



Life Sciences Industry Accounting Guide Financial Instruments

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Preface

The life sciences ecosystem encompasses a wide array of entities that discover, develop, and manufacture health care products. Such entities include pharmaceutical manufacturers; biotechnology companies; medical device, diagnostic, and equipment manufacturers; and service companies such as drug distributors, contract research organizations (CROs), contract manufacturing organizations (CMOs), and health technology companies.

Finance and accounting professionals in the life sciences industry face complex issues and must exercise significant judgment in applying existing rules to matters such as research and development (R&D) costs, acquisitions and divestitures, consolidation, contingencies, revenue recognition, income taxes, financial instruments, and financial statement presentation and disclosure. The 2026 edition of Deloitte's *Life Sciences Industry Accounting Guide* (the "Guide") addresses these and other relevant topics affecting the industry this year. It includes interpretive guidance; illustrative examples; recent standard-setting, legislative, and rulemaking developments (through March 6, 2026); and key differences between U.S. GAAP and IFRS[®] Accounting Standards. [Appendix B](#) lists the titles of standards and other literature we cited, and [Appendix C](#) defines the abbreviations we used. Key changes made to this Guide since publication of the 2025 edition are summarized in Appendix D.

We hope the Guide is helpful in navigating the various accounting and reporting challenges that life sciences entities face. We encourage clients to contact their Deloitte team for additional information and assistance.

Contacts



Jeff Ellis
Global and U.S. Life Sciences
Audit & Assurance Leader
Audit & Assurance Partner
Deloitte & Touche LLP
+1 412 338 7204
jeellis@deloitte.com



Dennis Howell
Life Sciences Industry
Professional Practice Director
National Office Senior
Consultation Partner
and Transformation Leader,
Accounting and Reporting
Services
Deloitte & Touche LLP
+1 203 761 3478
dhowell@deloitte.com



Katy Rossino
Life Sciences Deputy
Industry Professional
Practice Director
National Office
Consultation Partner,
Accounting and Reporting
Services
Deloitte & Touche LLP
+1 978 760 2396
krossino@deloitte.com

Chapter 9 — Financial Instruments

9.1 Introduction

Drug development is challenging, complex, time-consuming, and costly. The average R&D cost of advancing assets from discovery to launch is approximately \$2.2 billion per asset.¹ To fund the cost of drug development, life sciences entities frequently seek external financing. Many of the financing transactions include complex terms and conditions that require a careful accounting analysis.

The SEC staff historically has focused on the classification of liabilities and equity on the balance sheet when equity instruments have redemption provisions or financial instruments possess characteristics of both liabilities and equity. For example, classification of convertible debt instruments and freestanding warrants is often scrutinized since they may contain both liability and equity components under U.S. GAAP.

In addition, prospective SEC registrants in the life sciences industry may have previously outstanding instruments with characteristics of both liabilities and equity at the time they are approaching a potential IPO, or life sciences entities may issue new instruments in connection with a potential IPO. Even if certain instruments are already outstanding before an IPO, it may be appropriate for an instrument to be classified outside of permanent equity in accordance with SEC rules when public financial statements are initially filed. Further, for a life sciences entity that becomes a public company, there can be other accounting consequences that did not exist while the entity was private.

9.2 Industry Issues

The discussion below highlights guidance on the accounting for financial instruments that frequently affects life sciences entities. The guidance cited is not intended to be all-inclusive or comprehensive; rather, the discussion focuses on targeted considerations related to the application of the guidance most relevant to the industry. To complete an analysis of the accounting for financial instruments, entities must consider all facts and circumstances and use significant judgment. For additional guidance on the topics highlighted below, see Deloitte's Roadmaps [Distinguishing Liabilities From Equity, Contracts on an Entity's Own Equity](#), and [Issuer's Accounting for Debt](#).

¹ See, for example, the Deloitte Centre for Health Solutions' 15th annual pharmaceutical report, *Be Brave, Be Bold: Measuring the Return From Pharmaceutical Innovation*.

9.2.1 Sequence of Decision-Making

Upon the issuance of an equity instrument, a life sciences entity should first evaluate whether the instrument meets the definition of a liability in accordance with ASC 480, which applies to both PBEs (including SEC registrants) and private companies that are issuers of financial instruments within its scope. ASC 480 provides guidance on determining whether (1) certain financial instruments with both debt-like and equity-like characteristics should be accounted for “outside of equity” (i.e., as liabilities or, in some cases, assets) by the issuer and (2) SEC registrants should present certain redeemable equity instruments as temporary equity.

