

# Snapshot

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SNAPSHOT 2025-08

## FASB clarifies accounting for share-based consideration payable to a customer

The FASB issued 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*, with a dual purpose:

- To reduce diversity in practice in accounting for share-based payment awards issued by entities (grantors) to customers (grantees) that vest when the grantee purchases the grantor's goods or services, thus incentivizing customer purchases; and
- To more closely align the accounting for share-based payment awards in ASC 718 with the core principle in ASC 606—that is, for an entity to recognize revenue as the amount of consideration to which it *expects* to be entitled in exchange for transferring promised goods or services to a customer.

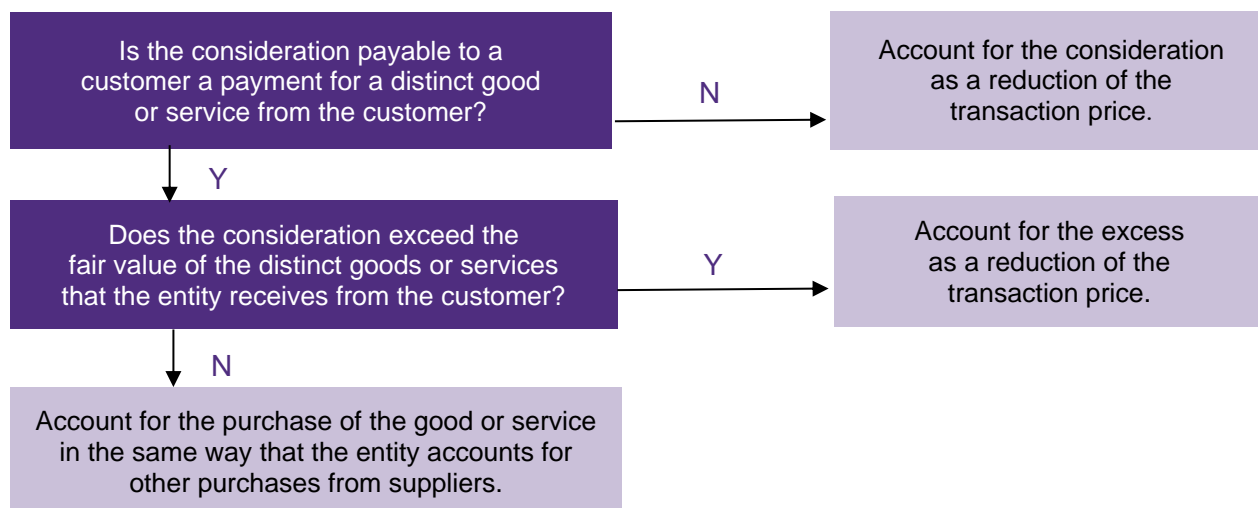
The amendments in the ASU revise the definition of a “performance condition” in ASC 718 to explicitly include these types of vesting conditions used to incentivize customer purchases. As a result, grantors must now assess whether it is probable that the grantee will earn these awards and reduce the transaction price, and therefore revenue, only for share-based payment awards that are deemed probable of vesting.

### Background

The growing volume of transactions involving the issuance of an entity's equity instruments to incentivize customer purchases can be attributed to various reasons, as entities endeavor to conserve cash, to align their interests with those of their significant customers, or to accede to the demands of certain major customers. These equity instruments often vest only if a customer purchases a specified volume or monetary amount of the entity's goods or services. The guidance in ASC 606 requires an entity to account for these payments to a customer, whether they are in cash, coupons, or share-based payments, as a reduction of the transaction price, unless the payment is for a distinct good or service at fair value. The logic behind this guidance, often referred to as the “consideration payable to a customer” guidance, is that an entity should not inflate its revenue by amounts given to customers in a contract that it will receive back through the purchase of its goods or services. For example, a product manufacturer enters into a contract with a retailer for 100,000 units of product at \$20 per unit, but the retailer also requires the manufacturer to pay \$10,000 as an incentive to enter into the contract. Because the manufacturer does

not receive a distinct good or service from the retailer, it should not recognize \$2 million in revenue; rather, its transaction price is \$1.99 million.

