their options before the end of the options' contractual term. Thus, the inability to sell or hedge an employee share option effectively reduces the option's value [compared to a transferable option] because exercise prior to the option's expiration terminates its remaining life and thus its remaining time value." Accordingly, FASB ASC Topic 718 requires that when valuing an employee share option under the Black-Scholes-Merton framework the fair value of employee share options [should] be based on the share options' expected term rather than the contractual term."

In addition, in SAB Topic 14.A., "Share-based Payments with Non-employees" the SEC has stated, "For example, due to the nature of specific terms in employee share options, including nontransferability,

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nonhedgability and the truncation of the contractual term due to post-vesting service termination, FASB ASC Topic 718 requires that when valuing an employee share option under the Black-Scholes-Merton framework, the fair value of an employee share option be based on the option's expected term rather than the contractual term. If these features (i.e., nontransferability, nonhedgability and the truncation of the contractual term) were not present in a nonemployee share option arrangement, the use of an expected term assumption shorter than the contractual term would generally not be appropriate in estimating the fair value of the nonemployee share options."

In our experience as a leading stock administration staffing, consulting and outsourcing firm within the equity compensation marketplace, most, if not all, option award agreements have similar nontransferability and nonhedgability features that apply to both employees and non-employees. Non-employees cannot freely transfer/sell their stock options. Like employees, non-employees can only exercise their stock options during an open trading window after the option's vesting conditions are met or if early exercises prior to vesting are permitted for favorable tax treatment. And with the recent trends fueled by Section 955 of the Dodd-Frank Act of 2010 and the related proposed SEC rules, some public entities have been proactively implementing, and disclosing in their annual proxy statements, Hedging Policies where hedging and/or pledging stock as collateral and short selling company stock is strictly prohibited by all directors, executives, employees and non-employees. In addition, non-employees are also subject to post-termination exercise periods, which also truncate the remaining contractual life of the stock option.

Should the FASB allow the use of the expected term in calculating the fair value of non-employee equity awards on the grant date, we hope the SEC will amend its guidance in SAB Topic 14.A and 14.D.2. and permit the use of the expected term for non-employee equity awards that have similar characteristics and features as employee equity awards. Use of the remaining contractual term should be an option of last resort if an entity firmly believes the option will be outstanding for that entire period and the expected term cannot be reasonably estimated.

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?*

Response: Yes, we agree that non-employee share-based payment awards containing performance conditions should consider the probability that the performance condition will be met in determining the appropriate period(s) of recognition. This same requirement to assess the probability of the performance condition is applied to performance-based equity awards granted to employees.

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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 post vesting classification assessment for employee and nonemployee share-based payment awards?*

Response: Yes, we agree that 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 is appropriate.

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?*

Response: We believe it is up to the Financial Statement Preparers at each entity to assess its accounting for forfeitures in accordance with ASC 718, as amended by ASU 2016-09. If an entity accounts for forfeitures when they occur, there should be no difference between employee share-based awards and non-employee share-based awards. If an entity continues to estimate forfeitures, the entity would need to consider the facts and circumstances and historical behaviors of its participants which some entities group by various categories.

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?*

Response: Yes, we agree that the practical expedient for non-public entities to substitute calculated values for expected volatilities when measuring share options and similar instruments issued to nonemployees is appropriate. ASC 718 provides guidance on estimating expected volatility for newly public and non-public entities that do not have sufficient stock price history by using select "Guideline Companies" or Peer Group Companies or an industry sector index until sufficient history is obtained on an entity's stock price. Given that there is generally no active market for a non-public entity's stock vs. a public entity's stock traded on a national securities exchange, use of Peer Group Volatility for non-employee share-based awards should be no different than how Peer Group Volatility is used for employee share-based awards in the option pricing model.

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?*

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Response: Yes, we agree that non-public entities should be allowed to make a one-time policy election to switch from measuring liability-classified nonemployee share-based payment awards at fair value to intrinsic value. Such policy election may need to be disclosed in the footnotes, if material of course, to prevent any perceived notion that the entity is using fair value and not intrinsic value.