Examples of contracts and transactions that may require evaluation under ASC 480 include:

- Redeemable shares.
- Redeemable noncontrolling interests.
- Forward contracts to repurchase own shares.
- Forward contracts to sell redeemable shares.
- Written put options on own stock.
- Warrants (and written call options) on redeemable equity shares.
- Warrants on shares with deemed liquidation provisions.
- Puttable warrants on own stock.
- Equity collars.
- Share-settled debt (i.e., a share-settled obligation that is not in the legal form of debt but has the same economic payoff profile as debt).
- Preferred shares that are mandatorily convertible into a variable number of common shares.
- Unsettled treasury stock transactions.
- Accelerated share repurchase (ASR) programs.
- Hybrid equity units.

However, ASC 480 does not apply to legal-form debt, which is always classified as a liability by the issuer. If the legal form of an instrument is equity, further evaluation is necessary.

ASC 480 applies only to items that have all of the following characteristics:

- They embody one or more obligations of the issuer. An obligation can be either unconditional or conditional. An obligation is unconditional if no condition needs to be satisfied (other than the passage of time) to trigger a duty or responsibility for the obligated party to perform. Examples of unconditional obligations include:
 - Mandatorily redeemable financial instruments (as defined in ASC 480-10-20).
 - Physically settled forward contracts that require the issuer to repurchase equity shares by transferring assets or a variable number of shares.
 - Preferred stock that mandatorily converts into a variable number of common shares.

An obligation is conditional if the obligated party only has a duty or responsibility to perform if a specified condition is met (e.g., the occurrence or nonoccurrence of an uncertain future event or the counterparty's election to exercise an option). Examples of conditional obligations include:

- Physically settled written put options that, if exercised, could require the issuer to purchase equity shares and transfer assets.
- Physically settled forward contracts that require the issuer to purchase equity shares upon the occurrence or nonoccurrence of an event that is outside the issuer's control.
- Net-settled forward contracts to purchase equity shares that could require the issuer to transfer cash or a variable number of equity shares to settle the contracts' fair value if they are in a loss position.
- Net-settled written options that require the issuer to transfer assets or shares if the counterparty elects to exercise the options.

ASC 480 does not address the accounting for financial instruments that do not embody any obligation of the issuer. Examples of such instruments include:

- Outstanding equity shares that do not have any redemption or conversion provisions.
- Purchased call options that permit but do not require the issuer to purchase equity shares for cash (see ASC 480-10-55-35).
- Purchased put options that permit but do not require the issuer to sell equity shares for cash.
- They meet the definition of a financial instrument. The scope of ASC 480 is limited to financial instruments, which include:
 - Ownership interests (e.g., common or preferred shares or interests in a partnership or limited liability company).
 - Contracts to deliver cash (e.g., net-cash-settled options or forward contracts).
 - Contracts to deliver shares (e.g., share-settled debt or net-share-settled options or forward contracts).
 - Contracts to exchange financial instruments (e.g., physically settled written options or forward contracts that involve the exchange of equity shares for cash or another financial asset).
- They meet the definition of a freestanding financial instrument; that is, they are not features embedded in a freestanding financial instrument. ASC 480-10-20 defines a freestanding financial instrument as a financial instrument that either (1) "is entered into separately and apart from any of the entity's other financial instruments or equity transactions" or (2) "is entered into in conjunction with some other transaction and is legally detachable and separately exercisable."
- Their legal form is that of a share, or they could result in the receipt or delivery of shares or are indexed to an obligation to repurchase shares.

