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FASB Clarifies Guidance on Share-Based Consideration Payable to a Customer

Overview

On May 15, 2025, the FASB issued [ASU 2025-04](#),¹ which clarifies the guidance in both ASC 606² and ASC 718³ on the accounting for share-based payment awards that are granted by an entity as consideration payable to its customer. The ASU is intended to reduce diversity in practice and improve existing guidance, primarily by revising the definition of a “performance condition” and eliminating a forfeiture policy election for service conditions associated with share-based consideration payable to a customer. In addition, the ASU clarifies that the guidance in ASC 606 on the variable consideration constraint does not apply to share-based consideration payable to a customer “regardless of whether an award’s grant date has occurred” (as determined under ASC 718).

Background

In November 2023, the FASB received an agenda request to clarify certain aspects of the current guidance on an entity’s accounting for share-based payment awards issued to a customer that are not in exchange for a distinct good or service. The agenda request focused primarily on awards that vest on the basis of customer purchases (or purchases by other parties that purchase the entity’s goods or services from its customers) and noted that (1) there is diversity in practice associated with whether these types of vesting conditions are performance conditions or service conditions and (2) this distinction affects how an entity accounts for the associated award.

¹ FASB Accounting Standards Update (ASU) No. 2025-04, *Clarifications to Share-Based Consideration Payable to a Customer*.

² FASB Accounting Standards Codification (ASC) Topic 606, *Revenue From Contracts With Customers*.

³ FASB Accounting Standards Codification Topic 718, *Compensation — Stock Compensation*.



Connecting the Dots

An entity that has adopted the amendments in ASU 2019-08⁴ must apply the guidance in ASC 718 to measure and classify share-based consideration payable to a customer if such consideration is not in exchange for a distinct good or service. The entity then records the amount as a reduction of the transaction price in accordance with the presentation guidance in ASC 606 on consideration payable to a customer. ASU 2019-08 also requires an entity to determine whether any vesting conditions represent service conditions or performance conditions. As a result, this determination may affect the entity's timing of revenue recognition. Specifically, an entity recognizes amounts related to an award that vests on the basis of a performance condition only if it is probable that the performance condition will be met (and, thus, it is probable that the award will vest). By contrast, an entity may initially recognize amounts related to an award that vests on the basis of a service condition even if it is not probable that the award will vest. This is because the entity may elect, as an accounting policy for awards issued to nonemployees (including customers), to only account for the effects of forfeitures of such awards as they occur.

Before the issuance of ASU 2025-04, the guidance in U.S. GAAP was unclear about whether entities should treat vesting conditions that are based on customer purchases (or purchases by other parties that purchase the entity's goods or services from its customers) as service conditions or performance conditions given that the definitions of those terms in the ASC master glossary did not explicitly acknowledge share-based payment awards issued to customers or awards that vest on the basis of the grantee's purchases of goods or services from the grantor.

When these vesting conditions are treated as service conditions and an entity elects to account for the effects of forfeitures as they occur, there can be a delay in revenue recognition for transactions that include the grant of awards for which vesting is not probable. Certain stakeholders have indicated that such a delay can diminish the usefulness of an entity's reported revenue information. For example, in this scenario, an entity would (1) initially reduce revenue for amounts related to an award that the entity does not expect will vest and (2) subsequently recognize revenue when the unvested award ultimately expires, which could conceivably occur in a reporting period after the entity has already satisfied the related performance obligation.

Main Provisions of ASU 2025-04

Revision of the Term “Performance Condition”

ASU 2025-04 amends the definition of “performance condition” in the ASC master glossary related to share-based consideration payable to a customer.⁵ The revised definition (1) incorporates conditions (including vesting conditions) that are based on a customer's purchases of goods or services from an entity and (2) includes performance targets based on purchases made by other parties that purchase the entity's goods or services from its customers (i.e., purchases made by an entity's customer's customer). Specifically, the ASU adds the following language to the definition of performance condition:

2. For share-based consideration payable to a customer that can result in a reduction of the transaction price in accordance with Topic 606, a condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that relates to any of the following:

⁴ FASB Accounting Standards Update No. 2019-08, *Codification Improvements — Share-Based Consideration Payable to a Customer*.

