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# Adoption of ASU 2018-07 in an Interim Period

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## Background

On June 20, 2018, the FASB issued [ASU 2018-07](#),<sup>1</sup> which simplifies 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.

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.<sup>2</sup> 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.

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

<sup>2</sup> For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's ["Titles of Topics and Subtopics in the FASB Accounting Standards Codification."](#)

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.
- The ASU 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.

## Determining the Adoption Date

For entities that choose to early adopt the ASU in an interim period, questions have arisen about how to determine the adoption date for the calculation of the transition adjustments. On the basis of discussions with the FASB staff, we believe that it is acceptable to determine the adoption date as of either (1) the beginning of the fiscal year in which the entity adopts the ASU or (2) the beginning of the interim period in which the entity adopts the ASU. In addition, because the guidance may not be clear, other approaches may be acceptable. However, under any approach, any transition adjustments should be reflected as of the beginning of the fiscal year of adoption.

## Practical Application

The journal entries below illustrate both approaches described above for the calculation and recognition of transition adjustments for share-based payment awards granted to nonemployees in a given set of facts and circumstances.

Entity A is a PBE with a December 31 fiscal year-end and adopts ASC 606 on January 1, 20X8. Entity A adopts ASU 2018-07 in the second quarter of 20X8. Entity A grants the following awards to its nonemployee service providers:

- 100,000 warrants are granted to Vendor B on January 1, 20X7, and they cliff vest on December 31, 20X8, as long as B provides specified services through that date. Services are provided ratably during the two years, and A has determined the warrants' measurement date to be the date on which B's performance is complete (i.e., December 31, 20X8). Before adoption of the ASU, the warrants were classified as equity and were remeasured at the end of each reporting period in accordance with ASC 505-50. Upon adoption of the ASU, the warrants will continue to be classified as equity under ASC 718. The fair-value-based measurement of each warrant is \$10 on December 31, 20X7, and \$12 on March 31, 20X8.

- 100,000 warrants are granted to Vendor C for services on January 1, 20X6, and they vest on December 31, 20X6. Before adoption of the ASU, the warrants were classified as equity under ASC 505-50 but were reclassified to a derivative liability under ASC 815 upon vesting. Upon adoption of the ASU, the warrants will be classified as equity under ASC 718. The fair value (and fair-value-based measurement) of each warrant is \$12 on December 31, 20X6, \$15 on December 31, 20X7, and \$17 on March 31, 20X8.
- 100,000 warrants are granted to Vendor D on January 1, 20X7, and they cliff vest on December 31, 20X8, as long as D provides specified services through that date and A achieves net revenue growth of 10 percent over that two-year period. Services are provided ratably during the two years, and A has determined the warrants' measurement date to be the date on which D's performance is complete (i.e., December 31, 20X8). Before adoption of the ASU, the warrants were classified as equity and were remeasured at the end of each reporting period in accordance with ASC 505-50. The fair-value-based measurement of each warrant is \$10 on December 31, 20X7, and \$12 on March 31, 20X8.

Because the quantity and terms of the warrants depend on a counterparty performance condition (i.e., A's achievement of net revenue growth of 10 percent over the specified two-year period), A recognizes expense for the warrants on the basis of their "then-current lowest aggregate fair value" as of each reporting period before the performance condition is "known" (i.e., achieved) in accordance with ASC 505-50. Therefore, given that the performance condition is not known as of either December 31, 20X7, or March 31, 20X8, and the then-current lowest aggregate fair value of the warrants is \$0 as of both December 31, 20X7, and March 31, 20X8, no expense is recognized for the warrants in either 20X7 or the first quarter of 20X8.

Upon adoption of the ASU, the performance-based warrants will continue to be classified as equity, but expense recognition related to the warrants will be based on the probability of achievement of the performance condition, which A has determined is probable.

