August 18, 2015

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

File Reference No. 2015-270: Proposed Accounting Standards Update, *Compensation-Stock Compensation (Topic 718)*

Dear Ms. Cosper:

Connor Group, Inc. is pleased to provide our comments on the Proposed Accounting Standards Update, *Compensation—Stock Compensation (Topic 718), Improvements to Employee Share-Based Payment Accounting*. Connor Group was founded in 2005 and is a technical accounting advisory firm built of Big 4 alumni and industry executives. We currently have over 400 clients and specialize in helping them solve complex technical accounting issues under both US GAAP and IFRS. Our clients include both private and public companies, and we assist many of them with aspects of their accounting and financial reporting during their IPO filing process. Most of our clients offer share-based payment awards to employees and/or non-employees, and as part of our services, we assist many of them in addressing and resolving accounting issues related to stock compensation.

We have included below our responses to each of the "Questions for respondents" included in the Proposed Accounting Standards Update.

Question 1: *Do you agree that the proposed amendments 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: We believe that the proposed amendments related to treatment of income tax benefits and deficiencies and related cash flow effects, forfeitures (with certain modifications as discussed below), minimum tax withholdings and classification of related cash flows effects, and expected term (also with certain modifications as discussed below) will considerably reduce the cost and complexity of the information required to be prepared by entities, while improving or at a minimum not deteriorating the quality of the information provided to users of financial statements. One-time adoption cost could arise, but is likely to be limited and be offset with more significant longer-term benefits.

Conversely, we believe that the proposed changes to the classification of awards with repurchase features exercisable upon a contingent event and the one-time nonpublic entity election regarding the use of intrinsic value for awards classified as liabilities are not conceptually preferable, will not result in practical simplifications and savings on the level of effort required by entities, and will not improve the quality of information conveyed in the financial statements. Please refer to our in-detail discussion in Responses to Questions 7 and 9 below.

Question 2: *Should excess tax benefits and tax deficiencies be recognized in the income statement? If not, why, and are there other alternatives that are more appropriate? Should an entity delay recognition of an excess tax benefit until the benefit is realized through a reduction to taxes payable? If yes, why?*

Response: We support the Board's conclusions regarding elimination of the APIC ("windfall") pool concept, recognition of all excess tax benefits and deficiencies in the income statement, and recognition of excess tax benefits when the amounts are reflected through tax returns. We believe the Board proposals would significantly simplify entities' accounting for one of the most complex, controversial, poorly understood and counterintuitive areas of stock based compensation, income taxes and earnings per share calculations. In addition, we believe these proposals are conceptually more solidly grounded than the currently existing accounting literature.

Question 3: *Should the effect on tax cash flows related to excess tax benefits be classified as an operating activity on the statement of cash flows? If not, what classification is more appropriate and why?*

Response: We agree with the Board's conclusion that the effect on tax cash flows related to excess tax benefits should be classified as an operating activity in the statement of cash flows, and not "grossed up" between the financing cash inflows and operating cash outflows.

Question 4: *Should entities be permitted to make an accounting policy election either to account for forfeitures when they occur or to estimate forfeitures? If not, why?*

Response: We agree that entities should be permitted to make an accounting policy election to account for forfeitures when they occur instead of estimating. Many early-stage companies struggle in establishing a thorough forfeiture rate due to limited historical basis upon which to base management's expectations. Also, the calculation of estimated forfeitures is often overly complex and rarely results in a significant impact on an entity's financial statements for a given period.

This is especially true for service-condition awards that are amortized using the entire-award approach described in ASC 718-10-35-8(b). For example, many companies grant stock options that vest over four years, with 25 percent of the award vesting after one year (the "cliff") and the remainder vesting monthly or quarterly over the three years thereafter. Thus, after the cliff, most awards are no more than one or three months away from the next vesting date as of the entity's reporting period end. Considering that the amount of compensation expense must always equal at least the portion of the grant-date value of the award vested as of the reporting date, forfeitures are highly unlikely to have a significant impact on the financial statements for these awards.

