

# FASB REFINES THE SCOPE OF DERIVATIVES AND CLARIFIES THE ACCOUNTING FOR SHARE-BASED NONCASH CONSIDERATION

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## SUMMARY

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2025-07, *Derivatives Scope Refinements and Scope Clarification for Share-Based Noncash Consideration from a Customer in a Revenue Contract*, to refine the scope of derivative accounting under ASC 815, *Derivatives and Hedging*, and clarify the treatment of share-based noncash consideration under ASC 606, *Revenue from Contracts with Customers*.

First, the ASU excludes certain nonexchange-traded contracts from derivative accounting when their settlement is based on operations or activities specific to one of the parties (like regulatory approvals or earnings targets). Those contracts are subject to the new exception from derivative accounting unless the underlying is tied to market rates, the price or performance of financial instruments, the reporting entity's equity, or call and put options on debt. This change is intended to reduce unnecessary complexity and better reflect the economic substance of contracts like research and development funding arrangements, litigation finance, or environmental, social, and governance-linked instruments, which were previously subject to derivative accounting.

Second, the ASU clarifies that when an entity receives share-based noncash consideration (like warrants or shares) from a customer in a revenue contract, it must initially apply ASC 606 to recognize and measure the consideration and only apply ASC 815 or ASC 321, *Investments – Equity Securities*, after the right to receive or retain the consideration becomes unconditional. This clarification addresses confusion about when to apply the financial instruments guidance and aims to improve consistency in practice, reduce diversity in interpretation, and lower compliance costs.

## MAIN PROVISIONS

### Derivatives Scope Refinement

Entities must account for a contract that meets the definition of a derivative instrument at fair value under ASC 815 except when the contract meets a scope exception. Similarly, an embedded feature must be accounted for separately as a derivative under ASC 815 if the criteria for bifurcation are met and no derivative scope exception applies. ASC 815 provides a number of exceptions from derivative accounting, including one that applies to contracts that are not traded on an exchange. The ASU expands the scope exception in ASC 815-10-15-59(e) and **excludes** from derivative accounting those contracts that have underlyings based on operations or activities specific to one of the parties to the contract. For example, the scope exception applies to underlyings based on the:

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- ▶ Occurrence or nonoccurrence of an event related to the operations or activities specific to one of the parties to the contract, such as change in control, initial public offering (IPO), obtaining regulatory approval, achieving a product development milestone, or meeting a greenhouse gas emissions target.
- ▶ Financial operating results (or components of those results) of one of the parties to the contract, such as revenues, net income, expenses, or EBITDA.

Some contracts reference activities at the consolidated-level or parent-entity level rather than at an individual reporting entity level. Solely for purposes of evaluating whether a contract meets the scope exception for contracts that are not traded on an exchange, the phrase “party to the contract” refers to any entity within a consolidated group (that is, the evaluation is not limited to activities or operations of the legal entity that entered the contract).

Also, when evaluating whether operations or activities are specific to one of the parties to the contract, it is irrelevant whether the outcome is within or outside the entity’s control.

#### **BDO INSIGHTS: UNDERLYINGS BASED ON OPERATIONS OR ACTIVITIES WITHIN AN ENTITY’S VALUE CHAIN**

A debt instrument may include a provision that adjusts the interest rate based on the direct and indirect greenhouse gas emissions (including upstream and downstream emissions) at the consolidated level of the borrower’s Parent. While the target emissions include indirect emissions that occur within the value chain, ASC 815-10-55-143F illustrates that such target would be considered based on activities specific to one of the parties to the contract. (In that example, the borrower and its Parent are committed to meeting the target and taking actions to reduce greenhouse gas emissions.) We believe entities should generally not extend the “value chain” concept to other types of targets that relate to the operations or activities of their suppliers or customers (for example, EBITDA of the supplier or customer), rather than their own.