**Figure 1: ASC 606's consideration payable to a customer guidance**



When an entity grants consideration payable to a customer in the form of a share-based payment, existing guidance requires the entity to apply Topic 718 to measure, classify, and determine whether the vesting conditions constitute a service or a performance condition. Prior to the issuance of ASU 2025-04, there was diversity in practice in determining whether vesting conditions based on a customer's purchase of a specified volume or monetary amount of the grantor's goods or services qualified as a service or as a performance condition, a determination that can significantly impact the timing of revenue recognition.

In addition, for awards with a service condition prior to ASU 2025-04, an entity only estimates awards expected to vest if the entity has elected to estimate forfeitures for nonemployee grantees. This means that even when the customer's achievement of a specified volume of purchases is not probable, an entity that accounts for forfeitures as they occur would still reduce the transaction price by the grant date fair value of the awards granted, resulting in reduced revenue that is recognized as control of each good or service is transferred to the customer. In these situations, entities would reverse the award's impact on the transaction price only when the award is forfeited, therefore delaying revenue recognition even for awards that are not probable of vesting. As stakeholders have noted, this outcome is inconsistent with the core principle in ASC 606, which is to measure the transaction price as the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer.

The following example illustrates the guidance before the issue of ASU 2025-04 and the concerns raised by stakeholders who requested the amendments.



**Example 1A: Application of guidance pre-ASU 2025-04**

On January 1, 20X0, Grantor A offers Customer B (Grantee) 100 shares of Grantor A's common stock if Customer B purchases 1 million of Grantor A's widgets by December 31, 20X1. The transaction price for

1 widget is \$1. The fair value of 1 share of Grantor A's common stock is \$1,000 on January 1, 20X0, for a total value of \$100,000.

Grantor A determines the following:

- The grant date of the award is January 1, 20X0.
- The stock award was not granted in exchange for a distinct good or service received from Customer B.
- It is not probable that Customer B will earn the award since Customer B's purchases have historically approximated 250,000 widgets per year, and Grantor A expects the demand for these widgets to decrease over the two-year vesting term.

Customer B's actual purchases during the two-year vesting term are as follows.

Year	Purchases of widgets
20X0	240,000
20X1	225,000

#### Analysis before ASU 2025-04

Grantor A estimates that Customer B will purchase 500,000 widgets and determines that the stock award constitutes consideration payable to a customer. Grantor A then measures and classifies the stock award in accordance with ASC 718 and concludes that the condition to purchase 1 million of Grantor A's widgets is a service condition. Grantor A has elected to account for forfeitures as they occur for nonemployee awards; therefore, Grantor A reduces the transaction price for the entire award until the award is forfeited.

As a result, Grantor A estimates the total revenue per widget to be \$0.80 ( $[500,000 \text{ widgets} \times \$1.00 \text{ transaction price per widget}] - \$100,000$  [100 shares of A common stock at grant-date fair value of \$1,000 per share]  $\div 500,000 \text{ widgets} = \$0.80 \text{ per widget}$ ).

As a result, Grantor A's revenue recognition is shown in the following table.

Year-end	Actual purchases of widgets during year	Revenue recognized in the year as control of the widgets transfers to the customer (\$0.80 / widget)	Adjustment to revenue after shares are forfeited on 12/31/X1 (to adjust to \$1.00 / widget)	Total revenue recognized for widgets transferred
12/31/X0	240,000	\$192,000		

12/31/X1	225,000	\$180,000	\$93,000	
<u>Total</u>	<u>465,000</u>	<u>\$372,000</u>		<u>\$465,000</u>

In this fact pattern, Grantor A determines that it is not probable that Customer B would earn the award, but it is nevertheless required to reduce its transaction price in 20X0 because the award's vesting condition is deemed to be a service condition and Grantor A had established a nonemployee forfeiture policy to recognize forfeitures as they occur. Grantor A then experienced a large positive true-up in revenue only when the shares were forfeited at 12/31/X1.

In addition to its inconsistency with the core principle of ASC 606, stakeholders indicated that this delay in revenue recognition can diminish the decision usefulness of a grantor's revenue information and may result in increased differences in financial reporting outcomes between share-based consideration payable to a customer and other forms of consideration payable to a customer (including cash consideration).

## The amendments under ASU 2025-04

### *Updated definition of 'performance condition'*

Because ASC 606 requires an entity to measure and classify share-based consideration payable to a customer using the guidance in ASC 718, an entity is required to determine whether the vesting conditions constitute a service or a performance condition.

