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FASB Simplifies the Accounting for Share-Based Payment Arrangements With Nonemployees

by Sandie Kim, Sean May, and May Yu, Deloitte & Touche LLP

Background

On June 20, 2018, the FASB issued [ASU 2018-07](#),¹ which simplifies² the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on such payments to nonemployees would be aligned with the requirements for share-based payments granted to employees.

Currently, share-based payment arrangements with employees are accounted for under ASC 718,³ while nonemployee share-based payments issued for goods and services are accounted for under ASC 505-50. ASC 505-50, before the ASU's amendments, differs significantly from ASC 718. Differences include (but are not limited to) the guidance on (1) the determination of the measurement date (which generally is the date on which the measurement of equity-classified share-based payments becomes fixed), (2) the accounting for performance

¹ FASB Accounting Standards Update (ASU) No. 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting*.

² The ASU was issued as part of the FASB's simplification initiative, which is intended to reduce the cost and complexity of current U.S. GAAP while maintaining or enhancing the usefulness of the related financial statement information. In March 2016, the Board issued [ASU 2016-09, Improvements to Employee Share-Based Payment Accounting](#), also as part of the initiative, to simplify several aspects of the accounting for employee share-based payment arrangements. It is assumed in this *Heads Up* that an entity has adopted ASU 2016-09.

³ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's ["Titles of Topics and Subtopics in the FASB Accounting Standards Codification."](#)

conditions, (3) the ability of a nonpublic entity to use certain practical expedients for measurement, and (4) the accounting for (including measurement and classification) share-based payments after vesting. The ASU eliminates most of the differences, as further described below.



Connecting the Dots

In the ASU's Basis for Conclusions, the FASB discusses the issuance of the guidance in ASC 505-50, noting that the differences between the accounting for employee and nonemployee awards was originally based on "the view that there is a fundamental difference between the relationship that employees and nonemployees have with the entity granting the awards." However, the Board concluded that awards granted to employees are economically similar to awards granted to nonemployees and that therefore two different accounting models were not justified.

Key Provisions of ASU 2018-07

Scope

The ASU supersedes ASC 505-50 and expands the scope of ASC 718 to include *all* share-based payment arrangements related to the acquisition of goods and services from both nonemployees and employees. As a result, most of the guidance in ASC 718 associated with employee share-based payments, including most of its requirements related to classification and measurement, applies to nonemployee share-based payment arrangements.



Connecting the Dots

Currently, ASC 505-50 provides guidance on the accounting for nonemployee share-based payments both (1) issued by the grantor and (2) received by the grantee. Under ASC 505-50, the grantor's accounting is similar to that of the grantee (e.g., the determination of the measurement date). In addition to the accounting for nonemployee share-based payments for goods and services, ASC 505-50 provides guidance on the grantor's accounting for share-based payments issued as sales incentives to customers.

An entity applies ASC 606 (once adopted) to share-based payments received by a vendor (grantee) from a customer (grantor) in a revenue transaction. Under ASC 606-10-32-21, an entity is required to measure the estimated fair value of noncash consideration, including share-based payments, at contract inception. The ASU 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, the ASU excludes share-based payments issued as sales incentives to customers from the scope of ASC 718.

While ASC 606 addresses how to recognize equity instruments granted as consideration payable to a customer, it does not provide guidance on the measurement of such equity instruments (including the measurement date). At its meeting on December 13, 2017, the FASB indicated that it will consider whether to add such guidance as part of a technical corrections and improvements project. We believe that in the absence of specific requirements, it is reasonable to apply, by analogy, ASC 606-10-32-21 through 32-23, which address noncash consideration received from a customer. In addition, under ASC 606-10-32-26, “[i]f consideration payable to a customer is a payment for a distinct good or service from the customer, then an entity shall account for the purchase of the good or service in the same way that it accounts for other purchases from suppliers.” Accordingly, if share-based payments are granted to a customer as payment for a distinct good or service from the customer, an entity should apply the guidance in ASC 718 as amended by the ASU.