If a contract has multiple underlyings and all of them meet the scope exception, the entire contract (or embedded feature) is exempt from derivative accounting. For example, two parties may enter a funding arrangement, in which the funding entity provides \$50 million to a biotech company to commercialize a drug compound. The biotech company must pay \$20 million upon Food and Drug Administration (FDA) approval and an additional \$80 million to the funding entity upon sales of the drug exceeding \$500 million. The occurrence of FDA approval related to the drug the biotech company is developing and the sales of the drug exceeding \$500 million are based on biotech company’s operations or activities. As such, the funding arrangement qualifies for the scope exception and is not accounted for as a derivative under ASC 815. Instead, both parties must apply other U.S. GAAP.

For contracts that have multiple underlyings in which some, but not all, qualify for the scope exception, an entity must perform a predominant characteristics assessment.



#### **PREDOMINANT CHARACTERISTICS ASSESSMENT FOR CONTRACTS WITH MULTIPLE UNDERLYINGS**

A contract (or embedded feature) may have multiple underlyings, some of which are excluded from derivative accounting (those that meet the scope exception) and some are not (those that do not meet the scope exception). For such a contract (or embedded feature), an entity must evaluate the contract’s (or embedded feature’s) predominant characteristics to determine whether the entire contract (or embedded feature) must be accounted for as a derivative under ASC 815. If the combined underlyings behave in a way that is highly correlated with the ones that do not qualify, the entire contract (or embedded feature) does not qualify for the scope exception. The ASU did not change the existing predominant characteristics assessment in ASC 815.

Further, the ASU includes guardrails to avoid changing the accounting for some types of contracts for which the accounting is well-known in practice. The table includes the types of contracts or underlyings that do **not** qualify for the exception in ASC 815-10-15-59(e) (the “new scope exception”).

DESCRIPTION	EXAMPLES
Underlying based on market rate, market price, or market index (including those listed in ASC 815-10-15-88(a) through (f))	Contracts (for example, interest rate swaps) that have only an interest rate or interest rate index underlying do not qualify for the new scope exception and would generally continue to be accounted for as derivatives. Similarly, commodity contracts that are based only on a commodity price or index do not qualify for the new scope exception. Instead, an entity continues to assess whether another scope exception applies, such as the normal purchases and normal sales exception.
Underlying based on the price or performance of a financial asset or financial liability of one of the parties	A guarantee contract with a payoff based on the performance of a financial asset or financial liability (for example, debt) of one of the parties to the contract does not qualify for the new scope exception. Instead, an entity continues to assess whether such contract qualifies for other scope exceptions, such as the exception for financial guarantee contracts in ASC 815-10-15-58.
Contracts or embedded features that are in the scope of ASC 815-40	An instrument that is convertible into the issuer's shares upon a change in control does not qualify for the new scope exception. Instead, the issuer continues to assess whether the conversion feature meets the scope exception in ASC 815-10-15-74(a) for instruments indexed to an entity's own stock.
Calls and put options on debt subject to ASC 815-15-25-41 through 25-43	A debt instrument that requires repayment if the issuer completes an IPO does not qualify for the new scope exception. Instead, the parties continue to assess whether the put feature meets the criteria for bifurcation without regard to the new scope exception.

### Share-Based Noncash Consideration

Vendors sometimes receive share-based noncash consideration (for example, shares, share options, or other equity instruments) from a customer that is contingent on the satisfaction of one or more performance obligations or on a specified outcome of the vendor's performance. The ASU clarifies that such consideration must be accounted for under the noncash consideration guidance in ASC 606-10-32-21 through 32-24.

In accordance with ASC 606, share-based noncash consideration is:

- ▶ Measured at fair value at contract inception and
- ▶ Recognized as an asset when the entity's right to receive or retain the share-based payment is no longer contingent on the satisfaction of a performance obligation.

ASC 606 applies to share-based noncash consideration from a customer until the vendor has an unconditional right to receive or retain the consideration. Only at that point will the vendor apply other guidance, such as ASC 815 and ASC 321, to the noncash consideration received.

To assess whether a right is unconditional under ASC 606, a vendor evaluates only the contract terms that relate to its performance obligations or a specific outcome of its performance. That evaluation is consistent with the guidance on recognizing a receivable, which states that a right to consideration is unconditional if only the passage of time is required before payment is due. As a result of the amendments, share-based noncash consideration from a customer in a revenue contract is expected to be accounted for in the same periods and in a similar manner to cash consideration and other forms of noncash consideration.