The amendments in ASU 2025-04 update the Master Glossary definition of the term "performance condition" to capture the most common types of vesting terms included in share-based consideration that is used to incentivize customer purchases (or potential purchases) of the grantor's goods or services, including purchases made over a specified period of time. This includes conditions that relate to the following:

- Achieving a performance target for the grantor's business
- Meeting or exceeding a specified monetary or volume target of purchases of the grantor's goods or services from either the grantor or the grantor's customers
- Meeting or exceeding a specified monetary or volume target of purchases of the grantor's goods or services from the grantee or the grantee's customers

As a result of these amendments, more entities will now conclude that conditions contingent upon customer purchases are performance conditions, which require that grantors estimate the probable outcome of those conditions. If the grantor determines that it is not probable the grantee will earn an award, the grantor will not reduce the transaction price by the grant-date fair value of the award.

**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:
  - 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.

As discussed above, the revised definition of a “performance condition” clarifies that it includes awards that vest based on the grantee’s purchases of the grantor’s goods or services from either the grantor or the grantor’s customers, as well as purchases of the grantor’s goods or services from either the grantee or grantee’s customers.



#### **Grant Thornton insight: Scope of the amended ‘performance condition’ definition**

Updates to the definition of a “performance condition” under the amendments should ensure that the most common types of vesting terms for share-based consideration payable to a customer will be deemed performance conditions. Not only will awards that vest based upon a customer’s purchases of the grantor’s goods or services be considered performance conditions, but also awards that vest based upon purchases of the grantor’s goods or services further down the distribution chain—for example, purchases of the grantor’s goods or services by the grantee’s customer or grantee’s customer’s customer.

Based upon discussions with the FASB staff, we believe the term “performance condition” also applies to awards that vest based upon purchases of a customer’s goods or services outside the grantor’s distribution chain. Platform companies may offer incentives to customers or to a customer’s customers that vest based upon the customer’s sales of its own goods or services that are distinct from the entity’s goods or services, typically with the objective of increasing the volume of goods or services the entity sells to the customer.

For example, Platform Company (the grantor) provides hosting services to its customer (Game Developer) while the customer provides online games to its customers (Gamers). Platform Company considers the Gamers to be outside of its distribution chain for its hosting services. Platform Company issues awards to its customer (Game Developer) that vest based upon the number of Gamers that play

Game Developer's games on the platform hosted by Platform Company. We believe the scope of the amended definition of performance condition includes these awards, despite the fact that the vesting is based upon the sales of services (online games) not provided by the grantor.

### Policy election for forfeitures

While it is expected that the number of share-based payment awards granted to customers that vest upon the satisfaction of a service condition will be reduced under the expanded definition of a performance condition, the FASB decided to eliminate the policy election permitting a grantor to account for forfeitures as they occur when share-based consideration payable to a customer contains a service condition. In other words, for share-based consideration with a service condition payable to a customer, an entity will now be required to estimate the number of forfeitures expected to occur and to reduce the transaction price by the grant-date fair value of those awards expected to vest.

However, the policy election permitting a grantor to account for forfeitures as they occur 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 is still available.

The following example illustrates the guidance after ASU 2025-04 was issued.



#### Example 1B: Application of guidance post-ASU 2025-04

On January 1, 20X0, Grantor A offers Customer B (Grantee) 100 shares of Grantor A's common stock if Customer B purchases 1 million of Grantor A's widgets by December 31, 20X1. The transaction price for 1 widget is \$1. The fair value of 1 share of Grantor A's common stock is \$1,000 on January 1, 20X0, for a total value of \$100,000.

Grantor A determines the following:

- The grant date of the award is January 1, 20X0.
- The stock award is not granted in exchange for a distinct good or service received from Customer B.
- It is not probable that Customer B will earn the award since Customer B's purchases have historically approximated 250,000 widgets per year, and Grantor A expects the demand for these widgets to decrease over the two-year vesting term.

Actual purchases during the two-year vesting term are shown in the following table.

Year	Purchases of widgets
20X0	240,000
20X1	225,000

### Analysis after ASU 2025-04

Grantor A estimates that Customer B will purchase 500,000 widgets and determines that the stock award constitutes consideration payable to a customer. Grantor A measures and classifies the stock award in accordance with ASC 718 and concludes that the condition to purchase 1 million of Grantor A's widgets is a performance condition and that it is not probable that Customer B will earn the stock award. As a result, Grantor A does not reduce its transaction price for the grant-date fair value of the shares.