Connecting the Dots

In the ASU's Basis for Conclusions, the FASB clarified that ASC 718 applies to "instruments granted for goods or services used or consumed in a grantor's own operations and does not apply to instruments granted essentially to provide financing to the issuer." The Board included this requirement as an anti-abuse measure to prevent entities from structuring a share-based payment transaction as a means of raising capital and accounting for it under ASC 718 (particularly its classification guidance).

Measurement Date

One of the more significant changes under the new guidance is related to the determination of the measurement date, which is generally the date on which the measurement of equity-classified share-based payments becomes fixed. The ASU eliminates the guidance in ASC 505-50 on determining the measurement date for nonemployee share-based payment arrangements. Rather, for equity-classified awards, the measurement date would generally be the grant date.



Connecting the Dots

Under ASC 505-50, the measurement date for nonemployee share-based payments that are classified as equity is the earlier of the date as of which (1) a commitment for performance by the counterparty to earn the equity instruments is reached (a "performance commitment") or (2) the counterparty's performance is complete. For a performance commitment to be reached, "sufficiently large disincentives for nonperformance" must exist so that "performance by the counterparty to earn the equity instruments is probable." In practice, a performance commitment is often not reached before the completion of performance, which delays the measurement date until performance is complete (i.e., the nonemployee awards are remeasured or "marked to market" each reporting period until they are vested). Under ASU 2018-07, the measurement of equity-classified nonemployee share-based payments is generally fixed on the grant date, as defined in ASC 718. This requirement could significantly affect the cost recognized for nonemployee awards issued for goods and services.

Example 1

On January 1, 20X1, Entity A enters into an arrangement with an advertising company that provides marketing services for the next two years in exchange for 1,000 equity-classified warrants. The warrants vest at the end of two years (i.e., when the marketing services are complete). In accordance with ASC 505-50, the measurement date is determined to be the date that the advertising company completes the marketing services (December 31, 20X2) because sufficiently large disincentives for nonperformance do not exist. The marketing services are provided ratably over the two-year period, and half of the services have been provided as of December 31, 20X1.

The fair-value-based measure of the warrants on January 1, 20X1; December 31, 20X1; and December 31, 20X2, is \$10, \$12, and \$14, respectively. The following journal entries illustrate the recognition under ASC 505-50 and ASU 2018-07:

| Journal Entry | ASC 505-50 | ASU 2018-07 |
|-----------------------------------|--|---|
| December 31, 20X1 | | |
| Marketing expense | 6,000 | 5,000 |
| Additional paid-in capital (APIC) | 6,000 | 5,000 |
| | To record marketing expense on the basis of the fair-value-based measure as of December 31, 20X1 (1,000 warrants × \$12 fair-value-based measure × 50% for 1 of 2 years of services rendered). | To record marketing expense on the basis of the grant-date fair-value-based measure (1,000 warrants × \$10 fair-value-based measure × 50% for 1 of 2 years of services rendered). |
| December 31, 20X2 | | |
| Marketing expense | 8,000 | 5,000 |
| APIC | 8,000 | 5,000 |
| | To record marketing expense on the basis of the fair-value-based measure as of December 31, 20X2 [(1,000 warrants × \$14 fair-value-based measure × 100% of services rendered) - \$6,000 marketing expense previously recognized]. | To record marketing expense on the basis of the grant-date fair-value-based measure [(1,000 warrants × \$10 fair-value-based measure × 100% of services rendered) - \$5,000 marketing expense previously recognized]. |

The following table summarizes the annual and cumulative cost recognized under ASC 505-50 and ASU 2018-07:

| Marketing Expense | ASC 505-50 | ASU 2018-07 |
|-------------------|------------|-------------|
| 20X1 | \$ 6,000 | \$ 5,000 |
| 20X2 | 8,000 | 5,000 |
| Total | \$ 14,000 | \$ 10,000 |

Vesting Conditions

Amended Definitions

While most nonemployee awards are issued in exchange for services, there may be instances in which such awards are issued for goods. Accordingly, ASU 2018-07 amends the definition of “vest” to incorporate vesting conditions tied to the delivery of goods (in addition to services) and uses the term “nonemployee vesting period” rather than “requisite service period” to describe the period in which the required nonemployee goods or services are provided.