The ASU similarly amends ASC 610-20, *Other Income – Gains and Losses from the Derecognition of Nonfinancial Assets*, to specify that an entity must apply ASC 610-20 to share-based noncash consideration in exchange for the transfer of a nonfinancial asset until the entity has an unconditional right to receive or retain the consideration under ASC 610-20.

### **BDO INSIGHTS: CONTINGENCIES UNRELATED TO CONTRACT OR VENDOR PERFORMANCE**

Some revenue contracts include contingencies that are not directly related to a vendor's performance or a specific performance obligation. For example, share-based noncash consideration might vest upon the customer entering a significant future transaction such as an IPO or a merger that is not solely within the control of the vendor nor a direct outcome of the revenue contract. Determining whether other guidance (such as ASC 321 or ASC 815) applies to the consideration prior to resolving the contingency requires the application of judgment based on the facts and circumstances.

The ASU added the following new example to the implementation guidance to demonstrate application of the noncash consideration guidance:



#### **EXAMPLE: SHARE-BASED NONCASH CONSIDERATION (QUOTED FROM ASC 606-10-55-250A THROUGH 55-250D)**

##### **Example 31A — Share-Based Noncash Consideration**

ASC 606-10-55-250A

*Example 31A illustrates the guidance in paragraph 606-10-15-3A on share-based noncash consideration from a customer for the transfer of goods or services and the guidance in paragraphs 606-10-32-21 through 32-24 on noncash consideration. In addition, the following guidance is illustrated in this Example:*

- a. Paragraph 606-10-25-14 on identifying performance obligations*
- b. Paragraph 606-10-32-4 on determining transaction price*
- c. Paragraphs 606-10-32-5 through 32-14 on variable consideration*
- d. Paragraphs 606-10-32-28 through 32-41 on allocating transaction price to the performance obligations in the contract*
- e. Paragraph 606-10-45-4 on an unconditional right to consideration.*

ASC 606-10-55-250B

*On January 1, 20X7, an entity enters into a contract with a customer to sell 5,000 units of Product A. The customer will pay \$100 for each unit upon delivery. If the entity delivers all 5,000 units within 2 years from contract inception, the customer promises a performance bonus of 100 warrants for the customer's common stock. The estimated fair value of the 100 warrants at contract inception is \$100,000. At contract inception, the entity concludes that each unit is a performance obligation that is satisfied at a point in time. Based on its experience, the entity expects that all 5,000 units will be delivered to the customer before the end of 20X8. Accordingly, it concludes that the variable consideration related to the 100 warrants is not constrained and the transaction price is \$600,000 ( $[5,000 \text{ units} \times \$100] + \$100,000$  estimated*

fair value of 100 warrants at contract inception). Accordingly, the transaction price allocated to each unit is \$120 (\$600,000/5,000 units).

ASC 606-10-55-250C

During 20X7, the entity delivers 3,000 units to the customer. At the end of 20X7, the entity continues to expect that the remaining 2,000 units will be delivered to the customer before the end of 20X8. Therefore, the transaction price determined at contract inception is unchanged. For 20X7, the entity recognizes revenue of \$360,000 (3,000 units × \$120), cash of \$300,000, and a contract asset of \$60,000 (\$100,000 estimated fair value of 100 warrants at contract inception × [3,000 delivered units/5,000 units]). The entity does not reflect any changes in the fair value of the 100 warrants in the transaction price. However, the entity assesses the related contract asset for impairment.

ASC 606-10-55-250D

During 20X8, the entity delivers the remaining 2,000 units to the customer. For 20X8, the entity recognizes revenue of \$240,000 (2,000 units × \$120), cash of \$200,000, and a contract asset of \$40,000 (\$100,000 estimated fair value of 100 warrants at contract inception × [2,000 delivered units/5,000 units]). The entity does not reflect any changes in the fair value of the 100 warrants in the transaction price. However, the entity assesses the related contract asset for impairment. When all 5,000 units have been delivered, the entity concludes that its right to receive or retain the 100 warrants is unconditional under this Topic. At that point, the entity derecognizes the contract asset and applies the guidance in other Topics to account for the 100 warrants.

