# Defining Issues®

## FASB affirms decisions on accounting for share-based consideration payable to a customer

November 15, 2019

KPMG reports on ASU 2019-08,[1] which clarifies that share-based consideration payable to a customer is measured under stock compensation guidance.[2]

### Applicability

All companies within the scope of ASC 606[3] that provide share-based payment awards to customers.

### Key facts and impacts

A company that gives share-based payment awards to customers:

— applies ASC 718 to measure the awards and determine whether the awards are classified as equity or liabilities;

— measures the awards at their grant-date fair value, and records the awards as a reduction to revenue or as an expense based on the revenue guidance; and

— estimates and adjusts the fair value of the awards each reporting period until a grant date is established, if a company is required to estimate the transaction price in the revenue guidance before a grant date is established under ASC 718.

### Background

ASU 2018-07[4] explicitly excluded from the scope of ASC 718 equity payments to customers accounted for under ASC 606. Questions emerged about how to account for these awards because ASC 606 does not have measurement guidance for equity instruments granted to a customer.

The following example illustrates the effect of these awards not being in the scope of ASC 718 before ASU 2019-08.

1 ASU 2019-08, Codification improvements—Share-Based Consideration Payable to a Customer

2 ASC 718, Compensation—Stock Compensation

3 ASC 606, Revenue from Contracts with Customers

4 ASU 2018-07, Improvements to Nonemployee Shared-Based Payment Accounting

### Example

On January 1, 2019, Company A executes a Master Supply Agreement (MSA) with Customer B to deliver custom widgets for one year. Enforceable rights and obligations exist only after Customer B issues a purchase order for a custom widget. ASC 606 specifies that a contract does not exist until each purchase order is issued.

Each custom widget is priced at $1,000, and Company A agrees to grant Customer B 500 fully vested stock shares as a sales incentive for each widget purchased. During 2019, Customer B issues 3 purchase orders for 1 widget each. Before ASU 2019-08, the accounting may have resulted in a reduction of the transaction price being measured at the date a contract exists under ASC 606.

| Issue date | Company A stock price | Measurement of award before ASU 2019-08 |
|---|---|---|
| | $1.00 – January 1, 2019 | |
| January 15, 2019 | $1.05 | $525 |
| March 1, 2019 | $1.50 | $750 |
| December 1, 2019 | $2.00 | $1,000 |

Although ASC 606 does not provide explicit guidance about accounting for equity payments to customers, it requires that a company determine the transaction price of a contract at inception and measure noncash consideration received at its fair value. Some stakeholders objected to this approach and requested clarification about when and how to measure equity payments to customers.

## New guidance

### Applying the measurement and equity vs. liability classification guidance of ASC 718

ASU 2019-08 clarifies that equity awards to customers are measured at the grant date, which is when there is a mutual understanding of the awards' terms and conditions. The awards are measured and classified as liabilities or equity following the guidance in ASC 718. However, the grant-date fair value of the awards is presented as a reduction of revenue unless it represents a fair value payment for a distinct good or service under ASC 606. The measurement provisions of ASC 718 apply when evaluating the share-based payment awards, including those provisions related to awards with market, performance or other conditions.

### KPMG observation

The grant date of awards promised to a customer may be the same date as the contract inception date under ASC 606. In most cases, both parties will have a mutual understanding of the awards' terms and conditions at the contract inception date. However, this may not always be the case as illustrated in the previous example.

However, referring to the example above, under ASU 2019-08 Company A's awards to Customer B are measured on January 1, 2019 using the stock price on the date of the MSA when there is a mutual understanding of the awards' terms and conditions. This results in a $500 reduction in the transaction price for each purchase order issued.

Even though the awards are measured under ASC 718, they are recognized in the income statement using the ASC 606 guidance. The fair value of the awards is part of the transaction price that is allocated to performance obligations of the customer contract and recognized as a reduction of revenue when (or as) control of the goods or services in the contract are transferred to the customer.

### Estimating fair value before the grant date

There may be cases in which a company has to estimate the fair value of the awards before the grant date. If a company promises or intends to provide an award to a customer and the grant date has not occurred, the entity follows the transaction price guidance in ASC 606 and estimates the fair value of the award. That amount will be used to reduce the transaction price in the contract to the consideration to which the company expects to be entitled. The estimate of fair value should be adjusted each reporting date until a grant date is achieved.[5]

#### KPMG observation

We observe that the accounting for an award when the grant date occurs before an ASC 606 contract exists may be mostly straightforward. However, the grant-date fair value guidance does not override the transaction price guidance and the core principle of ASC 606, which is to recognize revenue equal to the consideration to which the entity expects to be entitled.

A company that has a past practice of providing share-based payment awards to customers or otherwise promises or intends to provide an award cannot delay the recognition of a reduction in the transaction price of a customer contract because a grant date has not been established. This accounting could result in volatility because the entity is required to estimate the fair value of an equity instrument before there is a grant date, and then adjust the fair value each reporting period until the grant date occurs. This accounting is similar to the requirements under ASC 718 when the service inception date precedes the grant date.