ASC 480 requires an instrument that has all of the above characteristics to be classified outside of equity if it falls within one of the following classes of instruments:

- *Mandatorily redeemable financial instruments* — The issuer of a financial instrument that is in the form of a share must classify the share as a liability if it embodies an unconditional obligation requiring the issuer to redeem the share by transferring assets unless redemption would occur only upon the liquidation or termination of the reporting entity. Examples of mandatorily redeemable financial instruments include those mandatorily redeemable shares and mandatorily redeemable noncontrolling interests that do not contain any substantive conversion features.
- *Obligations to repurchase the issuer's shares by transferring assets (or financial instruments indexed to such obligations)* — A financial instrument other than an outstanding share is classified as an asset or a liability if it both (1) embodies an obligation to repurchase the issuer's equity shares (or is indexed to such an obligation) and (2) requires (or may require) the issuer to settle the obligation by transferring assets. Examples of financial instruments that meet these criteria include those forward purchase contracts and written put options on the entity's own equity shares that are either physically settled or net cash settled.
- *Certain obligations to issue a variable number of shares* — An outstanding share that embodies an unconditional obligation, or a financial instrument other than an outstanding share that embodies an obligation, is classified as an asset or a liability if the issuer must or may settle the obligation by issuing a variable number of its equity shares and the obligation's monetary value is based solely or predominantly on one of the following: (1) a fixed monetary amount, (2) variations in something other than the fair value of the issuer's equity shares, or (3) variations inversely related to changes in the fair value of the issuer's equity shares. Examples of instruments in this category include share-settled debt and those forward purchase contracts and written put options on the entity's own equity shares that are net share settled.

Financial instruments that are accounted for as assets or liabilities under ASC 480 are initially recognized at fair value, with one exception. A forward contract that requires the entity to repurchase a fixed number of its equity shares for cash is initially measured at the fair value of the shares at inception (i.e., not the fair value of the forward contract), with certain adjustments, and the offsetting entry is presented in equity (i.e., the transaction is treated as if the repurchase had already occurred with borrowed funds).

In subsequent periods, financial instruments classified as assets or liabilities under ASC 480 are remeasured at their then-current fair value, and changes in fair value are recorded in earnings, with two exceptions. ASC 480-10-35-3 states that physically settled forward contracts to repurchase "a fixed number of the issuer's equity shares in exchange for cash and mandatorily redeemable financial instruments shall be measured subsequently in either of the following ways," as applicable:

- a. If both the amount to be paid and the settlement date are fixed, those instruments shall be measured subsequently at the present value of the amount to be paid at settlement, accruing interest cost using the rate implicit at inception.
- b. If either the amount to be paid or the settlement date varies based on specified conditions, those instruments shall be measured subsequently at the amount of cash that would be paid under the conditions specified in the contract if settlement occurred at the reporting date, recognizing the resulting change in that amount from the previous reporting date as interest cost.

The fact that an instrument does not need to be classified as an asset or a liability under ASC 480 does not necessarily mean that it qualifies for equity classification. To determine whether an instrument qualifies for classification in equity in whole or in part, an entity must also consider other GAAP (e.g., ASC 470-20, ASC 815-10, ASC 815-15, and ASC 815-40). Further, under ASC 480-10-S99-3A, an entity that is subject to SEC guidance should consider whether an equity-classified instrument must be classified outside of permanent equity.

Once an issuer has determined that the appropriate balance sheet classification for the equity instrument is liability, temporary equity, or permanent equity, the issuer should further evaluate the instrument to identify any embedded features that may need to be bifurcated and accounted for separately as derivative instruments.

The sections below outline some of the more common types of securities that life sciences entities issue, together with the related accounting considerations.

9.2.2 Redeemable Equity Securities

The SEC staff believes that redeemable equity securities are significantly different from conventional equity capital because such securities possess characteristics similar to debt as a result of the redemption obligation attached to the securities. The guidance in ASC 480-10-S99-3A requires instruments to be classified outside of permanent equity in “temporary equity” if they are redeemable (1) at a fixed or determinable price on a fixed or determinable date, (2) at the option of the holder, or (3) upon the occurrence of an event that is not solely within the issuer’s control. To determine the appropriate classification, SEC registrants must evaluate all facts and circumstances related to events that could trigger redemption of the securities.² Issuers should evaluate whether equity instruments that do not meet the definition of a liability under ASC 480 nevertheless must be presented outside of permanent equity because of any of these provisions.

Because only public entities are required to present certain equity instruments as temporary equity (sometimes referred to as mezzanine equity) instead of permanent equity, the SEC staff frequently comments on this topic during the IPO process.

