

## ACCOUNTING FOR NON-EMPLOYEE RSUs

Recently a question was posted on an equity-compensation Yahoo Group of which I'm a member.

"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?"

She had assumed that because the system she was using for administration and accounting didn't perform mark-to-market accruals for non-employee RSUs, it wasn't required.

I explained that non-employee RSUs should be marked to market. And just because many systems don't support this, 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! (I had recently created a custom Crystal report for a client for non-employee RSUs, so knew the required calculations already.)

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

A few pointers on the basics behind the calculations:

- In general the FIN 28 (or "Multiple") approach is used for non-employee grants. This was explicitly required by EITF 96-18 which laid out the rules for accounting for non-employee grants in the pre-codification standards.
- 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. (Yet 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. (Expense will be true up to final market value on vest 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 true 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.
- 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 - that's what we did - made life much easier.)

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? Comments? Please contact me at [edodge@sos-team.com](mailto:edodge@sos-team.com).

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