

FASB FLASH REPORT

JULY 2018 / www.bdo.com

FASB Simplifies Accounting for Nonemployee Share-Based Payments

The FASB issued ASU 2018-07¹ to expand the scope of Topic 718² to include share-based payments issued to nonemployees. The new ASU is available [here](#), and the effective date for public companies is for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. For all other entities, the effective date is fiscal years beginning after December 15, 2019. Early adoption is permitted.

BACKGROUND

On June 20, 2018, the FASB issued ASU 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting*, as part of its ongoing Simplification Initiative. Currently, share-based payments to nonemployees are accounted for under Subtopic 505-50³ which significantly differs from the guidance for share-based payments to employees under Topic 718. This ASU supersedes Subtopic 505-50 by expanding the scope of Topic 718 to include nonemployee awards and generally aligning the accounting for nonemployee awards with the accounting for employee awards (with limited exceptions).

¹ Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting

² Compensation—Stock Compensation

³ Equity – Equity-Based Payments to Non-Employees

MAIN PROVISIONS

The amendments specify that Topic 718 applies to all share-based payment transactions where the grantor is acquiring goods or services being used or consumed in its own operations by issuing these awards. They do not apply to share-based payments that are used to effectively provide financing for the grantor/issuer or that are granted in conjunction with selling goods or services to customers as part of a contract which should be accounted for under Topic 606.

Key Amendments Applicable to All Entities

- ▶ Equity-classified nonemployee share-based payment awards are no longer measured at the earlier of the date at which a commitment for performance by the counterparty is reached or the date at which the counterparty's performance is complete. Rather, they are now measured at the grant date.
- ▶ Nonemployee share-based payment awards with performance conditions are measured at the lowest aggregate fair value under today's guidance, which often results in zero value. The new ASU aligns the accounting for nonemployee share-based payment awards with performance conditions with accounting for employee share-based payment awards under Topic 718 by requiring entities to consider the probability of satisfying performance conditions.
- ▶ Subtopic 505-50 requires equity-classified nonemployee share-based payment awards to follow other guidance (e.g. Topic 815⁴) upon vesting, which then requires entities to reassess classification of the awards under that other guidance at that time. This ASU eliminates the reassessment of classification upon vesting and instead, requires the nonemployee share-based payment awards to continue to be subject to Topic 718 unless they are modified after the good has been delivered, the service has been rendered, or any other conditions necessary to earn the right to benefit from the instruments have been satisfied, and the nonemployee is no longer providing goods or services, consistent with the treatment of employee awards.
- ▶ Current guidance requires entities to use the contractual term for measurement of the nonemployee share-based payment awards. The new ASU allows entities to make an award-by-award election to use either the expected term (consistent with employee share-based payment awards) or the contractual term for nonemployee awards.

BDO Observation:

Entities should note the ASU does not change the period of time over which nonemployee awards vest or their pattern of recognition in the financial statements. The Board decided to maintain current practice on this point, which generally requires nonemployee awards to be recognized in the same period and in the same manner (i.e., capitalize or expense) that a cash-based payment would be. Therefore, the timing of recognition for nonemployee awards could continue to differ from the timing of recognition for employee awards which are recognized ratably over the service period.

Amendments Applicable to Nonpublic Entities

Intrinsic Value

Entities are required to measure liability-classified nonemployee share-based payment awards at fair value under current guidance. The new ASU now permits nonpublic entities to elect a policy to measure all liability-classified share-based payments to nonemployees at intrinsic value instead of fair value. However, this accounting policy must be elected for awards to both nonemployees and employees. For example, if an entity already has made a policy election for its employee awards, it should also apply the policy election to nonemployee awards. The nonpublic entity is not required to evaluate whether the change in accounting policy is preferable under Topic 250.

Calculated Value

When a nonpublic entity is not able to reasonably estimate the fair value of nonemployee awards because it is not practicable to estimate the expected volatility of its share price, the entity may account for the awards using the calculated value method under Topic 718. The nonpublic entity may account for the awards on the basis of a value calculated using the historical volatility of an appropriate industry sector index. This calculated value should be consistent between employee share-based payment transactions and nonemployee share-based payment transactions.

EFFECTIVE DATE AND TRANSITION

The amendments in this Update are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

Early adoption is permitted, but no earlier than an entity's adoption date of Topic 606.⁵ If an entity elects to early adopt the ASU in an interim period, the adoption must be reflected as of the beginning of the relevant fiscal year.

Upon adoption, an entity should remeasure liability-classified awards that have not been settled by the date of adoption and equity-classified awards for which a measurement date has not been established at fair value as of the adoption date. The impact of remeasurement must be recognized through a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year of adoption.

If the cost associated with nonemployee awards was capitalized as part of an asset, the entity must not remeasure assets that are completed. For example, finished goods inventory or equipment that has begun amortization should not be remeasured upon transition.

Disclosures required at transition include the nature of and reason for the change in accounting principle and, if applicable, quantitative information about the cumulative effect of the change on retained earnings or other components of equity.

⁵ Revenue from Contracts with Customers

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