### Approach 1

Entity A determines its ASU 2018-07 adoption date to be January 1, 20X8. Entity A thus calculates and recognizes any transition adjustment as of January 1, 20X8, by using the warrants' January 1, 20X8, fair-value-based measurement.

#### Warrants Granted to Vendor B

##### **Entry 1 — year ended December 31, 20X7 (before adoption)**

Expense	500,000	
Equity — additional paid-in capital (APIC)		500,000

To record expense for the warrants (\$10 fair-value-based measurement on 12/31/20X7 × 100,000 warrants × 50 percent of services rendered through 12/31/20X7).

##### **Entry 2 — quarter ended March 31, 20X8 (before adoption)**

Expense	250,000	
Equity — APIC		250,000

To record expense for the warrants [(\$12 fair-value-based measurement on 3/31/20X8 × 100,000 warrants × 62.5 percent of services rendered through 3/31/20X8) – \$500,000 expense previously recognized in 20X7].

**Approach 1 (continued)****Entry 3 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)**

Equity — APIC	250,000	
Equity — retained earnings (expense*)		250,000

\* If the first quarter of 20X8 is presented (whether for the year-to-date amounts or in subsequent filings that include the first quarter of 20X8), the adjustment to retained earnings will instead be an adjustment to the expense recognized.

To reverse the expense previously recognized for the warrants in the first quarter of 20X8 before adoption of the ASU.

**Entry 4 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)**

Equity — retained earnings (expense*)	125,000	
Equity — APIC		125,000

\* If the first quarter of 20X8 is presented (whether for the year-to-date amounts or in subsequent filings that include the first quarter of 20X8), the adjustment to retained earnings will instead be an adjustment to the expense recognized.

To record expense for the warrants for the first quarter of 20X8 upon adoption of the ASU  $[(\$10 \text{ fair-value-based measurement as of } 1/1/20X8 \times 100,000 \text{ warrants} \times 62.5 \text{ percent of services rendered through } 3/31/20X8) - \$500,000 \text{ expense previously recognized in } 20X7]$ .

Expense recognized in the second quarter of 20X8 and for the remainder of the year will continue to be based on the fair-value-based measurement of \$10 as of January 1, 20X8.

**Warrants Granted to Vendor C****Entry 1 — year ended December 31, 20X7 (before adoption)**

Loss	300,000	
Derivative liability		300,000

To record a loss for the warrants  $[(\$15 \text{ fair value as of } 12/31/20X7 \times 100,000 \text{ warrants}) - (\$12 \text{ fair value as of } 12/31/20X6 \times 100,000 \text{ warrants})]$ .

**Entry 2 — quarter ended March 31, 20X8 (before adoption)**

Loss	200,000	
Derivative liability		200,000

To record a loss for the warrants  $[(\$17 \text{ fair value as of } 3/31/20X8 \times 100,000 \text{ warrants}) - (\$15 \text{ fair value as of } 12/31/20X7 \times 100,000 \text{ warrants})]$ .

**Entry 3 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)**

Derivative liability	200,000	
Equity — retained earnings (loss*)		200,000

\* If the first quarter of 20X8 is presented (whether for the year-to-date amounts or in subsequent filings that include the first quarter of 20X8), the adjustment to retained earnings will instead be an adjustment to the loss recognized.

To reverse the loss previously recognized for the warrants in the first quarter of 20X8 before adoption of the ASU.

## Approach 1 (continued)

### **Entry 4 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)**

Derivative liability	1,500,000	
Equity — APIC		1,500,000

To reclassify the warrants to equity.

No further expense or loss will be recognized in the second quarter of 20X8 and for the remainder of the year because the warrants are fully vested and classified as equity.

### **Warrants Granted to Vendor D**

As described above, before adoption, there are no journal entries to record for the year ended December 31, 20X7, or March 31, 20X8, because the then-current lowest aggregate fair value of the warrants on each of those dates is \$0.

