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Taking Stock

Share-based Consideration Payable to Customers

FASB's ASU 2019-08, Compensation—*Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606), Codification Improvements–Share-Based Consideration Payable to a Customer* is applicable to all companies within the scope of ASC 606, *Revenue from Contracts with Customers*, that provide shared-based payment awards to their customers.

This ASU applies only to share-based awards issued to customers under ASC 606 and does not address stock awards issued by lessors to lessees under ASC 842, *Leases*.

The guidance aims to eliminate diversity in practice with respect to measuring stock awards that companies grant to customers. The standard requires that companies measure share-based consideration payable to a customer as either equity or liability on their balance sheets under stock compensation guidance; however, the awards should be recognized as a reduction in the transaction price under revenue recognition guidance.

ASU 2019-08 relies heavily on the provisions of ASC 718, *Compensation–Stock Compensation*, and ASC 606, and as a result, embeds some obscure technicalities carried over from these two standards.

Share-based Consideration Payable to a Customer

ASC 606-10-32-25A requires companies to measure and classify the stock awards that they grant to customers in conjunction with selling goods or services under Topic 718 on stock compensation. The share-based considerations granted to customers subject to ASU 2019-08 have the rudiments of ASC 718:

- Companies measure the share-based consideration payable to customers at fair value on grant date.
- Companies estimate the fair value of their stipulated grants in revenue contracts prior to an actual grant and adjust their fair values at grant date.

Companies **measure** the share-based consideration payable to customers at fair value on **grant date.**

- Companies elect a forfeiture policy for stock grants to their customers at the outset, and adjust the value of their grants periodically as appropriate.
- Companies classify their grants as equity or liability and account for them accordingly.

Grant Date of Stock Awards

Grant date is the date at which a grantor (a seller) and a grantee (a customer) reach an understanding of the key terms and conditions of a share-based payment award. The grantor becomes obligated to issue the stock awards prior to approval and actual grant.

Fair Value of Stock Awards

If a company grants equity awards to customers, since observable market prices are generally not available for such stock awards, it uses an option-pricing (or equity valuation) model to estimate the fair value of such awards. The best-known valuation models are the Black-Scholes-Merton (BSM), Monte Carlo simulation and lattice (binomial).

Estimating, Adjusting the Fair Value of Stock Awards

If a company needs to estimate the fair value of customer stock awards before their grant dates, it needs to adjust their fair values in each reporting period until it grants the awards.

Estimating Stock Awards' Forfeitures

Companies may elect to either account for forfeitures as they occur or estimate and adjust the estimate when it is likely to change or when actual forfeitures differ from estimates. When a company grants stock awards to its customers, and subsequently changes its estimates or some of the awards get forfeited, it should adjust the revenue amount accordingly.

Equity vs. Liability Classification

The classification of stock awards as equity or liability is an important aspect of the accounting for share-based arrangements, since companies measure their equity-based awards on grant date and do not remeasure them unless the awards are modified; whereas, companies remeasure the liability-based awards at the end of each reporting period and reflect the result as a reduction of revenue in accordance with ASC 606.

The FASB has identified criteria in ASC 718-10-25-6 through 25-19 for determining if companies should classify stock awards as a liability or equity. The following are instances that companies should take note of:

- Stock awards with conditions or other features that are indexed to something

other than a market, performance, or service condition.
- Stock awards that meet certain criteria of ASC 480, Distinguishing Liabilities from Equity.
- Stock awards with a repurchase feature that permits a grantee to avoid risks and rewards.

Revenue Contracts & Customers

ASC 606-10-20 defines a contract as "[a]n agreement between two or more parties that creates enforceable rights and obligations [for the parties involved]." ASC 606-10-25-1 requires that companies meet the following criteria before they can account for a contract with a customer under ASC 606:

- Parties to the contract have approved it and are committed to perform their respective obligations;
- Contract can identify each party's rights and obligations regrading goods and services transacted;
- Seller can identify the payment terms of the contract;
- The contract has a commercial substance; and
- Seller considers the collection of the consideration as probable.

Contract Consideration

ASC 606-10-32-25 defines consideration payable to a customer as follows:

- Cash amounts that an entity pays, or expects to pay, to the customer (or to other parties that purchase the entity's goods or services from the customer);
- Credit or other items (for example, a coupon or voucher) that can be applied against amounts owed to the entity (or to other parties that purchase the entity's goods or services from the customer); and
- Equity instruments (liability or equity classified) granted in conjunction with selling goods or services (for example, shares, share options, or other equity instruments).

An entity shall account for consideration payable to a customer as a reduction of the transaction price and, therefore, of revenue unless the payment to the customer is in exchange for a distinct good or service (as described in paragraphs ASC 606-10-25-18 through 25-22) that the customer transfers to the entity.

> The **best-known valuation models** are the Black-Scholes-Merton (BSM), Monte Carlo simulation and lattice (binomial).

Variable Consideration

In some instances, companies may need to estimate the transaction price due to the contingent fair value of stock awards. If so, they should follow ASC 606-10-32-5 guidance: "If the consideration promised in a contract includes a variable amount, an entity shall estimate the amount of consideration to which the entity will be entitled in exchange for transferring the promised goods or services to a customer."

ASC 606 views consideration variable if the amount an entity receives is contingent upon a future event, even though the amount is fixed. ASC 606-10-32-8 provides that entities can estimate the variable consideration using one of the following methods: the expected value (the sum of probability—weighted amounts in the range of possible consideration amounts), or the most likely amount (the single most likely outcome of a contract).

Conclusion

Implementation of this guidance requires judgment and analysis. This article provides only a general framework; some transactions may have intricacies underlying their business content that must be analyzed and researched in more depth.

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