

To the Point

FASB – final guidance

FASB clarifies guidance on share-based consideration payable to a customer

The amendments are 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 issued final guidance to clarify the accounting for share-based consideration payable to a customer in conjunction with selling goods or services.
- ▶ The guidance revises the definition of a performance condition to include conditions based on a customer's purchases and eliminates the policy election allowing grantors to account for forfeitures of customer awards as they occur. It also clarifies that the guidance on constraining estimates of variable consideration does not apply to share-based consideration payable to a customer.
- ▶ The guidance applies to all reporting entities that issue share-based consideration to a customer in the scope of ASC 606.
- ▶ The guidance is effective for fiscal years beginning after 15 December 2026, and interim periods within those fiscal years. Entities may apply the guidance either on a modified retrospective or retrospective basis. Early adoption is permitted.

Overview

The Financial Accounting Standards Board (FASB or Board) issued a final **Accounting Standards Update** (ASU)¹ amending the guidance in 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 (e.g., customer incentive awards).



The better the question.
The better the answer.
The better the world works.



Shape the future
with confidence

The amendments:

- ▶ 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 FASB said the ASU will improve the decision usefulness and operability of the guidance for share-based consideration payable to a customer in conjunction with selling goods or services and reduce diversity in practice. 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.

In accordance with ASC 718, 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.

Before adopting the new guidance, if a vesting condition is determined to be a service condition, the entity is 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 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 amendments apply to all reporting entities that issue share-based consideration to a customer in the scope of ASC 606. The Board believes the amendments will 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 ASU revises the Master Glossary definition of a performance condition to address share-based consideration payable to a customer. The amendments 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 (or potential 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) are also 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) encompasses the same instruments (e.g., shares, options, warrants) as share-based payment arrangements. However, the amendments clarify that a grantee does not need to be a supplier of goods or services to the grantor.

How we see it

The ASU drives 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 also drives consistency in the calculation of diluted earnings per share, because awards with performance conditions are treated differently than those with service conditions.²

Elimination of forfeiture policy election for customer awards with service conditions

The Board expects the amendments to the definition of a performance condition to result in fewer customer awards with service conditions. For awards that have service conditions, the guidance eliminates 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.³ When measuring these awards, grantors are required to estimate the number of expected forfeitures. As a result, the timing of revenue recognition aligns 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 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 guidance clarifies 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 assesses whether an award will vest using only the guidance in ASC 718.

Effective date and transition

The guidance is effective for all entities for fiscal years beginning after 15 December 2026, and interim periods within those fiscal years. Early adoption is permitted for both interim and annual financial statements that have not yet been issued or made available for issuance. An entity that adopts the guidance in an interim period will do so as of the beginning of the fiscal year that includes that interim period.

The guidance can be applied either on a modified retrospective basis or a retrospective basis.

Entities that elect the modified retrospective approach are required to recognize 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) as of the beginning of the period of adoption. They should not recast any information in the financial statements before the period of adoption.

Entities that elect the retrospective approach are required to apply the guidance 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). They are required to use the actual outcome, if known, of a performance or service condition in calculating the cumulative-effect adjustment and amounts recognized in recast periods.⁴

Entities should 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.

The Board expects fewer customer awards to have service conditions as a result of the amendments related to performance conditions.

Transition disclosures

In both the interim period (if applicable) and the annual reporting period of the change, entities are required to disclose (1) the nature of the change in accounting principle, including an explanation of the newly adopted accounting principle, (2) the method used to apply 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.

Entities applying the guidance retrospectively are 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.

Endnotes:

- ¹ ASU 2025-04, *Compensation – Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606), Clarifications to Share-Based Consideration Payable to a Customer*.
- ² Paragraph BC53 of the Background Information and Basis for Conclusions.
- ³ The ASU also eliminates 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.
- ⁴ If the actual outcome is unknown, entities will use its estimate of probability as of the beginning of the annual reporting period of adoption for all prior-period estimates.

EY | Building a better working world

© 2025 Ernst & Young LLP.
All Rights Reserved.

SCORE No. 27125-251US

ey.com/en_us/technical/accountinglink

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multi-disciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via ey.com/privacy. EY member firms do not practice law where prohibited by local laws. For more information about our organization, please visit ey.com.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global Limited operating in the US.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax or other professional advice. Please refer to your advisors for specific advice.