### Subsequent changes in probability estimates

The number of equity instruments granted may be variable due to service or performance conditions that affect vesting. For example, the number of awards may increase depending on the customer's purchase volume.

Each reporting date, the estimated number of awards is updated until the awards vest. The ASU requires changes in the grant-date fair value of an award as a result of changes in the expected outcome of a service or a performance condition (whether the condition affects vesting or not) to be recorded as a reduction in the transaction price. This includes changes as a result of forfeitures of awards.

### Private company considerations for liability-classified awards

Private companies should initially and subsequently measure at fair value liability-classified awards issued to customers. Use of the intrinsic value method is not permitted when measuring the fair value of share-based payment awards granted to a customer, unless those awards are issued in exchange for distinct goods or services.

### Goods or services received from a customer

A company follows the guidance in ASC 606 for distinct goods or services received from a customer and assesses their fair value when determining whether share-based payment awards granted as consideration payable to a customer should reduce the transaction price. To the extent the fair value of the share-based awards issued to a customer exceed the fair value of the goods or services received, the incremental value should be recorded as a reduction of the transaction price.

### Definition of a customer

The ASU amends ASC 718 to require share-based consideration granted to a customer to cease being accounted for under ASC 718 if the terms of the award are modified after the grantee vests in the award and is no longer a customer. In this situation, the award may become subject to other guidance such as derivatives and hedging guidance.

[5] ASC 606-10-55-88B

**KPMG observation**

The definition of a customer is "a party that has contracted with a company to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration." Because the counterparty may be someone that has previously contracted to buy goods or services, the ASU is not clear when a grantee is no longer a customer. It is also unclear when an award modification would be considered a contract modification under ASC 606. A company should evaluate its past and future relationship with the grantee and consider why the modification is being made to determine whether the grantee is a customer and what accounting guidance to apply.

## Effective dates and transition

<table>
<tr><th></th><th>Public business entities and others that have adopted ASU 2018-07</th><th>All other entities</th></tr>
<tr><td>Annual periods – In fiscal years beginning after</td><td>December 15, 2019</td><td>December 15, 2019</td></tr>
<tr><td>Interim periods – In fiscal years beginning after</td><td>December 15, 2019</td><td>December 15, 2020</td></tr>
<tr><td>Early adoption allowed?</td><td colspan="2">Yes, for financial statements that have not yet been issued, but not earlier than the adoption of ASU 2018-07.</td></tr>
<tr><td>Transition – Adoption of ASU 2019-08 in the same fiscal year in which ASU 2018-07 was adopted</td><td colspan="2">— Retrospectively apply adoption to all previous prior interim periods within the same fiscal year in which ASU 2018-07 was adopted.<br>— Record a cumulative-effect adjustment to beginning retained earnings as of the beginning of the fiscal year in which ASU 2018-07 was adopted.<br>— Consider the transition guidance in ASU 2018-07 when determining the cumulative-effect adjustment.</td></tr>
<tr><td>Transition - Adoption of ASU 2019-08 in a fiscal year after the fiscal year in which ASU 2018-07 was adopted</td><td colspan="2">— Apply the transition requirements as if the ASU was adopted in the same year as ASU 2018-07; or<br>— Apply a modified retrospective transition approach through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which ASU 2019-08 is adopted. Reevaluate awards granted to customers for classification.<br>  – Only certain instruments are included in the assessment – e.g. unsettled liability-classified awards, and equity-classified awards that do not have a measurement date.<br>  – Nonpublic companies apply the fair value measurement requirement prospectively.</td></tr>
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## KPMG observation

The ASU requires companies that have already adopted ASU 2018-07 to adopt the ASU retrospectively through a cumulative-effect adjustment to retained earnings as of the beginning of the same year as they recorded the cumulative-effect adjustment to retained earnings for the adoption of ASU 2018-07. For all other companies, the ASU provides the option to adopt either using the same method as companies that have already adopted ASU 2018-07 or to adopt as of the beginning of the fiscal year of adoption of the ASU through a cumulative-effect adjustment to beginning retained earnings.

For companies that have adopted ASU 2018-07, or for those that plan to apply the transition requirements as if the ASU was adopted in the same year as ASU 2018-07, the transition provision in ASU 2018-07 provided alternative measurement date approaches. If ASU 2018-07 was adopted at the beginning of an interim period other than the first interim period of its fiscal year, entities may have measured the effect as of the beginning of the fiscal year, or as of the beginning of a subsequent interim period.

We believe a company adopting ASU 2019-08 would follow the same approach that it followed for its adoption of ASU 2018-07.

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**KPMG's Financial Reporting View**
kpmg.com/us/frv

**kpmg.com/socialmedia**