<u>Estimated forfeitures when accounting for a modification of an award</u>

In Paragraph BC12 of the Background Information and Basis for Conclusions, the Board indicates that a Company would still have to estimate forfeitures when accounting for the modification of an award. We encourage the Board to reconsider this conclusion. While there is accounting software that can estimate and account for estimated forfeitures for "standard", unmodified awards, we are not aware of any software that can appropriately estimate or account for the impact of estimated forfeitures upon the award modification. For example, depending on whether an award is expected to be forfeited at the time of certain modifications of vesting conditions, the modification type, and thereby, accounting, would vary. This may practically arise when an entity modifies awards to add a provision to accelerate vesting upon a change in control. However, practically speaking, forfeiture estimate is not made at an individual award level. Thus, upon subsequent actual vesting or actual forfeiture of an award companies struggle determining whether such vested or forfeited award was originally expected to vest or be forfeited at the time the modification occurred, and thereby, whether it should be accounted for at the grant-date or modification-date fair value. Complicated estimation and calculation methods are developed, invariably in Excel, to address the issue to entities' and their auditors' satisfaction. However, we have not yet seen an instance where such calculations result in a meaningful impact on the financial statements that their users would find helpful to comprehend. These instances also frequently require entities to use the assistance of external accounting professionals, increasing the cost of compliance.

While we agree that allowing forfeitures to be accounted for based on actual would impact the ultimate amount of expense the entity would recognize in its financial statements, we believe the impact of such practical expedient would not result in systemic bias introduced into the entity's financial statements, and as such, we encourage the Board to consider allowing entities to elect not to estimate forfeitures when award modifications occur. This would significantly simplify accounting for stock compensation awards for the affected companies and especially benefit entities with less robust accounting resources, without a meaningful deterioration in the quality of the financial information the entity would generate.

Question 5: *Is the proposed expansion of the exception to liability classification related to the amount withheld for employee's taxes appropriate? If not, is there another exception that is more appropriate and why?*

Response: We believe that expanding the exception to liability classification related to an employee's tax withholdings is appropriate. We believe that the current requirement is overly stringent and this proposed change will simplify the application of accounting requirements.

Question 6: *Should the cash paid by an employer to the taxing authorities when directly withholding shares for tax-withholding purposes be classified as a financing activity on the statement of cash flows? If not, what classification is more appropriate and why?*

Response: We agree with the Board's conclusion that classification of cash paid by an entity to the taxing authorities as a financing activity in the statement of cash flows is conceptually most appropriate.

Question 7: *When assessing the classification of an award with a repurchase feature that can only be exercised on the occurrence of a contingent event, should a contingent event within the employee's control be assessed in the same manner as a contingent event outside the employee's control? If not, why should there be a difference in the assessment?*

Response: We believe both the existing approach and the approach currently proposed by the Board have conceptual merits that could justify adopting either of them as the authoritative guidance. From a practical perspective, we would like to share two concerns about the newly proposed approach. First, it is conceivable that entities might issue awards with repurchase features within the employee's control, whereby a non-substantive contingency may be added and could result in equity classification of the award. To give an extreme example, the repurchase right could be triggered if the employee writes and sends a free-form letter to the entity's Human Resources requesting to activate the repurchase right. Since in many instances entities would likely still conclude that the occurrence of such event before the employee bears risks and rewards of stock ownership is not probable, equity classification would likely result, until the employee actually acts to write and send the requisite letter. It is arguable whether classification of such award as equity or liability is conceptually the best approach; however, we find it hard to support that such an award should have different accounting from an award with put call features that are not contingent. Second, we do not believe there is much of a practical benefit from adopting this proposed change, as it would likely result in additional work required to evaluate whether the repurchase features of such awards would be exercised prior to employees bearing risks and rewards of share ownership.

Question 8: *Is the practical expedient for nonpublic entities to estimate the expected term of all awards with performance conditions that affect vesting or service conditions appropriate? If not, are there other practical expedients that are more appropriate and why? Should the expedient be limited to nonpublic entities?*

Response: We agree that codifying the simplification allowing nonpublic entities to estimate the expected term of share-based awards is appropriate. In practice, many nonpublic entities already apply this "simplified method" absent historical basis or technical know-how to prepare an alternative estimation. Codifying this practice will simplify the auditability of financial reporting for these entities.

However, we do not agree with the approach being proposed for awards with performance conditions. Many performance conditions are considered improbable of vesting at the grant date. For example, an award to a salesperson that provides for vesting if sales during an annual period meet a certain amount may not be considered probable at the grant date, for example, based on the how aggressive the sales target is. However, ultimately, this award will either vest or expire. We do not believe that the salesperson's expected exercise behavior would be impacted based on whether the award was probable of vesting at the grant date.

We believe such behavior is primarily affected by the liquidity of the underlying equity, the intrinsic value of the award, the holder's expectations of future performance and market volatility, tax effects of exercise, and whether the employee continues to work for the entity. In our opinion, none of these factors correlate with the management's assessment of probability of the award vesting at its grant date.

