

# To the Point

FASB – proposed guidance

## FASB proposes clarifying guidance on share-based consideration payable to a customer

The proposal is intended to reduce diversity in practice in accounting for share-based consideration payable to a customer in conjunction with selling goods or services.

### What you need to know

- ▶ The FASB proposed amendments to clarify its accounting guidance for share-based consideration payable to a customer in conjunction with selling goods or services.
- ▶ The proposal would revise the definition of a performance condition to include conditions based on a customer's purchases and eliminate the policy election allowing grantors to account for forfeitures of customer awards as they occur. It also would clarify that the guidance on constraining estimates of variable consideration does not apply to share-based consideration payable to a customer.
- ▶ The proposal would apply to all reporting entities that issue share-based consideration to a customer in the scope of ASC 606.
- ▶ Entities would apply the guidance on a modified retrospective or retrospective basis.
- ▶ Comments are due by 14 November 2024.

### Overview

The Financial Accounting Standards Board (FASB or Board) **proposed** amending Accounting Standards Codification (ASC) 606, *Revenue from Contracts with Customers*, and ASC 718, *Compensation – Stock Compensation*, to clarify the accounting for share-based consideration payable to a customer in conjunction with selling goods or services that are not in exchange for a distinct good or service (e.g., customer incentive awards).<sup>1</sup> The amendments would:

- ▶ Revise the definition of a performance condition to address share-based consideration payable to a customer and include conditions that are based on a customer's purchases of goods or services from the grantor

- ▶ Eliminate the policy election permitting entities to account for forfeitures of customer awards as they occur
- ▶ Clarify that the guidance in ASC 606 on constraining estimates of variable consideration does not apply to share-based consideration payable to a customer that is measured and classified under ASC 718

The proposal is intended to reduce diversity in practice and improve the decision usefulness and operability of the guidance for share-based consideration payable to a customer in conjunction with selling goods or services. Stakeholders had asked the Board to more closely align how forfeitures of share-based consideration to customers with service conditions and forfeitures of share-based consideration to customers with performance conditions affect the measurement of the transaction price, which can also affect the timing of revenue recognition.

Under the current guidance, if a vesting condition is determined to be a performance condition, the grantor is required to estimate the number of equity instruments it will be obligated to issue to the customer until the awards vest or are forfeited in accordance with ASC 718.

If a vesting condition is determined to be a service condition, the entity is currently required to apply its forfeiture policy election for nonemployee awards. This means that if an entity's nonemployee forfeiture policy requires forfeitures to be accounted for as they occur, the fair value of the total number of awards that it could be obligated to issue is recorded as a reduction to the transaction price, even if the awards are not expected to vest. This may lead to a delay in revenue recognition because the forfeiture of the customer awards may occur several reporting periods after the entity has satisfied the related performance obligation, even if there has been no change in the likelihood that the awards will vest.

The proposal would apply to all reporting entities that issue share-based consideration to a customer in the scope of ASC 606. The Board believes the proposal would most significantly affect entities that previously granted share-based awards to customers and determined that conditions based on customer purchases were service conditions.

## Key considerations

### Revision of the definition of performance condition

The proposal would revise the Master Glossary definition of a performance condition to address share-based consideration payable to a customer. The proposal would clarify that performance conditions include targets based on the grantee (or other parties that purchase the grantor's goods or services from the grantee) making purchases from the grantor, including those based on the volume, monetary amount or timing of a customer's purchases.

The examples of performance targets currently listed in the definition of a performance condition for employee and nonemployees awards (e.g., a change in control) would also be considered performance conditions for share-based consideration payable to a customer.

Share-based consideration payable to a customer (or other parties that purchase the grantor's goods or services from the customer) would encompass the same instruments (e.g., shares, options, warrants) as share-based payment arrangements. However, the proposal would clarify that a grantee does not need to be a supplier of goods or services to the grantor.

## How we see it

The proposal would drive consistency in revenue recognition by clarifying that customer awards that vest based on purchases of the grantor's goods or services contain performance conditions.

This clarification would also drive consistency in the calculation of diluted earnings per share (EPS) because awards with performance conditions are treated differently than those with service conditions.<sup>2</sup>

### **Elimination of forfeiture policy election for customer awards with service conditions**

The Board expects fewer customer awards to have service conditions given the proposed amendments related to performance conditions. For awards that have service conditions, the proposal would eliminate the policy election permitting entities to account for forfeitures as they occur for customer awards that are not in exchange for a distinct good or service.<sup>3</sup>

When measuring these awards, grantors would be required to estimate the number of expected forfeitures. As a result, the timing of revenue recognition would align with that of customer awards with performance conditions and other forms of consideration payable to a customer, including cash consideration.

Separate policy elections for forfeitures would remain available for share-based payment awards with service conditions granted to employees and nonemployees in exchange for goods or services to be used or consumed in the grantor's own operations.

### **Guidance on constraining estimates of variable consideration**

The proposal also would clarify that a grantor should not apply the guidance in ASC 606 on constraining estimates of variable consideration when measuring share-based consideration payable to a customer that is measured and classified under ASC 718. Rather, the grantor would need to assess whether an award will vest using only the guidance in ASC 718.

### **Effective date and transition**

Entities would have the option to apply the guidance either on (1) a modified retrospective basis as of the beginning of the annual reporting period in which the guidance is adopted or (2) a retrospective basis as of the beginning of the first period presented in accordance with ASC 250, *Accounting Changes and Error Corrections*, by recognizing a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position). Entities would apply the guidance to all share-based consideration payable to a customer as of the date the cumulative-effect adjustment is made under either transition approach.

In both the interim period (if applicable) and the annual reporting period of the change, entities would be required to disclose (1) the nature of the change in accounting principle, including an explanation of the newly adopted accounting principle, (2) the method of applying the change and (3) the cumulative effect of the change on retained earnings or other components of equity in the statement of financial position as of the annual reporting period in which the guidance is adopted.

If adopting on a retrospective basis, entities would also be required to disclose the effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item and any affected per-share amounts for any prior periods retrospectively adjusted.

The proposal would clarify that conditions based on customer purchases are performance conditions.

The FASB will determine the effective date and whether to permit early adoption of the guidance after it considers stakeholder feedback on the proposal.

#### Endnotes:

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- <sup>1</sup> The proposed guidance would also apply to share-based consideration payable to a customer that is in exchange for a distinct good or service and there is a reduction of the transaction price in accordance with ASC 606-10-32-26 (e.g., when the consideration payable to the customer exceeds the fair value of the distinct good or service that the grantor receives from its customer).
- <sup>2</sup> Paragraph BC37 of the proposal's Background Information and Basis for Conclusions.
- <sup>3</sup> The proposed guidance would also eliminate the policy election permitting entities to account for forfeitures as they occur for share-based consideration payable to a customer that is in exchange for a distinct good or service and results in a reduction of the transaction price in accordance with ASC 606-10-32-26.

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