### **Entry 1 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)**

Equity — retained earnings	500,000	
Equity — APIC		500,000

To record expense for the warrants for 20X7 upon adoption of the ASU [(\$10 fair-value-based measurement as of 1/1/20X8 × 100,000 warrants × 50 percent of services rendered through 12/31/20X7) – \$0 expense previously recognized in 20X7].

### **Entry 2 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)**

Equity — retained earnings (expense*)	125,000	
Equity — APIC		125,000

\* If the first quarter of 20X8 is presented (whether for the year-to-date amounts or in subsequent filings that include the first quarter of 20X8), the adjustment to retained earnings will instead be an adjustment to the expense recognized.

To record expense for the warrants for the first quarter of 20X8 upon adoption of the ASU [(\$10 fair-value-based measurement as of 1/1/20X8 × 100,000 warrants × 62.5 percent of services rendered through 3/31/20X8) – \$500,000 expense previously recognized in 20X7 as a result of Entry 1].

Expense recognized in the second quarter of 20X8 and for the remainder of the year will continue to be based on the fair-value-based measurement of \$10 as of January 1, 20X8.

## Approach 2

Entity A determines its ASU 2018-07 adoption date to be April 1, 20X8. Entity A thus calculates and recognizes its transition adjustment as of April 1, 20X8, by using the warrants' April 1, 20X8, fair-value-based measurement.



### **Connecting the Dots**

Note that if from January 1, 20X8, to March 31, 20X8, (1) an equity-classified award has vested or otherwise reached a measurement date or (2) a liability-classified award has been settled, those awards would not be subject to the ASU's transition provisions if April 1, 20X8, is used as the adoption date.

The journal entries recorded before adoption are the same as those under Approach 1. The journal entries recorded as of April 1, 20X8 (upon adoption, reflected as of January 1, 20X8), are below.

## Approach 2 (continued)

### Warrants Granted to Vendor B

There are no journal entries to record given that the total expense previously recognized (over the life of the warrants) was based on the warrants' fair-value-based measurement on March 31, 20X8 (and on April 1, 20X8, A's adoption date).

Expense recognized in the second quarter of 20X8 and for the remainder of the year will continue to be based on the fair-value-based measurement of \$12 as of April 1, 20X8.

### Warrants Granted to Vendor C

Derivative liability	1,700,000	
Equity — APIC		1,700,000

To reclassify the warrants to equity. Journal entries to retained earnings are not necessary given that the total expense and loss previously recognized (over the life of the warrants) was based on the warrants' fair value on March 31, 20X8 (and on April 1, 20X8, A's adoption date).

No further expense or loss will be recognized in the second quarter of 20X8 and for the remainder of the year because the warrants are fully vested and classified as equity.

### Warrants Granted to Vendor D

#### ***Entry 1 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)***

Equity — retained earnings	600,000	
Equity — APIC		600,000

To record expense for the warrants for 20X7 upon adoption of the ASU [(\$12 fair-value-based measurement as of 4/1/20X8 × 100,000 warrants × 50 percent of services rendered through 12/31/20X7) – \$0 expense previously recognized in 20X7].

#### ***Entry 2 — April 1, 20X8 (upon adoption, reflected as of January 1, 20X8)***

Equity — retained earnings	150,000	
Equity — APIC		150,000

To record expense for the warrants for the first quarter of 20X8 upon adoption of the ASU [(\$12 fair-value-based measurement as of 4/1/20X8 × 100,000 warrants × 62.5 percent of services rendered through 3/31/20X8) – \$600,000 expense previously recognized in 20X7 as a result of Entry 1]. If the first quarter of 20X8 is presented (whether for the year-to-date amounts or in subsequent filings that include the first quarter of 20X8), an adjustment to the expense that would have been recognized (if the guidance in the ASU was applied as of the beginning of the fiscal year) is not required (i.e., the income statement for the first quarter of 20X8 would not need to be revised).

Expense recognized in the second quarter of 20X8 and for the remainder of the year will continue to be based on the fair-value-based measurement of \$12 as of April 1, 20X8.

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