

To the Point

FASB – final guidance

FASB expands derivative scope exceptions and clarifies guidance for share-based noncash consideration

The amendments are intended to reduce the cost and complexity of applying derivative accounting to certain contracts and clarify the applicability of ASC 606 to share-based noncash consideration.

What you need to know

- ▶ The FASB issued final guidance to exclude from the scope of derivative accounting certain contracts with underlyings that are based on the operations or activities of one of the parties to the contract.
- ▶ The guidance clarifies that an entity receiving share-based noncash consideration from a customer that is consideration for the transfer of goods or services in a revenue contract is required to apply the guidance on noncash consideration in ASC 606.
- ▶ An entity would not apply the guidance in other topics (e.g., ASC 815, ASC 321) to share-based noncash consideration from a customer for the transfer of goods or services unless and until the entity's right to receive or retain the share-based noncash consideration is unconditional under ASC 606.
- ▶ The guidance is effective for annual reporting periods beginning after 15 December 2026, and interim periods within those annual periods. Entities may apply the guidance either on a modified retrospective or prospective basis. Early adoption is permitted.

Overview

The Financial Accounting Standards Board (FASB or Board) issued a final **Accounting Standards Update** (ASU)¹ to expand the scope of contracts that are excluded from derivative accounting (i.e., measured at fair value through earnings). The ASU is in response to stakeholder questions about the application of the definition of a derivative and related scope exceptions to contracts such as research and development funding arrangements, litigation financing arrangements and bonds with interest payments based on environmental, social and governance metrics.



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Stakeholders have said that applying derivative accounting to certain contracts with variables (referred to as underlyings) based on the operations or activities of one of the parties to the contract is complex and does not always provide decision-useful information. The new guidance is intended to better portray the economics of these contracts in the financial statements and reduce the complexity and cost for entities applying the guidance in Accounting Standards Codification (ASC) 815, *Derivatives and Hedging*.

In addition, the guidance clarifies the accounting by an entity that receives share-based noncash consideration (such as warrants or shares) from a customer that is consideration for the transfer of goods or services in a revenue contract. Stakeholders have said there is a lack of clarity about which guidance an entity should apply to recognize such consideration.

For example, stakeholders have questioned whether share-based noncash consideration that is contingent on the satisfaction of a performance obligation should be (1) recognized at contract inception under ASC 815 or ASC 321, *Investments – Equity Securities*, or (2) recognized upon the satisfaction of the performance obligation under ASC 606, *Revenue from Contracts with Customers*. The amendments are intended to reduce diversity in practice and provide investors with more comparable information.

Key considerations

Derivatives scope refinements

Scope exceptions

The ASU expands the scope exceptions for certain contracts that are not traded on an exchange to include contracts with underlyings based on the operations or activities of one of the parties to the contract, including those based on:

- The financial operating results (or components of those results) of one of the parties
- The occurrence or nonoccurrence of an event specific to the operations or activities of one of the parties (e.g., obtaining regulatory approval, achieving a product development milestone or a greenhouse gas emissions target)

The scope exception does not apply to underlyings based on (1) a market rate, market price or market index or (2) the price or performance (including default) of a financial asset or financial liability of one of the parties to the contract. Additionally, contracts involving (1) an entity's own equity subject to paragraph ASC 815-10-15-74(a) and ASC 815-40, *Derivatives and Hedging – Contracts in Entity's Own Equity*, and (2) call and put options on debt instruments subject to paragraphs ASC 815-15-25-41 through 25-43 do not qualify for the scope exception.

How we see it

The Board decided to exclude certain contracts involving (1) an entity's own equity and (2) call and put options on debt instruments from qualifying for the scope exception based on stakeholder feedback that including such contracts (or embedded features) would make their accounting more complex. Stakeholders said applying the current guidance to these instruments (or embedded features) results in appropriate financial reporting outcomes. As such, the ASU preserves current practice and guidance for these types of contracts and features.

Scope clarification for share-based noncash consideration from a customer in a revenue contract

The ASU clarifies that an entity receiving share-based noncash consideration from a customer for the transfer of goods or services applies the guidance on noncash consideration in ASC 606-10-32-21 through 32-24. The entity would not apply the guidance in other topics, such as ASC 815 and ASC 321, unless and until its right to receive or retain the share-based noncash consideration is unconditional under ASC 606. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due.