Connecting the Dots

When nonemployee awards are exchanged in a business combination, it is important for an entity to determine what portion of the replacement awards is attributed to “precombination vesting” (and therefore included in the consideration transferred) and what portion is attributed to “postcombination vesting” (and therefore recognized in the postcombination period). ASU 2018-07 includes examples illustrating how an acquirer that has provided replacement awards to nonemployees of an acquiree would attribute such replacement awards to precombination vesting and postcombination vesting.

Under ASC 718, service and performance conditions are vesting conditions, while market conditions are incorporated into the fair-value-based measurement of share-based payments. ASU 2018-07 extends that guidance to nonemployee awards and modifies the definitions of service and performance conditions to incorporate characteristics of nonemployee awards. Accordingly, the ASU expands the definition of a service condition to include “a nonemployee delivering goods or rendering services to the grantor over a vesting period” and the definition of a performance condition to include the “performance of the grantee if such performance is in accordance with the terms of the award and solely relates to the grantor’s own operations (or activities).”



Connecting the Dots

While ASC 505-50 provides guidance on “counterparty performance conditions,” it does not discuss or define service conditions. However, in recognizing the cost of nonemployee goods or services under ASC 505-50, an entity may in practice treat certain counterparty vesting conditions as service conditions if they are more similar to service-type conditions than counterparty performance conditions. Because the vesting conditions of nonemployee awards might not be similar to those of employee awards (e.g., employment for a specified period), an entity must use significant judgment to determine which conditions are more akin to service-type conditions and which are more akin to performance-type conditions. For example, vesting conditions for certain nonemployee awards may be tied to specific tasks and activities (e.g., promoting the entity’s products at a defined number of events) rather than to the provision of service for a specific period. In such circumstances, those specific tasks and activities may represent service-type conditions instead of counterparty performance conditions. As discussed [below](#), the accounting treatment of counterparty performance conditions under ASC 505-50 is significantly different from that of service-type conditions.

Under ASU 2018-07, an entity would still need to apply judgment in determining whether a nonemployee vesting condition is a service condition or performance condition. To meet the definition of a performance condition, the vesting requirement must be related to the grantor’s operations or activities, not the grantee’s. Therefore, certain tasks and activities that a nonemployee must perform (e.g., quality-control services that include an assessment of a minimum number of locations each year) to vest in awards may be characterized as service conditions because they are not solely related to the grantor’s own operations or activities. However, the significance of distinguishing between such conditions may not be as great under the ASU as it is under current guidance since an entity that elects to estimate forfeitures (see discussion [below](#)) would assess the probability that both service and performance conditions will be met.

Example 2

Entity B grants 100 warrants to a distributor that is not a customer (i.e., it is a vendor). The warrants will vest as long as the distributor provides B's products at 20 of its locations for two years. In addition, if the distributor generates \$100 million in sales for B during that two-year period, an additional 100 warrants will vest. While the maintenance of B's products at 20 of the distributor's locations and the generation of \$100 million in sales for B are both related to the distributor's performance, B would need to assess whether each vesting condition is a service or performance condition. Under ASC 505-50, B may reasonably conclude that maintaining its products at 20 of the distributor's locations is a service-type condition and that achieving \$100 million in sales to earn additional warrants is a counterparty performance condition. Under the ASU, B may reasonably reach similar conclusions. While achievement of \$100 million in sales for B is associated with the distributor's service and performance, such performance is related solely to B's own operations. By contrast, maintaining B's products at 20 of the distributor's locations may not be related solely to B's own operations and may therefore be treated as a service condition.

Treatment of Performance Conditions

The treatment of nonemployee share-based payment performance conditions under ASU 2018-07 is significantly different from that under existing guidance. In recognizing the cost of nonemployee awards, an entity generally is precluded by ASC 505-50 from considering whether it is probable that the performance conditions will be met. Rather, if the quantity and terms of nonemployee awards depend on counterparty performance conditions, the entity measures any cost recognized on the basis of the "then-current lowest aggregate fair value" of the awards as of each reporting period until the performance conditions are "known" (i.e., achieved). This can often result in a scenario in which the lowest aggregate fair value is zero and no cost is recognized until the performance conditions are achieved, even if the performance conditions are expected to be met. Many stakeholders believe that such an accounting outcome does not reflect the economics of share-based payment transactions and that entities should recognize the costs when the related goods or services are provided and the awards are expected to vest, in a manner similar to recognizing cost for a payment that was made in cash. Under the ASU, the guidance on nonemployee awards with performance conditions is aligned with that in ASC 718. Accordingly, an entity is required to recognize any cost on the basis of the probable outcome of performance conditions.

