In brief

National Office

FASB proposes amendments on derivatives and revenue scoping

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At a glance

The FASB proposed new accounting guidance that would create an exception for certain contracts from being accounted for as derivatives and clarify the accounting for share-based payments received from customers in revenue arrangements. Feedback on the proposal is due by October 21.

What happened?

On July 23, the FASB issued a proposed ASU, *Derivatives Scope Refinements and Scope Clarification for a Share-Based Payment from a Customer in a Revenue Contract,* that would amend the scope of derivative accounting in ASC 815, *Derivatives and Hedging,* and clarify the interaction between the revenue guidance in ASC 606, *Revenue from Contracts with Customers,* and the financial instruments guidance in ASC 815 and ASC 321, *Investments – Equity Securities,* for certain revenue transactions.

The proposed amendments would reduce the number of contracts accounted for as derivative instruments and reduce the number of embedded derivatives that are required to be bifurcated from host contracts and separately accounted for as derivatives. The proposed amendments would also reduce diversity in practice in how to account for share-based consideration received from a customer as consideration for the transfer of goods and services.

Derivatives scope exception

The FASB proposed a new scope exception from the derivative accounting model under ASC 815 for non-exchange traded contracts when the underlying is based on the operations or activities specific to one of the parties to the contract unless the underlying is based on a market rate, market price, market index, or the price or performance of a financial asset or financial liability.

Underlyings considered to be based on the operations or activities of an entity include financial statement metrics and metrics derived from and components of amounts presented in the financial statements. The proposed scope exception would also extend to underlyings related to the occurrence or nonoccurrence of an event related to the activities or operations of an entity. The proposed ASU includes examples of contracts with embedded derivatives that would qualify for this scope exception, including:

- bonds with interest payments that may vary based on ESG-linked metrics,
- research and development funding arrangements, and
- litigation funding arrangements.

ASC 815 currently includes guidance for situations when instruments (or embedded features) have multiple underlyings when one underlying qualifies for a non-exchange traded contract scope exception, but another underlying does not. The determination of whether an instrument with multiple underlyings qualifies for a non-exchange traded scope exception depends on the predominant characteristic of the instrument. The proposal would also change the predominance assessment to consider which underlying is expected to have the largest impact on changes in fair value.

Interaction of revenue and financial instruments guidance

The FASB also proposed guidance for when an entity receives a share-based payment from a customer (such as shares of the customer or warrants to purchase the customer's stock) that is consideration for the transfer of goods or services. The proposal would require the application of the guidance for noncash consideration within ASC 606 and clarify that a share-based payment should not be recognized as an asset until the entity's right to receive or retain the payment is no longer contingent upon satisfying a performance obligation. For example, in an arrangement in which an entity is entitled to receive warrants to purchase a customer's stock contingent upon providing a service to the customer, an asset for the noncash consideration (that is, the warrants) would not be recognized until the entity provides the service. Consistent with the existing guidance on noncash consideration within ASC 606, the asset and related revenue would be recorded based on the estimated fair value of the share-based payment at contract inception. The proposal also clarifies that ASC 815 and ASC 321 should not be applied until the share-based payment asset is recognized under ASC 606.

What's next?

Comments on the proposal are due by October 21, 2024. The effective date of the proposed amendments will be determined based on stakeholder feedback.

The proposed amendments to the derivatives scope exceptions would be applied prospectively to contracts entered into after the adoption date, but entities would have the option to apply the amended guidance to existing contracts through a cumulative-effect adjustment. For certain arrangements impacted by the guidance, the proposal would permit the election of fair value option under ASC 825, *Financial Instruments*.

The proposed amendments related to share-based payments would be applied to existing contracts through a cumulative-effect adjustment.

To have a deeper discussion, contact:

Chip Currie	Angela Fergason	Mike Shea
Partner	Partner	Director
Email: frederick.currie@pwc.com	Email: angela.fergason@pwc.com	Email: michael.a.shea@pwc.com

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