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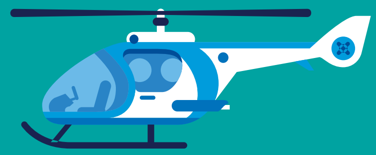

Defining Issues®

FASB simplifies the accounting for share-based payments to nonemployees

June 22, 2018

KPMG reports on ASU 2018-07[1], which more closely aligns the accounting for employee and nonemployee share-based payments.

Applicability

All companies that enter into nonemployee share-based payment transactions.

Key facts and impacts

The ASU eliminates the separate accounting model for nonemployee share-based payment awards and generally requires companies to account for share-based payment transactions with nonemployees in the same way as share-based payment transactions with employees.

The accounting remains different for attribution and a contractual term election for valuing nonemployee equity share options.

Attribution of nonemployee awards

Attribution, which represents how the equity-based payment cost is recognized over the vesting period, will continue to be applied for nonemployee awards as if the company issuing equity had paid cash for the goods and/or services.

Therefore, a company should consider the nature of what it received to determine the appropriate period and pattern in which to recognize the cost.

Example: Attribution of stock options provided to a supplier

Fact pattern

On March 31, 20X2, ABC enters into an agreement with a supplier to provide inventory on June 30, 20X2 and September 30, 20X2.

The supplier agrees to provide the inventory in exchange for 500 stock options for each inventory delivery. The grant date requirements are met on the date ABC enters into the agreement.

Evaluation

ABC recognizes the grant-date fair value for the stock options on June 30, 20X2 and September 30, 20X2 when the company receives the inventory.

[1] ASU 2018-07, Improvements to Nonemployee Share-Based Payment Accounting, June 20, 2018

Example: Attribution of stock options provided to a service provider

Fact pattern

On December 15, 20X1, ABC enters into an agreement with a public relations firm to provide services throughout the 20X2 year.

The public relations firm agrees to provide the services in exchange for 500 stock options. The grant date requirements are met on the date ABC enters into the agreement.

Evaluation

ABC recognizes the grant-date fair value for the 500 stock options when it receives the services. For example, if the public relations firm provides the services relatively evenly each month, the expense is recognized ratably each month.

Valuation of nonemployee equity share options

When valuing nonemployee equity share options or similar instruments, a company may elect on an award-by-award basis to use the contractual term as the expected term. As a result, unlike employee awards, a company may not need to monitor post-vesting transfers to determine the expected term for nonemployee equity share option awards. However, on an individual award basis, a company may elect to calculate an expected term as the measurement input for nonemployee awards. This may result in a term that is less than the contractual term of the award, and therefore also has a lower grant-date fair value.

In addition, if a nonpublic entity chooses to apply a midpoint practical expedient to estimate the expected term of its nonemployee awards, it must apply this practical expedient to all nonemployee awards that meet certain conditions (e.g. the award must be granted at the money, the award cannot include a market condition, there is a limited time to exercise the award after the goods or services are provided and the award cannot be hedged or sold).

Forfeitures

Forfeitures for nonemployee awards are treated similarly to forfeitures for employee awards. A company is permitted to make an entity-wide policy election to estimate forfeitures or to recognize them as they occur.

KPMG observation

While a company is required to make an entity-wide policy election about forfeitures, we believe the ASU permits separate entity-wide policies for employee and nonemployee awards.

Because of the different attribution for nonemployee awards, a company may consider whether a separate forfeiture accounting policy is more appropriate for nonemployee awards compared with employee awards.

In addition, we believe that a company would continue to differentiate between employee and nonemployee share-based payment awards within its accounting records. The ability to use the contractual term for valuing nonemployee equity share options, and the election of a separate entity-wide policy for estimating forfeitures for employee awards and nonemployee awards would require separate tracking to account for them correctly.

Nonpublic company effective date election

Nonpublic companies may elect as of the effective date to:

- change the fair value measurement of liability-classified nonemployee awards to be measured at intrinsic value (one-time election); and
- measure equity share options and similar instruments issued to nonemployees at a calculated value that uses historical volatility of an appropriate industry sector index, only if it is not practicable to estimate the expected volatility of the company's share price.

If a nonpublic entity already measures its liability-classified employee awards at intrinsic value, this ASU requires the nonpublic entity to also measure its liability-classified nonemployee awards at intrinsic value.