Example 3

On January 1, 20X1, Entity C enters into a contract with an advertising company that provides marketing services in exchange for a cash fee. The marketing services are completed on December 31, 20X1. The cost associated with the cash fee is recognized as the marketing services are performed. In addition, if C achieves \$100 million in sales over a one-year period after the services are provided (January 1, 20X2, through December 31, 20X2), the advertising company will receive 100 equity-classified warrants. Entity C concludes that it is **probable** that it will achieve \$100 million in sales for the one-year period, and it achieves the sales target on December 31, 20X2. Under ASC 505-50, C will not recognize any cost associated with the warrants (the lowest aggregate fair value is zero until the performance condition is achieved) when the marketing services are provided. Rather, the cost of the warrants will be recognized when or if the sales level is achieved on the basis of the fair-value-based measure of the warrants on the date of achievement. As a result, any cost associated with the warrants is recognized after the marketing services have been provided. Under the ASU, C recognizes the grant-date fair-value-based measure of the warrants earlier than it would under current guidance since achievement of the sales target is probable. In addition, C would generally recognize the cost as the marketing services are performed.

Example 3 (continued)

The fair-value-based measure of the warrants on January 1, 20X1; December 31, 20X1; and December 31, 20X2, is \$10, \$12, and \$14, respectively. The following journal entries illustrate the recognition under ASC 505-50 and ASU 2018-07:

| Journal Entry | ASC 505-50 | ASU 2018-07 |
|--------------------------|---|--|
| December 31, 20X1 | | |
| Marketing expense | No entry is recorded since the lowest aggregate fair value is zero until the performance condition is achieved. | 1,000 |
| APIC | | 1,000 |
| December 31, 20X2 | | |
| Marketing expense | 1,400 | To record marketing expense on the basis of the grant-date fair-value-based measure since it is probable that the performance condition will be achieved (100 warrants × \$10 fair-value-based measure). |
| APIC | 1,400 | |

The following table summarizes the annual and cumulative cost recognized under ASC 505-50 and ASU 2018-07:

| Marketing Expense | ASC 505-50 | ASU 2018-07 |
|-------------------|--------------|-----------------|
| 20X1 | \$ — | \$ 1,000 |
| 20X2 | 1,400 | — |
| Total | <u>1,400</u> | <u>\$ 1,000</u> |

Forfeitures

As in the case of employee awards, ASU 2018-07 permits an entity to make an entity-wide policy election for all nonemployee awards to either (1) estimate forfeitures or (2) recognize forfeitures when they occur. The policy election is independent of the entity's policy election for employee awards. If the entity elects to estimate forfeitures, it should recognize the cost of nonemployee awards on the basis of its estimate of awards for which the goods are expected to be delivered or the service is expected to be rendered, and the entity should revise its estimate as appropriate.



Connecting the Dots

An entity's forfeiture policy is associated solely with service conditions because the entity must assess probability and may not make a policy election for performance conditions.⁴ However, as noted above, unlike employee service conditions, nonemployee vesting conditions might not be tied to the provision of service for a specific period. An entity will need to use judgment to determine whether its forfeiture policy applies to certain nonemployee vesting conditions, because it may not be obvious whether such conditions are service or performance conditions.

⁴ In the Basis for Conclusions of ASU 2016-09, the FASB states, "The Board concluded that the accounting policy election for forfeitures only applies to service conditions. For an award with a performance condition, an entity would continue to assess at each reporting period whether it is probable that the performance condition will be achieved."