To assess whether the right is unconditional under ASC 606, an entity evaluates only the contract terms that relate to its performance obligations (or a specific outcome of its performance) in the scope of ASC 606. These terms could include achieving a specified performance-related milestone (e.g., selling a certain number of units, completing performance in a certain period). A contingent event unrelated to an entity's performance obligation (or a specific outcome of its performance) (e.g., the occurrence of an initial public offering) is not relevant in assessing whether the right is unconditional under ASC 606.

The Board noted² that once performance-related contingencies have been resolved, the entity's right to receive or retain the share-based noncash consideration from a customer is unconditional (other than by the passage of time) under ASC 606, and the entity should begin accounting for the share-based noncash consideration under other topics.

How we see it

Determining whether or not a contingent event relates to an entity's performance obligation (or a specific outcome of its performance) under ASC 606 may require significant judgment.

An entity applies the presentation guidance in ASC 606-10-45 if it performs by transferring goods or services to a customer before or after the entity's right to receive or retain the share-based noncash consideration is no longer contingent on the satisfaction of a performance obligation (or a specific outcome of the entity's performance).

For example, an entity that performs by transferring goods or services to a customer before the customer pays the noncash consideration or before payment of the noncash consideration is due should present the share-based noncash consideration as a contract asset, excluding any amounts presented as a receivable, until the share-based noncash consideration is recognized.

Effective date, transition and disclosures

The guidance is effective for all entities for annual reporting periods beginning after 15 December 2026, and interim periods within those annual periods. Early adoption is permitted, including adoption in an interim or annual period for which an entity's financial statements have not been issued or made available for issuance. However, an entity that decides to early adopt is required to apply both the guidance on derivatives scope refinements and the guidance on share-based noncash consideration at the same time. An entity that adopts this guidance in an interim period will do so as of the beginning of the annual period that includes that interim period.

Entities can elect to apply the ASU (1) on a prospective basis to new contracts entered into during annual periods (and interim periods within those annual periods) beginning on or after the date of adoption or (2) on a modified retrospective basis to all affected contracts existing as of the beginning of the annual period of adoption through a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the annual period of adoption. Under the prospective transition approach for the guidance on share-based noncash consideration, new contracts include modified contracts accounted for as separate contracts in accordance with ASC 606-10-25-12.

The transition method an entity elects for the guidance on derivatives scope refinements may be different from the method it elects for the guidance on share-based noncash consideration. That is, an entity can elect prospective adoption for one and modified retrospective adoption for the other.

In addition, under the modified retrospective transition approach, an entity that no longer applies derivative accounting to existing contracts (or embedded features) after adoption has a one-time option to irrevocably elect,³ on an instrument-by-instrument basis, the fair value option in ASC 825, *Financial instruments*.

Similarly, an entity that previously elected the fair value option for contracts containing embedded derivatives that otherwise would have required bifurcation may choose to revoke this election on an instrument-by-instrument basis if the embedded feature would no longer require bifurcation upon the adoption of this guidance. An entity is required to apply its decision to elect or revoke the fair value option in the statement of financial position as of the beginning of the year of adoption. For existing contracts where the fair value option is not elected, an entity will need to consider which US GAAP topic may apply.

How we see it

The Board observed⁴ that guidance exists in US GAAP on how to account for certain contracts that are no longer in the scope of ASC 815 after adoption of the ASU. While some excluded contracts, such as research and development funding arrangements, may be in the scope of ASC 730-20 upon adoption of the ASU, entities will need to carefully consider which US GAAP guidance applies to excluded contracts, such as litigation financing arrangements.

Entities would also be required to make certain transition-related disclosures in accordance with ASC 250, *Accounting Changes and Error Corrections*, for any of the amendments adopted.

Endnotes:

- ¹ ASU 2025-07, *Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for Share-Based Noncash Consideration from a Customer in a Revenue Contract*.
- ² Paragraph BC59 of ASU 2025-07.
- ³ This election can only be made for instruments within the scope of ASC 825-10-15-4.
- ⁴ Paragraph BC16 of ASU 2025-07.

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