⁵ As specified in the ASU, share-based consideration payable to a customer encompasses “the same instruments as share-based payment arrangements” (as defined in the ASC master glossary), but the grantee need not be a supplier of goods or services to the grantor.

- a. Achieving a specified performance target that is defined solely by reference to the grantor's own operations (or activities) or by reference to the grantee's (the customer's) performance related to the grantor's own operations (or activities)
- b. The grantee's purchase (or potential purchase) of the grantor's goods or services from either the grantor or the grantor's customers
- c. A purchase (or potential purchase) of the grantor's goods or services from either the grantee or the grantee's customers.

The performance targets listed in this definition for employee and nonemployee awards (for example, a change in control) are also examples of performance conditions for share-based consideration payable to a customer.

In accordance with the ASU, a performance condition explicitly includes any condition related to achieving a specified performance target that is defined by reference to a grantee's purchase of the grantor's goods or services from the grantor (or the grantor's customers) or a purchase of the grantor's goods or services from the grantee (or the grantee's customers). Therefore, under the ASU's guidance, a vesting condition that is based on a specified volume or a specified monetary amount "of goods or services [purchased from the grantor] (including over a specified period of time)" is a performance condition. This includes "performance targets achieved upon the first purchase from the grantor (or the grantor's customers)" as well as targets based on purchases of an entity's goods or services by a customer's customer. The amended definition reflects the FASB's decision that awards that vest upon direct customer purchases and those that vest upon purchases made by a customer's customer are similar and therefore do not warrant different accounting treatment.⁶

Example

Share-Based Sales Incentive Contingent on Cumulative Purchases

On January 1, 20X1, Entity A executes a one-year master supply agreement (MSA) to sell and deliver widgets to Customer B. Customer B agrees to pay A \$1,000 for each widget purchased under the MSA, which includes the following terms:

- Customer B will earn 1,000 shares of A's common stock if or when B purchases five widgets within one year of the MSA's execution.
- Customer A's payment of shares to B is not in exchange for distinct goods or services.
- Customer A determines that this payment represents share-based consideration payable to a customer and that it must be classified as equity under ASC 718.

Entity A determines that the terms of the MSA are sufficient to establish a grant date for the share-based consideration in accordance with the criteria in ASC 718. Therefore, A measures the share-based consideration issued to B on January 1, 20X1. The grant-date fair-value-based measure is \$1 per share.

Entity A concludes that the share-based consideration payable to B includes a performance condition because the shares issuable to B vest on the basis of a condition related to B's (i.e., the grantee's) purchase of goods from A (the grantor).⁷ Accordingly, A estimates the probable outcome of the performance condition and concludes that it is not probable that B will purchase five widgets within one year of the MSA's execution. As a result, A (1) does not recognize any reduction in transaction price because it is not probable that the share-based consideration payable to B will vest and (2) does not apply the guidance on constraining estimates of variable consideration under ASC 606.

⁶ Paragraph BC24 of ASU 2025-04 states, "Although the term *purchases* (including *potential purchases*) is not defined in the amendments in this Update, the Board intends for that term to be interpreted broadly. For example, performance targets based on (a) payments by a grantee (including advance payments) in connection with a grantee's purchase of goods and services from the grantor, (b) delivery of purchased goods or services by the grantor to the grantee, or (c) the grantee, upon inception of a contract, committing to purchase goods or services from the grantor in exchange for consideration are performance conditions for the purpose of applying the definition."

⁷ This conclusion is based on the revised definition of "performance condition" in ASU 2025-04. Therefore, A would not necessarily reach the same conclusion under U.S. GAAP before its adoption of the ASU.

Example (continued)

Throughout 20X1, A must continually assess the probability that the performance condition will be met. If it becomes probable at any point during the year that the shares issuable to B will vest on the basis of B's expected purchases, A would (1) reduce the transaction price by \$1,000 (1,000 shares expected to vest × \$1 grant-date fair-value-based measure) and (2) recognize this reduction in transaction price in conjunction with its recognition of the related revenue, which may potentially include an immediate reversal of some amount of revenue already recognized under the MSA during the period in which A did not think it was probable that the shares would vest.