In addition, the number of nonemployee award grantees may not be significant relative to employee award grantees (which often consist of large employee pools). Consequently, there may be insufficient historical forfeiture data, which may make it difficult for an entity to estimate how many nonemployee awards will be forfeited. In such circumstances, an entity might conclude that each nonemployee will fulfill its contract and that no awards are estimated to be forfeited. However, an entity may reasonably estimate forfeitures on the basis of historical forfeiture data if the volume of nonemployee providers is large and the nonemployees are similar. For example, an entity may grant awards to employees of a third-party management advisory company that vest if the grantees provide advisory services for a specified period. In this situation the entity may be able to use historical forfeiture data to estimate forfeitures if the grantees function in a manner similar to that of the entity's employees.

Manner and Period of Cost Recognition

Although the total cost recognized for nonemployee awards could change under ASU 2018-07, the manner of and period(s) for recognizing costs will not. The ASU incorporates certain recognition guidance from ASC 505-50 into ASC 718; thus, any cost recognized for nonemployee share-based payments will continue to be recognized under other applicable accounting guidance as though the grantor paid cash. That is, ASC 718 under the ASU does not prescribe the period(s) or the manner (i.e., capitalize or expense) in which nonemployee share-based payments will be recognized. Rather, an entity should recognize an asset or expense (or reverse a previously recognized cost) in the same period(s) and in the same manner as though the entity had paid cash for the goods or services. Accordingly, an entity recognizes the cost of nonemployee awards "when it obtains the goods or as services are received."



Connecting the Dots

Under ASC 718, compensation cost is generally recognized ratably over the requisite service period (or ratably over multiple requisite service periods). Because of the nature of nonemployee awards, ratable recognition over a service period may not necessarily be appropriate. Accordingly, the ASU retains the principle in ASC 505-50 that any asset or expense should be recognized in the same period(s) and in the same manner as though the grantor had paid cash. The Board decided that further clarification or requirements related to attribution are not necessary because "[f]eedback from outreach efforts indicated that this area did not pose a significant concern or create a significant amount of confusion" and that "there is an absence of this type of specific guidance for costs paid in cash."

An entity must use judgment in determining the attribution of cost since it may not tie directly to nonemployee vesting conditions. An entity could grant awards to a vendor that provides services ratably but for which vesting is tied solely to the level of performance. For instance, a vendor could provide services associated with a call center ratably over time, but vesting of the awards could be tied to the resolution of issues within a certain period. Similarly, awards could be provided to a nonemployee for goods, but vesting may not be tied to the delivery of goods. For example, a nonemployee award issued for goods may vest if less than 1 percent of all goods delivered over a specified period are defective.

In addition, an entity is required under ASC 718 to elect, as its accounting policy for employee awards that have graded vesting schedules and that only contain service conditions (i.e., no performance or market conditions), to recognize compensation cost on a straight-line basis over the requisite service period for either of the following:

- Each separately vesting portion of the award as if the award was, in substance, multiple awards.
- The entire award (i.e., over the requisite service period of the last separately vesting portion of the award).

Under the ASU, the policy election continues to be limited to employee awards.



Connecting the Dots

ASC 505-50 does not provide explicit guidance on the period(s) or manner of cost recognition and consequently does not permit entities to make a similar policy election for graded vesting awards. In practice, some entities may have analogized to the guidance in ASC 718 and selected an accounting policy for nonemployee awards with graded vesting schedules when such awards were for services (in a manner similar to the policy election described above for employee awards). While ASU 2018-07 limits the policy election to employee awards, it does not provide prescriptive guidance on cost recognition for nonemployee awards. Accordingly, an entity should carefully evaluate the facts and circumstances associated with its nonemployee awards to determine the appropriate recognition of cost.

Fair-Value-Based Measurement

Under ASC 505-50, nonemployee share-based payment awards are measured at the fair value of either the consideration received (i.e., fair value of the goods or services received) or the equity instruments issued, whichever is more reliably measurable. In practice, such awards generally are measured on the basis of the fair value of the equity instruments issued. Under ASU 2018-07, nonemployee awards are always measured on the basis of the fair value⁵ of the equity instruments issued, in a manner consistent with the measurement for employee awards. That is, the fair-value-based measurement objective for nonemployee awards would align with that for employee awards. However, in calculating the fair-value-based measurement of nonemployee stock options and similar instruments, an entity can elect on an award-by-award basis to use the contractual term as the expected term.



