

## Interpretation of the Emerging Accounting Issues (E) Working Group

### INT 00-32: EITF 00-8: Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services

#### ISSUE NULLIFIED BY SSAP NO. 104R

#### INT 00-32 Dates Discussed

September 12, 2000; December 4, 2000

#### INT 00-32 References

##### Current:

*SSAP No. 104R—Share-Based Payments* (SSAP No. 104R)

##### Superseded:

*SSAP No. 13—Stock Options and Stock Purchase Plans* (SSAP No. 13)

#### INT 00-32 Issue

1. Entities often sell goods or provide services in exchange for equity instruments issued by the purchaser of the goods or services. From the standpoint of the entity granting the equity instruments (the purchaser or grantor), appropriate accounting guidance for those transactions exists in FASB Statement No. 123, *Accounting for Stock-Based Compensation* (FAS 123) and *EITF 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services* (EITF 96-18). Paragraph 8 of FAS 123 states that those transactions should be measured at the fair value of the consideration received or the fair value of the equity instruments issued, whichever is more reliably measurable. EITF 96-18 addresses the measurement date from the standpoint of the grantor in those transactions.
2. While certain of those transactions that involve the contemporaneous exchange of equity instruments for goods or services do not create practice issues, others are more complex in that the exchange spans several periods and the issuance of the equity instruments is contingent upon service or delivery of goods that must be completed by the grantee (that is, the goods or services provider) in order to vest in the equity instrument. Additionally, transactions are becoming common in practice where a fully vested, nonforfeitable equity instrument issued to a grantee contains terms that may vary based on the achievement of a performance condition or certain market conditions. For example, a fully vested stock option may be issued to a grantee that contains a provision that the exercise price will be reduced if the grantee completes a project by a specified date. In certain cases, the fair value of the equity instruments to be received may be more reliably measurable than the fair value of the goods or services to be given as consideration. Currently, there are mixed views in practice about the appropriate date or dates to be used by the grantee to measure revenue under some of those complex transactions.
3. The issues are:
  - a. Issue 1—For transactions in which an entity provides goods or services in exchange for equity instruments, what date(s) the grantee (the provider) should

use to measure the fair value of those equity instruments for revenue recognition purposes

- b. Issue 2—For transactions in which any of the terms of the equity instruments are subject to adjustment after the measurement date (that is, the terms of the equity instrument are subject to adjustment based on performance above the level committed to in a performance commitment, performance after the instrument is earned, or market conditions), how the grantee should account for an increase in fair value as a result of an adjustment (upon resolution of the contingency after the measurement date) as revenue.

### INT 00-32 Discussion

4. The working group reached a consensus to adopt the consensus positions reached in *EITF 00-8, Accounting by a Grantee for an Equity Instrument to Be Received in Conjunction with Providing Goods or Services* with minor modifications. The modifications were made to replace GAAP references with the applicable SSAP references and to modify the effective date to January 1, 2001. The modified positions are outlined in paragraphs 5-10.

5. The Task Force reached a consensus on Issue 1 that the grantee should measure the fair value of the equity instruments using the stock price and other measurement assumptions as of the earlier of either of the following dates:

- a. The date the parties come to a mutual understanding of the terms of the equity-based compensation arrangement and a commitment for performance by the grantee to earn the equity instruments (a “performance commitment”) is reached,
- b. The date at which the grantee’s performance necessary to earn the equity instruments is complete (that is, the vesting date).

The earlier of the above dates is hereafter referred to as the measurement date.

6. The Task Force reached a consensus on Issue 2 that if on the measurement date the quantity or any of the terms of the equity instrument are dependent on the achievement of a market condition, then the grantee should measure revenue based on the fair value of the equity instruments inclusive of the adjustment provisions. That fair value would be calculated as the fair value of the equity instruments without regard to the market condition plus the fair value of the commitment to change the quantity or terms of the equity instruments if the market condition is met. That is, the existence of a market condition that, if achieved, results in an adjustment to an equity instrument generally affects the value of the instrument. Pricing models have been adapted to value many of those path-dependent equity instruments.

7. Also on Issue 2, the Task Force reached a consensus that if on the measurement date the quantity or any of the terms of the equity instruments are dependent on the achievement of grantee performance conditions (beyond those conditions for which a performance commitment exists), changes in fair value of the equity instrument that result from an adjustment to the instrument upon the achievement of a performance condition should be measured as additional revenue from the transaction using a methodology consistent with “modification accounting.” That is, the adjustment should be measured at the date of the revision of the quantity or terms of the equity instrument as the difference between (a) the then-current fair value of the revised instruments utilizing the then-known quantity and terms and (b) the then-current fair value of the old equity instruments immediately before the adjustment. Changes in fair value of the equity instruments after the measurement date unrelated to the achievement of performance conditions should be accounted for in accordance with any relevant literature on the accounting and

reporting for investments in equity instruments, such as *SSAP No. 30—Investments in Common Stock (excluding investments in common stock of subsidiary, controlled or affiliated entities)*.

8. The following example illustrates the application of this measurement date guidance for a transaction in which a performance commitment exists prior to the time that the grantee's performance is complete and the terms of the equity instrument are subject to adjustment after the measurement date based on the achievement of specified performance conditions.

On 1/1/X2, Company grants Service Provider 100,000 options with a life of 2 years. The options vest if Service Provider advertises products of Company on Service Provider's web site for 18 months ending 6/30/X3. Company also agrees that if Service Provider provides 3 million "hits" or "click-throughs" during the first year of the agreement, the life of the options will be extended from 2 years to 5 years. If Service Provider fails to provide the agreed upon minimum of 18 months of advertising through 6/30/X3, Service Provider will pay Company specified monetary damages that, in the circumstances, constitute a "sufficiently large disincentive for nonperformance."

Service Provider would measure the 100,000 stock options for revenue recognition purposes on the performance commitment date of 1/1/X2 using the 2-year option life. Assume that at the measurement date (1/1/X2) the fair value of the options is \$400,000. On 12/1/X2, Service Provider has provided 3 million "hits" and the life of the option is adjusted to 5 years. Service Provider would measure additional revenue pursuant to the achievement of the performance condition as the difference between the fair value of the adjusted instrument at 12/1/X2 (that is, the option with the 5-year life assumed to be \$700,000) and the then fair value of the old instrument at 12/1/X2 (that is, the option with the 2-year life, which is assumed to be \$570,000). Accordingly, additional revenue of \$130,000 would be measured. The remaining \$170,000 increase in fair value of the instrument should be accounted for in accordance with the relevant literature on the accounting and reporting for investments in equity instruments, such as SSAP No. 26.

9. This Issue does not address when revenue is recognized. However, the Task Force observed that a liability (deferred revenue) or revenue would be recognized in the same period(s) and in the same manner as it would if the enterprise was to receive cash for the goods or services instead of the equity instruments.

10. The Task Force reached a consensus that this Issue applies to all grants and to modifications of existing grants that occur after January 1, 2001. "Modifications of existing grants" does not include changes to the quantity or terms of an equity instrument that occur when any originally unknown quantity or term becomes known pursuant to the terms of the original instruments.

#### **INT 00-32 Status**

11. No further discussion is planned.