Further, the measurement premise for service- and performance-based awards is that the probability of the vesting condition being met is not incorporated into the value of the award. However, given the significant impact that the expected term may have on the value of an award, the proposed guidance would effectively create a measurement difference based solely on the probability of the performance condition being met.

We also note that in current practice, the simplified method is commonly used absent a more reliable alternative to estimate the expected term of awards with performance conditions and awards with both service and performance conditions in addition to awards with only service conditions. The proposed guidance may disqualify entities from using this method in circumstances where there may not be any other practical alternatives. What is more likely to happen though, is that entities would continue to use the same approach informally, "by analogy", assessing and concluding that it does not result in material errors in the financial statements.

We agree the estimation of the expected term is a challenge for many nonpublic entities and note that many newly-public entities also continue to rely on the simplified method to estimate the expected term of their awards until they have sufficient historical experience and know-how upon which to determine a more precise alternative.

We recommend that the Board allow the practical expedient to be applied if vesting is dependent upon either a service condition, a performance condition, or a service and performance condition.

Further, we believe this expedient should also be expanded to public entities. A recent client of ours, a European entity that is currently undergoing an IPO in the US meets the definition of a public entity because its shares are traded thinly, from time to time, on a European over-the-board stock exchange. However, it does not have any substantial history of option exercise or cancellation behavior to develop and use a policy other than the simplified method.

Finally, we believe the proposed pre-requisite to using the simplified approach that has been included in ASC 718-10-30-20B(a), the fact that the awards are granted at the money, can and should be relaxed. For private companies in particular, there are often retrospective changes in the value of the common stock which are likely to impact whether the awards were granted at the money, and thereby, whether the simplified method is available. If the proposed guidance is adopted as is, entities may find that such retrospective changes require the use of other methodologies to estimate the expected term, and for which they simply may not have all the relevant data. We would re-formulate ASC 718-10-30-20B(a) to say, "The share option or similar award is granted at-the-money, or at another price that is not expected to result in a significantly different option exercise behavior".

Last, but not least, many companies allow the practice of early exercising (i.e., prior to vesting) the stock options. If an option is early exercised, e.g. upon grant, the simplified method does not properly reflect its expected term, which instead should equal its vesting period. We believe the proposed ASC 718-10-30-20B should include an additional pre-requisite, specifically, that the award is not subject to early exercise (or is not expected to be early exercised).

Question 9: *Should nonpublic entities be allowed to make a one-time election to switch from measuring liability-classified awards at fair value to intrinsic value? If not, why? While not proposed, should the Board consider making the ability to elect intrinsic value an ongoing election alternative for nonpublic entities?*

Response: While we agree that the one-time election would simplify the accounting for certain entities, we do not believe that allowing nonpublic entities to switch from measuring liability-classified awards at fair value to intrinsic value upon the effective date of the new pronouncement would be an effective long-term solution, at least in view of the background reasons quoted. Given that this guidance currently exists, we expect that in the future there will continue to be other companies and other practitioners who will have missed the existing intrinsic value election alternative for nonpublic companies, including no doubt some that will also have missed the current Proposed Accounting Standards Update.

Alternatively, we believe that clarifying that in the case of nonpublic entities that the use of the intrinsic value option could be preferable to the fair value, given the respective costs and benefits of the two approaches. This will allow unaware companies to change accounting policies with decreased resistance from auditors or other regulators.

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

Response: We agree that the transition requirements are appropriate. Further, we also believe that the Board should allow early adoption of the Proposed Accounting Standards Update when it is issued. We assist many nonpublic entities through their IPO process and transition to public entity reporting requirements, and we believe allowing entities to early adopt the new accounting guidance would be helpful in allowing them to streamline their implementation of enhanced accounting policies and procedures and present financial statements for all periods included in the IPO filings on a comparable basis.

Question 11: *How much time will be necessary to adopt the amendments in this proposed Update? Should the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?*

Response: We believe that the guidance may require changes to entities' existing accounting systems and other processes; however, such changes are not likely to be pervasive or affect many entities. We estimate public entities will typically need six months to a year to prepare and adopt the Proposed Accounting Standards Update. Further, we believe nonpublic entities would be capable of adopting over a similar time period. Finally, as noted in Question 10 above, we believe that allowing entities to early adopt new guidance would be helpful.

We would be pleased to respond to any questions the FASB or its staff may have concerning our comments. Please direct any questions to Aleks Zabreyko (650-353-7044, aleks.zabreyko@connorgp.com) or Jacob Sperry (203-621-4636, jacob.sperry@connorgp.com).

Sincerely,

Connor Group, Inc.