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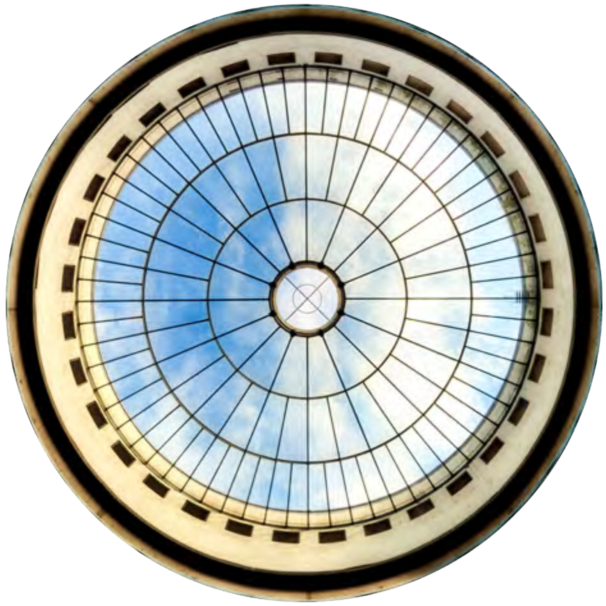

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FASB Issues Proposed ASU to Address the Accounting for Share-Based Payments Issued as Sales Incentives to Customers

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On March 4, 2019, the FASB issued a proposed ASU[1] that would clarify the accounting for share-based payments issued as sales incentives to customers ("share-based sales incentives") under ASC 606.[2] Comments on the proposed ASU are due by April 18, 2019. For ease of reference, the proposal's questions for respondents are reprinted in the appendix of this *Heads Up*.

Background

In June 2018, the FASB issued ASU 2018-07,[3] which supersedes ASC 505-50 and expands the scope of ASC 718 to include share-based payment arrangements related to the acquisition of goods and services from nonemployees. ASU 2018-07 also amends the guidance in ASC 606-10-32-25 on consideration payable to a customer to expand the scope of the form of consideration to include equity instruments granted in conjunction with the sale of goods or services. Accordingly, under ASU 2018-07, share-based payments issued to a customer that are not in exchange for a distinct good or service (i.e., share-based sales incentives) are outside the scope of ASC 718 and must be accounted for under ASC 606. While ASC 606 addresses how to recognize share-based sales incentives (i.e., as a reduction of revenue), it

[1] FASB Proposed Accounting Standards Update (ASU), *Codification Improvements — Share-Based Consideration Payable to a Customer*.

[2] For titles of *FASB Accounting Standards Codification* references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

[3] FASB Accounting Standards Update No. 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting*. For key provisions of ASU 2018-07, see Sections 9.1 through 9.10 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* (2018).

does not provide guidance on the measurement (or measurement date) of such incentives. Therefore, upon adoption of ASU 2018-07, there is no guidance that addresses the measurement of share-based sales incentives.

Key Provisions of the Proposed ASU

The proposed ASU would require that entities measure and classify share-based sales incentives by applying the guidance in ASC 718. Accordingly, under the proposed ASU, entities would measure share-based sales incentives by using a fair-value-based measure[4] on the grant date, which would be the date on which the grantor (the entity) and the grantee (the customer) reach a mutual understanding of the key terms and conditions of the share-based sales incentive. The resulting measurement of the share-based sales incentive would be reflected as a reduction of revenue in accordance with the guidance in ASC 606 on consideration payable to a customer. After initial recognition, the measurement and classification of the share-based sales incentive would continue to be subject to ASC 718 unless (1) the award is subsequently modified when vested and (2) the grantee is no longer a customer.

The amendments in the proposed ASU apply to share-based sales incentives issued to customers under ASC 606. Therefore, the proposed ASU does not directly address similar equity-based incentives issued by a lessor to a lessee under ASC 840 or ASC 842.

Connecting the Dots

While ASC 718 requires that liability-classified share-based payment awards be remeasured at the end of each reporting period until settlement, the proposed ASU specifies that only the grant-date fair-value-based measure of a liability-classified share-based sales incentive would be reflected as a reduction of revenue in accordance with ASC 606. Any changes to the measurement of the share-based sales incentive after the grant date that are due to the form of the consideration would be reflected elsewhere in the income statement.[5] Therefore, although an entity would be required to remeasure liability-classified share-based sales incentives at the end of each reporting period until settlement under the proposed ASU, subsequent changes to the fair-value-based measure that are due to the form of the consideration would not be reflected as an adjustment to revenue.