Connecting the Dots

Under ASC 718, an entity measures employee stock options by using an expected term that takes into account the effects of employees' expected exercise and postvesting employment termination behavior. The expected term is used because employee stock options differ from transferable or tradable options "in that employees cannot sell (or hedge) their share options — they can only exercise them; because of this, employees generally exercise their options before the end of the options' contractual term." However, determining an expected term for nonemployee awards could be challenging because entities may not have sufficient historical data related to any early exercise behavior of nonemployees, particularly if nonemployee awards are not frequently granted. In addition, nonemployee stock option awards may not be exercised before the end of the contractual term if they do not contain certain features typically found in employee stock option awards (i.e., nontransferability, nonhedgability, and truncation of the contractual term because of postvesting service termination). Because of these potential differences between employee and nonemployee awards, the ASU allows an entity to elect on an award-

⁵ In certain circumstances, nonpublic entities are permitted to use calculated value or intrinsic value. See discussion below of [nonpublic entity practical expedients](#).

by-award basis to use the contractual term as the expected term for nonemployee awards. If an entity elects not to use the contractual term for a particular award, the entity estimates the expected term. However, when estimating the expected term, a nonpublic entity can make an accounting policy election to apply a practical expedient to estimate the expected term for awards that meet certain conditions (see discussion below). If the practical expedient is elected, the entity would apply the policy to all qualifying awards for which the entity had first elected not to use the contractual term as the expected term.

Nonpublic Entity Practical Expedients

Whereas ASC 505-50 does not offer nonpublic entities practical expedients for measuring nonemployee awards, ASU 2018-07 permits such entities to use the same practical expedients as those provided for employee awards.

Calculated Value

Under ASC 718, a nonpublic entity is required to use “calculated value” to measure its stock options and similar instruments granted to employees if it is unable to reasonably estimate the fair value of such awards because it is not practicable for it to estimate the expected volatility of its stock price. Calculated value is a measure that uses the historical volatility of an appropriate industry sector index instead of the expected volatility of the entity’s stock price. Under the ASU, the practical expedient related to calculated value is extended to nonemployee awards and needs to be consistently applied to both employee and nonemployee awards.



Connecting the Dots

In practice, many nonpublic entities may not have used calculated value for their employee awards since it is often practicable to estimate the expected volatility of a nonpublic entity’s stock price on the basis of the expected volatilities of similar public entities.

Intrinsic Value

Under the ASU, the accounting policy election permitting nonpublic entities to measure all liability-classified share-based payment awards at intrinsic value instead of fair value is extended to nonemployee awards. If an entity has already elected to apply the practical expedient to employee awards, that election would also apply to nonemployee awards (i.e., this practical expedient must be consistently applied to both employee and nonemployee awards). The election should be made upon adoption of the ASU.

Expected Term

As previously noted, the ASU allows an entity to make an award-by-award election to use the contractual term as the expected term. If an entity does not elect to use the contractual term, it estimates the expected term. However, as in the case of employee awards, the ASU allows a nonpublic entity to elect, as a practical expedient, to estimate the expected term for nonemployee stock options and similar awards that meet the conditions in ASC 718-10-30-20B.⁶ The practical expedient is an entity-wide accounting policy election that must be consistently applied to both employee and nonemployee awards. In addition, if elected, the

⁶ ASC 718-10-30-20B states that a “nonpublic entity that elects to apply the practical expedient . . . shall apply the practical expedient to a share option or similar award that has all of the following characteristics:

- a. The share option or similar award is granted at the money.
- b. The grantee has only a limited time to exercise the award (typically 30–90 days) if the grantee no longer provides goods or terminates service after vesting.
- c. The grantee can only exercise the award. The grantee cannot sell or hedge the award.
- d. The award does not include a market condition.”

practical expedient must be applied to all nonemployee awards that meet the conditions in ASC 718-10-30-20B and for which the entity did not elect to use the contractual term as the expected term. Under the practical expedient, the expected term is generally estimated as the midpoint between the nonemployee vesting period and the contractual term of the award.⁷

Example 4

Entity D enters into a contract with an advertising company that provides marketing services in exchange for warrants. In accordance with the terms of the award, the number of warrants earned will depend on the market price of D's common shares when the marketing services are completed. For this award, D elects not to use the contractual term as the expected term. In addition, D has made an entity-wide accounting policy election to use the practical expedient to estimate the expected term for awards that meet the required conditions. Therefore, D reviews the guidance in ASC 718-10-30-20B to determine whether it should use the practical expedient to estimate the expected term. Because the warrants include a market condition, the practical expedient cannot be applied, and D must estimate the expected term.