Current guidance for equity-based payments to nonemployees[2]	New requirements	Aligned with stock compensation guidance[3]
Overall measurement objective		
Select the fair value of either the consideration received or the equity instruments issued, whichever is more reliable.	Use the fair value at the grant date of the equity instruments that the company is obligated to issue.[4]	✔
Measurement date (equity-classified)		
Measure equity-classified awards at the earlier of the commitment date for performance by the counterparty or the date when performance is complete.	Measure equity-classified awards at the grant date.	✔
Awards with performance conditions		
Measure awards at the lowest aggregate fair value, and remeasure them until all performance conditions are met.	Measure awards at fair value, and recognition is associated with the probable outcome.	✔
Subsequent measurement		
Reassess classification under other US GAAP once awards are vested and no further performance is required.	Measure awards using stock compensation guidance unless they are modified after the nonemployee stops providing goods or services.	✔
Attribution of compensation cost		
Recognize in the same manner as if the company issuing equity had paid cash for the goods and/or services.	No change.	See note.
Note: The ASU moves the attribution guidance for nonemployee share-based payment awards to ASC 718 from ASC 505-50. However, the FASB did not change the attribution guidance; therefore, there may continue to be differences in the accounting for nonemployee and employee share-based payment awards.		

2 ASC 505-50, Equity—Equity-Based Payments to Non-Employees

3 ASC 718, Compensation—Stock Compensation

4 ASC 718-10-30-10A states that on an award-by-award basis, an entity may elect to use the contractual term as the expected term when estimating the fair value of nonemployee awards. This election does not exist for employee awards.

Current guidance for equity-based payments to nonemployees[2]	New requirements	Aligned with stock compensation guidance[3]
Disclosures		
Provide disclosures similar to those required for employee stock compensation to the extent they explain the effect of the share-based transactions on the financial statements.	No additional disclosures required; however, existing disclosure requirements within the stock compensation guidance also apply to nonemployee awards.	✔

KPMG observation
In general, a company is required to separately disclose information related to share-based payment transactions if this information is necessary to understand their effect on the financial statements. While there is no specific provision for a company to separately disclose agreements with nonemployees, if this information is important to understanding their effect, separate disclosure should be provided.

Effective dates and transition

	Public business entities	All other entities
Annual periods – Fiscal years beginning after	December 15, 2018	December 15, 2019
Interim periods – In fiscal years beginning after	December 15, 2018	December 15, 2020
Early adoption allowed?	Yes, but no earlier than the company's adoption date of ASC 606.[5]	
Transition	— Modified retrospective approach with fair value measurement of unsettled liability-classified nonemployee awards (i.e. unvested or vested awards that have not been exercised) and equity-classified nonemployee awards where a measurement date has not been established. — A cumulative effect adjustment to the opening balance of retained earnings as of the date of adoption. — Completed assets – e.g. finished goods inventory or amortized equipment are not remeasured.	

[5] ASU 2018-07 amended ASC 606, Revenue from Contracts with Customers, to clarify that consideration payable to a customer also includes equity-based instruments (liability- or equity-classified) granted when selling goods or services.

KPMG observation

For assets that are not complete, the transition guidance requires the remeasurement of capitalized costs at fair value for unsettled liability-classified nonemployee awards and equity-classified nonemployee awards where a measurement date has not been established. Therefore, a company would need to measure those awards at the adoption-date fair value, which may be different from how the awards were measured before adoption of the ASU.

For example, a company may issue equity-based instruments to external software engineers, and these share-based costs qualify for capitalization as an internal-use software asset.

If the internal-use capitalized software asset is not yet ready for its intended use (i.e. not complete) at the adoption date, the company would measure any related unsettled liability-classified nonemployee awards and equity-classified nonemployee awards where a measurement date has not been established, at the adoption-date fair value and include it in the transition adjustment.

The transition guidance does not address those assets that may be ready for its intended use, yet not placed in service (e.g. computer software after all substantial testing is completed that will be placed in service in planned stages that may extend beyond the adoption date). Judgment may be required to distinguish whether an asset is complete and therefore excluded from the measurement adjustment.

Contributing authors

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KPMG's Financial Reporting View

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