In addition, the manner in which share-based sales incentives would be recognized is based on the guidance in ASC 606, since ASC 718 would only apply to measurement and classification of such awards. Accordingly, under ASC 606-10-32-27, an entity would recognize the grant-date fair-value-based measure of share-based sales incentives as a reduction of revenue when (or as) the later of either of the following events occurs:

a. The entity recognizes revenue for the transfer of the related goods or services to the customer.

b. The entity pays or promises to pay the consideration (even if the payment is conditional on a future event). That promise might be implied by the entity's customary business practices.

[4] There are several practical expedients in ASC 718 that are available to nonpublic entities that are measuring share-based payment awards. Most of these measurement-related practical expedients are also available to nonpublic entities that are measuring share-based sales incentives under the proposed ASU. However, nonpublic entities would be required to use a fair-value-based measure for all liability-classified share-based sales incentives; the policy election for nonpublic entities to use intrinsic value is not available for such liability-classified awards. For more information about the measurement-related practical expedients available to nonpublic entities, see Section 4.13 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* (2018).

[5] Other than stating that subsequent changes due to the form of the consideration should not be presented in revenue, the proposed ASU does not specify where such changes should be reflected in the income statement. Therefore, an entity would use judgment to determine the appropriate presentation in such circumstances.

Example

On January 1, 20X1, Entity A executes a one-year master supply agreement (MSA) to sell and deliver widgets with certain specifications to Entity B (a customer). The MSA includes general terms and conditions but does not contain any minimum purchase requirements. Accordingly, legally enforceable rights and obligations associated with a revenue contract between A and B do not exist until B issues a purchase order for a specific number of widgets. In other words, the criteria in ASC 606-10-25-1 are only met each time B issues a subsequent purchase order under the MSA.

Entity B agrees to pay A $1,000 for each widget purchased under the MSA. As a share-based sales incentive, A includes terms in the MSA that grant B 500 fully vested shares of A's common stock for each widget that B purchases. The share-based sales incentive is not in exchange for distinct goods or services. Entity B issues three separate purchase orders, each for one widget, on January 31, March 1, and December 31, 20X1. On the same day on which A receives each purchase order, it transfers control of each widget to B and also issues to B 500 shares of A's common stock in fulfillment of the terms of the MSA.

The fair value of A's common stock is $1.00 per share on January 1, 20X1, and appreciates during 20X1 as follows:

Date	Entity A Common Stock Fair Value (per Share)
January 1, 20X1	$ 1.00
January 31, 20X1	$ 1.05
March 1, 20X1	$ 1.50
December 31, 20X1	$ 2.00

Entity A adopted ASC 606 and ASU 2018-07 on January 1, 20X1. Entity A concludes that the terms of the MSA are sufficient to establish a grant date for the share-based sales incentive in accordance with the guidance in ASC 718. Under the proposed ASU, A would measure the share-based sales incentive issued to B on January 1, 20X1, because a grant date exists for the share-based sales incentive in accordance with the criteria in ASC 718. Entity A will thus recognize a reduction in revenue for each separately sold widget by the grant-date fair-value-based measure of the share-based sales incentive of $500 (500 shares × $1.00), measured as of January 1, 20X1, and will recognize the following revenue during 20X1:

	January 31, 20X1	March 1, 20X1	December 31, 20X1	Total
Revenue	$ 1,000	$ 1,000	$ 1,000	$ 3,000
Less: share-based sales incentive	500	500	500	1,500
Net revenue	$ 500	$ 500	$ 500	$ 1,500

Entity A would classify the share-based sales incentive in accordance with the guidance in ASC 718 and would continue to classify and measure the share-based sales incentive in accordance with ASC 718 unless it is subsequently modified when it is vested and B is no longer a customer.

Example (continued)

Connecting the Dots

Because of the lack of guidance addressing the measurement of share-based sales incentives upon the adoption of ASU 2018-07, there may be diversity in practice related to how entities that have adopted ASU 2018-07 account for these awards. The FASB received feedback "that the lack of guidance for such transactions could lead to diversity, with entities applying either the noncash consideration guidance in Topic 606 or the guidance in Topic 718 on measuring share-based consideration to a customer."