Classification

The guidance in ASC 718 on the classification of employee share-based payment awards also applies to nonemployee awards under ASC 505-50 before they vest. However, under ASC 505-50, nonemployee awards become subject to other guidance in U.S. GAAP that generally applies to financial instruments (e.g., ASC 815) once performance is complete (i.e., the awards are vested). By contrast, employee awards remain within the scope of ASC 718 (even after they vest) unless they are modified after the holder ceases to be an employee (except under an equity restructuring that meets certain criteria). Since ASU 2018-07 aligns the classification treatment of employee and nonemployee awards, nonemployee awards will generally remain within the scope of ASC 718 unless they are modified after the awards vest and the nonemployee is no longer providing goods and services (except under an equity restructuring that meets certain criteria). An exception, however, is a nonemployee award that is granted in the form of a convertible instrument and was originally within the scope of ASC 718. Such an award is subject to other guidance in U.S. GAAP once it vests, including ASC 470-20.



Connecting the Dots

Under current U.S. GAAP, certain nonemployee awards that are classified as equity under ASC 505-50 meet the definition of a derivative financial instrument under ASC 815. Accordingly, once performance is complete, they would be classified as a derivative liability and remeasured at fair value through earnings each reporting period. Under the ASU, such awards generally continue to be classified as equity unless modified as described above.

Disclosure

The FASB decided not to add specific disclosure requirements for nonemployee share-based payment arrangements because the existing disclosures in ASC 718 are sufficient. Separate disclosures would be required "to the extent that the differences in the characteristics of the awards make separate disclosure important to an understanding of the entity's use of share-based compensation."

⁷ An exception to using the midpoint is an award that has an implicit vesting period and a performance condition that is not probable of being met. In this circumstance, the expected term is the contractual term.

Effective Date

For public business entities,⁸ the amendments in ASU 2018-07 are effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. 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 public business entities) 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.

Transition and Related Disclosures

ASU 2018-07 generally requires an entity to use a modified retrospective transition approach, 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. 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 previously established under ASC 505-50 because of the existence of a performance commitment or because performance was complete.
- It may be difficult for some entities to determine the grant-date fair-value-based measure of nonemployee equity-classified awards. The ASU therefore requires equity-classified awards (for which a measurement date has not been previously established) to 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.
- An entity should not adjust the basis of assets that include nonemployee share-based payment costs if the assets are completed (e.g., finished goods inventory or fixed assets for which amortization has commenced).

However, if a nonpublic entity changes its measurement of nonemployee awards to calculated value instead of a fair-value-based measure, the ASU requires the entity to use a prospective approach.



Connecting the Dots

In applying a modified retrospective transition approach, an entity is required to adjust the basis of any assets that include nonemployee share-based payment costs if the assets are not completed. For example, any change in nonemployee share-based payment costs resulting from adoption of ASU 2018-07 that are capitalizable as part of assets under construction or in progress will require an entity to adjust those asset balances.

⁸ The FASB retained the current definitions in ASC 718 of a "public entity" and a "nonpublic entity" for use in the determination of whether a nonpublic entity practical expedient can be elected. However, an entity will determine the ASU's effective date on the basis of whether it meets the ASC master glossary's definition of a "public business entity."

In addition, while a change in measurement associated with the use of a calculated value is applied prospectively, an entity should apply other changes to its measurement approach by using a modified retrospective transition approach. For example, a nonpublic entity that has elected to apply the practical expedient in determining expected term should apply that revised measurement approach when measuring the awards subject to transition on the effective date.

In the first interim and fiscal year of adoption, an entity is required to disclose the following:

- The nature of and reason for the change in accounting principle.
- The cumulative effect of the 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.

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