Grantor A's revenue recognition is as follows.

	Actual purchases of widgets during year	Revenue recognized in the year as control of the widgets transfers to the customer (\$1.00 per widget)	Adjustment to revenue after shares deemed forfeited on 12/31/X1	Total revenue recognized for widgets transferred
12/31/X0	240,000	\$240,000		
12/31/X1	225,000	\$225,000		
<u>Total</u>	<u>465,000</u>	<u>\$465,000</u>		<u>\$465,000</u>

### Applicability of the constraint guidance

The amendments in this ASU clarify that a grantor should not apply the guidance in ASC 606 on constraining estimates of variable consideration to share-based consideration payable to a customer. In other words, the grantor should apply the guidance in ASC 718 on assessing the probability that an award will vest.



#### Grant Thornton insight: More reversals of revenue

Under ASC 606, an entity is required to include estimated variable consideration in the transaction price from a contract with a customer only to the extent that it is probable that a significant reversal in the amount of cumulative revenue recognized will not occur when the uncertainty associated with the variable consideration is subsequently resolved. This is often referred to as the “constraint guidance” in ASC 606.

Prior to the issuance of ASU 2025-04, the guidance in ASC 606 was not explicit as to whether the constraint guidance applied to share-based consideration payable to a customer, resulting in diversity in practice. The amendments clarify that the constraint guidance in ASC 606 does not apply to share-based consideration payable to a customer that is measured and classified under ASC 718.

In paragraph 68 of the Basis for Conclusions to ASU 2025-04, the Board acknowledges that requiring grantors to estimate the likelihood that grantees will achieve conditions based on customer purchases

could result in more revenue reversals, since the amendments clarify that the constraint guidance in ASC 606 does not apply to these transactions.

**Figure 2: Comparison of pre-ASU 2025-04 guidance and post-ASU 2025-04 guidance for typical share-based payment awards granted to a customer**

Vesting condition: Grantee's purchase of \$1M of grantor's goods or services	ASC 718 condition type	ASC 718 accounting for forfeitures	ASC 606 resulting accounting	Accounting if awards are forfeited
<b>Pre-ASU 2025-04</b>	Frequently determined to be a service condition, with some diversity in practice.	<p><i>For service conditions:</i></p> <p>Policy choice to estimate forfeitures or use actuals for all nonemployee awards as a group.</p> <p>Frequently, entities elected to account for forfeitures as they occur (actuals), with some diversity in practice.</p>	<p><i>For entities that account for forfeitures as they occur:</i></p> <p>Reduce the transaction price by the grant-date fair value of the awards assuming 100% of the awards will vest, regardless of probability.</p> <p>Recognize revenue as each good or service is transferred to the customer at the reduced transaction price allocated to each.</p>	Record a positive true-up to revenue if and when awards are forfeited.
<b>Post-ASU 2025-04</b>	Performance condition	Required to estimate probability of vesting.	Reduce the transaction price only for awards that are probable of vesting.	Update estimate of awards probable of vesting until awards vest or are forfeited.



### *Effective date and transition*

The amendments are effective for all entities for annual reporting periods, including interim reporting periods within annual reporting periods, beginning after December 15, 2026. Entities may early adopt the amendments in an interim or annual reporting period in which the financial statements have not yet been issued (or been made available for issuance) as of the beginning of the annual reporting period of adoption.

Grantors may apply the revised guidance on a modified retrospective or retrospective basis. If applying the revised guidance on a modified retrospective basis, the grantor should recognize a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the annual reporting period of adoption. The grantor need not recast any periods prior to the annual reporting period of adoption for modified retrospective adoption.

Conversely, if applying the revised guidance on a retrospective basis, the grantor should 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 in the financial statements. If applying the revised guidance on a retrospective basis, grantors should use hindsight—that is, the actual outcome, if known—of the service or performance-based vesting condition as of the beginning of the annual reporting period of adoption for all prior-period estimates. If the actual outcome of the service or performance-based vesting condition is unknown, the grantor should use its best estimate of the probability that the grantee will achieve the condition as of the beginning of the annual reporting period of adoption for all prior-period estimates.

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