An entity that applies the noncash consideration guidance in ASC 606 to the above example may reasonably conclude that the share-based sales incentive should not be measured on January 1, 20X1, because the MSA does not establish a revenue contract inception date in accordance with the guidance in ASC 606-10-25-1 and ASC 606-10-32-21. Rather, the entity may separately measure each of its three issuances of stock on the basis of the fair value of the issued stock as of each corresponding purchase order date (i.e., January 31, March 1, and December 31, 20X1), because those are the points in time at which a contract inception date is established for each purchase order. Under this approach, the total reduction in revenue would be $2,275 [(500 shares × $1.05) + (500 shares × $1.50) + (500 shares × $2.00)]. However, given the lack of direct guidance, other approaches may also be reasonable.

Transition and Effective Date

Transition

The proposed ASU would require an entity to apply the same transition provisions as those in ASU 2018-07.

Connecting the Dots

ASU 2018-07 generally requires an entity to use a modified retrospective transition approach,[6] with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year, for all (1) liability-classified nonemployee awards that have not been settled as of the adoption date and (2) equity-classified nonemployee awards for which a measurement date has not been established as of the adoption date. In the application of a modified retrospective transition approach:

- The ASU's transition provisions do not apply to equity-classified awards for which a measurement date was established before the adoption date.
- The ASU requires that equity-classified awards (for which a measurement date has not been established before the adoption date) be remeasured on the basis of their adoption-date fair-value-based measure.
- An entity applies the guidance on modifications of an award from liability to equity classification (i.e., the unsettled liability award as measured on the adoption date would be reclassified to equity) to determine the cumulative-effect adjustment to equity for unsettled awards that are currently classified as a liability but will be classified as equity under the ASU.

[6] A nonpublic entity that changes its measurement of nonemployee awards to calculated value instead of a fair-value-based measure must use a prospective approach under the ASU.

If an entity has already adopted ASU 2018-07, it should adopt the provisions of the proposed ASU retrospectively for all relevant prior periods beginning with its initial ASU 2018-07 adoption date, with a cumulative-effect adjustment to retained earnings as of the beginning of the fiscal year in which it adopted ASU 2018-07.

In the first interim period and fiscal year of the proposed ASU's adoption, an entity must disclose the following:

- The nature of and reason for a change in accounting principle.
- The cumulative effect of a change on retained earnings (or other components of equity or net assets) in the statement of financial position as of the beginning of the period of adoption.

Effective Date

The effective date of the proposed ASU will depend on whether an entity has previously adopted ASU 2018-07:

- An entity that has not yet adopted ASU 2018-07 would apply the amendments in the proposed ASU when it first applies the amendments of ASU 2018-07. For public business entities (PBEs), the amendments in ASU 2018-07 are effective for fiscal years beginning after December 15, 2018, including interim periods therein. 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 if financial statements have not yet been issued (for PBEs) or have not yet been made available for issuance (for all other entities), but no earlier than an entity's adoption date of ASC 606. If early adoption is elected, all amendments in the ASU that apply must be adopted in the same period. In addition, if early adoption is elected in an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period.
- An entity that has already adopted ASU 2018-07 would apply the amendments in the proposed ASU in its first reporting period beginning after the proposed ASU's effective date, which the FASB will determine after considering stakeholder feedback on the proposed ASU.

For further details regarding the application of the transition provisions of ASU 2018-07, see Section 9.10 of Deloitte's *A Roadmap to Accounting for Share-Based Payment Awards* (2018).

Appendix — Questions for Respondents

The proposed ASU's questions for respondents are reproduced below for reference.

Question 1: Do you agree that share-based payment awards issued to customers as consideration payable should be measured at the grant date of the award? If not, why should there be a difference in the measurement date for share-based payment awards issued to customers and nonemployee share-based payment awards, and what other alternatives would be more appropriate?

Question 2: Do you agree that share-based payment awards issued to customers as consideration payable should be classified in accordance with the guidance in Topic 718?

Question 3: Do you agree that the amendments in this proposed Update provide sufficient guidance to account for share-based consideration to a customer?

Question 4: Are the transition requirements for the proposed amendments appropriate? If not, what transition approach would be more appropriate and why?

Question 5: How much time would be necessary to adopt the proposed amendments? Should early adoption be allowed?

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