For more information on accounting treatment under ASC 606, see BDO’s Blueprint on [Revenue Recognition Under ASC 606](#).

EFFECTIVE DATE AND TRANSITION

The following table summarizes transition for ASU 2025-07:

	DERIVATIVES SCOPE REFINEMENT — ALL ENTITIES	SHARE-BASED NONCASH CONSIDERATION — ALL ENTITIES
Effective date	Annual reporting periods beginning after December 15, 2026, including interim periods within those annual reporting periods.	Annual reporting periods beginning after December 15, 2026, including interim periods within those annual reporting periods.
Early adoption	Early adoption is allowed, including adoption in an interim or annual period for which an entity’s financial statements have not yet been issued (or made available for issuance). If early adopted, the entity must apply the transition requirements as of the beginning of the annual reporting period. If an entity early adopts the amendments on derivative	Early adoption is allowed, including adoption in an interim or annual period for which an entity’s financial statements have not yet been issued (or made available for issuance). If early adopted, the entity must apply the transition requirements as of the beginning of the annual reporting period. If an entity early adopts the amendments on share-based

	DERIVATIVES SCOPE REFINEMENT — ALL ENTITIES	SHARE-BASED NONCASH CONSIDERATION — ALL ENTITIES
	scope refinement, the entity also shall early adopt the amendments on share-based noncash consideration simultaneously.	noncash consideration, the entity also shall early adopt the amendments on derivatives scope refinement simultaneously.
Transition	<p>An entity must select one of the following approaches:</p> <ul style="list-style-type: none"> <li>▶ Prospectively to contracts entered on or after the adoption date.</li> <li>▶ On a modified retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the annual period of adoption for contracts existing as of the beginning of the annual reporting period of adoption.</li> </ul>	<p>An entity must apply the amendments either:</p> <ul style="list-style-type: none"> <li>▶ Prospectively to new contracts entered into during annual reporting periods (and interim reporting periods within those annual reporting periods) beginning on or after the date of adoption, including modified contracts accounted for as new contracts in accordance with ASC 606.</li> <li>▶ On a modified retrospective basis through a cumulative-effect adjustment to the opening balance of retained earnings as of the beginning of the annual reporting period of adoption for contracts existing as of the beginning of the annual reporting period of adoption.</li> </ul>
Special instructions	<p>Under the modified retrospective method of adoption:</p> <ul style="list-style-type: none"> <li>▶ If an entity had contracts that were accounted for as derivatives (or bifurcated derivatives) but are no longer accounted for as derivatives as a result of applying the ASU, the entity has a one-time option as of the beginning of the fiscal year of adoption to irrevocably elect the fair value option.</li> <li>▶ If an entity had previously elected the fair value option for contracts with embedded derivatives (that otherwise would have been bifurcated) that no longer require bifurcation as a result of applying the ASU, the entity has an option to revoke the fair value option as of the beginning of the annual reporting period of adoption.</li> </ul>	None.



	DERIVATIVES SCOPE REFINEMENT – ALL ENTITIES	SHARE-BASED NONCASH CONSIDERATION – ALL ENTITIES
Transition disclosures	<div>Disclose the following in both the interim and annual period of adoption:</div> <div><div>▶ The nature and reason for the change in accounting principle.</div><div>▶ If adopted using the modified retrospective transition method, the cumulative effect of the change on retained earnings as of the beginning of the period of adoption and a description of the financial statement line items affected.</div></div>	<div>Disclose the following in both the interim and annual period of adoption:</div> <div><div>▶ The nature and reason for the change in accounting principle.</div><div>▶ If adopted using the modified retrospective transition method, the cumulative effect of the change on retained earnings as of the beginning of the period of adoption.</div></div>

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Link to [ASU 2025-07](#).

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