Elimination of Forfeiture Policy Election

As a result of the revision to the definition of "performance condition," fewer awards issued to customers are expected to have service conditions. However, ASU 2025-04 also amends the guidance in ASC 718-10-35-1D on service conditions in share-based payment arrangements, which permits entities to elect a policy of recognizing the effect of forfeitures when they occur. The ASU eliminates that policy election for share-based consideration payable to a customer that is not in exchange for distinct goods or services. Further, the ASU amends ASC 718-10-35-1D to indicate, in part, that "[i]f share-based consideration payable to a customer is a payment for a distinct good or service from the customer and the grantor accounts for any portion of the share-based consideration as a reduction of the transaction price in accordance with paragraph 606-10-32-26, the grantor shall estimate the number of forfeitures expected to occur for the entire award (including the portion that is not accounted for as a reduction of the transaction price)." Thus, for service conditions associated with share-based consideration payable to a customer, entities are required to estimate the number of forfeitures expected to occur for the entire award.



Connecting the Dots

In the ASU's Basis for Conclusions, the Board explains that it considered an alternative approach under which it would not have revised the definition of performance condition but would have merely eliminated an entity's ability to elect an accounting policy of recognizing the effect of forfeitures as they occur (and thereby required entities to estimate the number of forfeitures expected to occur) for service conditions associated with share-based consideration payable to a customer. Under this approach, entities would need to estimate the number of awards expected to vest regardless of their conclusion about whether a vesting condition is a service condition or a performance condition, which would have achieved the same objective as the guidance in ASU 2025-04 (i.e., improving an entity's estimate of the transaction price in a contract with a customer) without having to amend the definition of performance condition.

However, the Board ultimately decided to amend the definition of performance condition because of its concern about the consequences of failing to address underlying issues associated with the definition's lack of clarity. The Board noted that one such consequence is related to differences in how awards with service conditions and awards with performance conditions are incorporated into the calculation of diluted earnings per share (EPS). Accordingly, by amending the definition of performance condition, the ASU not only improves the guidance on estimating the transaction price in a contract with a customer that includes share-based consideration payable to a customer but also addresses diversity in practice related to other areas of U.S. GAAP in which entities need to distinguish between service conditions and performance conditions for share-based consideration payable to a customer. For further discussion of the impact of service conditions and performance conditions in the calculation of EPS for share-based payment awards, see [Section 7.1](#) of Deloitte's Roadmap *Earnings per Share*.

The FASB had initially requested feedback on whether entities should be permitted, upon adopting the amendments, to make a one-time change to their forfeiture policy for nonemployee awards if they previously elected to estimate forfeitures for such awards. However, the Board ultimately decided to not allow such change.

Variable Consideration Constraint Guidance

The ASU clarifies that the guidance on constraining estimates of variable consideration in ASC 606 “should not be applied to share-based consideration payable to a customer that is measured and classified under Topic 718, regardless of whether an award’s grant date has occurred.” This clarification addresses the diversity in practice that has resulted from an absence of guidance that clearly describes the extent to which the variable consideration requirements in ASC 606 (which includes such constraint guidance) apply to share-based consideration payable to a customer.

Effective Date and Transition

Effective Date

ASU 2025-04 is effective for fiscal years beginning after December 15, 2026, including interim periods within those fiscal years. Early adoption is permitted.

Transition

Entities can use either a modified retrospective or a retrospective method to adopt the ASU’s amendments. Under the modified retrospective approach, an entity would recognize a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the fiscal year of adoption and would not recast any comparative periods presented. Under the retrospective approach, an entity would recast comparative periods and recognize a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the earliest period presented.

An entity that elects to apply the guidance retrospectively should use the actual outcome, if known, of a performance condition or service condition as of the beginning of the annual reporting period of adoption for all prior-period estimates. If actual outcomes are unknown as of the beginning of the annual reporting period of adoption, the entity should use its estimate of the probability that it will meet a service condition or performance condition as of the beginning of the annual reporting period of adoption for all prior-period estimates.

Under either approach, an entity would apply the ASU’s guidance as of the date of initial application to all arrangements for share-based consideration payable to a customer.

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