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

Response: We support the use of the modified retrospective transition approach. We recommend the Board clarify the transition approach to be applied to “unsettled awards” still outstanding or deferred. There are various awards (i.e., awards with service conditions, performance conditions and/or market conditions). Awards that have previously vested should not have expense adjusted. However, entities may not have determined the fair value of a non-employee equity award at the grant date due to the guidance in ASC 505-50, which required measuring the fair value at the earlier of i) the performance commitment date or ii) the date the services required under the arrangement had been completed. If the proposed guidance is adopted, we recommend entities be permitted to perform a remeasurement as of the adoption date of the proposed guidance for the unvested awards to fix the fair value prospectively for the unvested shares over the remaining service/performance commitment period. This would be similar to a change in status from non-employee to employee. An expedient should be afforded to allow entities to estimate the expected term for a non-employee equity award using a “modified” SEC Simplified Method or historical entity data, if available. By “modified” SEC Simplified Method, it’s very likely the fair market value on the date of adopting the proposed guidance will not equal the original exercise price, which is a key characteristic of a “plain vanilla option” where the Simplified Method is permitted. However, calculating the midpoint between the vesting period and the remaining contractual term is reasonable, unless an entity’s historical data provides a more precise estimate.

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?*

Response: We believe it is up to each entity and its auditors to determine if asset bases including share-based payment costs should be adjusted. We generally do not believe an entity should be required to adjust the basis of an asset that includes share-based payment costs when applying the transition requirements. As fun and exciting as that may seem, it appears to be a complex and expensive exercise which would be contrary to the proposed guidance’s goal of reducing cost and complexity. We believe assets should remain at their historical values and the proposed guidance be applied prospectively.

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

Response: We believe the Financial Statement Preparers at each entity should determine with their auditors whether non-employee equity awards are material enough to warrant separate disclosure in the financial statement footnotes. The disclosure requirement in ASC 718-10-50-2g to provide separate disclosures to the extent there are differences in the characteristics of the awards should be sufficient. The item that we do recommend the Board clarify is the expense attribution model. Given the effort to align expense attribution for non-employee equity awards with employee equity awards, we recommend, for simplicity sake, that the Board allow entities to use straight-line amortization as an option of recognizing stock-based compensation expense. Most equity databases follow the ASC 505-50 guidance and uses the accelerated attribution method or front-load the expense for non-employee equity awards. Such expense recognition is very conservative, but entities generally want to be able to record the expense evenly over the requisite service period like they do for their employee equity awards. If equity grants granted to non-employees will be treated similar as equity grants granted to employees, it is reasonable to expect that expense amortization methods can also be similar if each type of award has similar characteristics.

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?*

Response: We believe Financial Statement Preparers along with the auditors at each entity are in the best position to estimate the time necessary to assess the impact of this new guidance. It should not take years unlike other more comprehensive/far reaching guidance like the Revenue Recognition guidance (ASC Topic 606 and related ASUs) and Accounting for Leases guidance (ASC Topic 842 and related ASUs). Similar to ASU 2016-09, non-public entities should be afforded a one-year deferral to adopt the new guidance after public entities are required to do so. However, early adoption is recommended should entities want to make the switch to the proposed guidance and simplify their accounting for non-employee equity awards sooner.

Finally, some interpretative examples from the Board on the following would also be helpful in assisting entities in properly applying the proposed guidance:

- i) Initial measurement of a non-employee stock option (assuming the suggested revision to utilize the expected term is permitted)**
- ii) Expense attribution (assuming the suggested revision to utilize straight-line amortization as an expense attribution method option is permitted)**
- iii) Applying the proposed guidance to unvested awards as of the adoption date using the modified retrospective approach

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- iv) Example ASC 718 footnote disclosure of non-employee equity awards accounted for under the new proposed guidance (prospectively) to the extent non-employee equity awards are deemed material or have different characteristics from an entity's other equity awards.

**If referring to the existing examples in ASC 718 for employee equity grants, we recommend the Board consider explicitly clarifying that the employee examples can also be applied for non-employee equity awards. That would reduce the number of revisions and avoid duplicate examples.

In conclusion, entities who issue employee equity awards also have and/or have the ability to issue similar equity awards to non-employees (except for Incentive Stock Options and Employee Stock Purchase Plan options which are only issued to eligible employees under IRC 422 and IRC 423, respectively). The proposed guidance should reduce cost and complexity and could generate further improvements assuming the suggested revisions to utilize the expected term in the option pricing model and straight-line amortization for non-employee awards are also permitted. This effort by the Board, along with the issuance of ASU 2016-09, is evidence that the gap is shrinking and we're getting closer to achieving convergence with the IASB's IFRS 2. There is still some work to converge the two share-based payment standards, but progress is being made and that's better than no progress at all.

Thank you for the opportunity to comment on the FASB's Exposure Draft, *Compensation- Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*. If you would like to discuss these comments further, please do not hesitate to contact me at (408) 385-8781.

Respectfully submitted,



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