9.2.2.1 Mandatorily Redeemable Equity Securities

ASC 480 requires mandatorily redeemable securities to be reported as liabilities. Other redeemable equity securities are classified outside of shareholders’ equity in “temporary equity” under the SEC staff’s guidance. More specifically, for a redeemable equity security to be classified as a liability under ASC 480, it must be certain that redemption will occur; redeemable equity securities whose redemption is not certain are classified as temporary equity under the SEC staff’s guidance. Therefore, mandatorily redeemable preferred securities that have substantive conversion options at issuance would not be considered liabilities under ASC 480 even though such securities are called mandatorily redeemable convertible securities. This is because as long as the conversion option is substantive, it is not certain that redemption will occur. If the issuer does not have control over any event that could trigger redemption of the security, the security would be classified as temporary equity under the SEC staff’s guidance.

The treatment of the return paid to the holder of redeemable securities differs depending on whether the securities are classified as liabilities or as temporary equity. For securities classified as liabilities under ASC 480, such a return is treated as an expense. For redeemable securities classified as temporary equity, such a return is treated as a dividend.

² See ASC 480-10-S99-3A(5).



Connecting the Dots

In general, an entity should first apply the guidance in ASC 480 when determining the appropriate presentation of redeemable securities on the balance sheet. If the securities are not classified as liabilities under ASC 480, the entity should examine them under SEC staff guidance to determine whether it is appropriate to classify them as temporary equity. In addition, registrants should be familiar with the SEC staff's views on the applicability of its guidance in certain situations. For example, if redemption is required only upon the liquidation of the reporting entity, an instrument is not considered redeemable. This situation and others are described in ASC 480-10-S99-3A.

9.2.2.2 Redeemable Securities Whose Redemption Is Outside the Issuer's Control

The analysis of whether a security's redemption is not solely within the issuer's control could be complicated depending on the triggering events associated with redemption. The SEC staff believes that the issuer should evaluate each triggering event separately, along with relevant facts and circumstances, to determine whether it is outside the issuer's control. If *any* triggering events are outside the issuer's control, the security should be classified outside of permanent equity regardless of the probability of such events.³ ASC 480-10-S99-3A(6)–(9) provide examples of events that are outside the issuer's control.



Connecting the Dots

Nonpublic life sciences entities, including start-ups and other entities financed by private equity or venture capital firms, often have one or more series of convertible preferred stock issued and outstanding. In evaluating the appropriate classification in the statement of financial position of convertible preferred stock, a life sciences entity should first consider whether the convertible preferred stock represents a mandatorily redeemable financial instrument that is required to be classified as a liability under ASC 480-10-25-4. If a preferred stock instrument contains an embedded conversion option that is considered a substantive feature as of the issuance date,⁴ the convertible preferred stock instrument would not qualify as a mandatorily redeemable financial instrument.⁵

When convertible preferred stock is not required to be classified as a liability, life sciences entities should consider the SEC staff's guidance in ASC 480-10-S99-3A⁶ to determine whether it is appropriate to classify the convertible preferred stock in permanent equity. Convertible preferred stock should be classified in temporary equity if the instrument contains (1) a stated redemption feature that allows or requires the holder to put the security to the issuer on a specified date (or dates) or (2) a stated redemption feature that allows the holder to put the security to the issuer upon the occurrence of a specified event that is not solely within the issuer's control. Therefore, when the holders of convertible preferred stock have control over the entity, the following convertible preferred stock instruments must also be classified in temporary equity:

- Convertible preferred stock that contains a stated redemption feature that allows the issuer to call the security on a specified date (or dates).

³ See [footnote 2](#).

⁴ A conversion feature that results in settlement of the instrument through the issuance of a variable number of shares of common stock equal to a fixed monetary amount is equivalent to "share-settled" debt and would not represent a substantive conversion option. For additional guidance, see ASC 470-20-40-5 through 40-10.

⁵ See ASC 480-10-55-11 and 55-12.

⁶ The SEC's temporary equity guidance applies to SEC registrants' financial statements that are prepared in accordance with SEC Regulation S-X (e.g., in annual reports on Form 10-K and registration statements on Form S-1). While the SEC's temporary equity guidance is not required to be applied to financial statements that are not filed with the SEC, an entity that is not filing financial statements with the SEC may elect to apply it anyway (e.g., if it contemplates becoming an SEC registrant in the future).

- Convertible preferred stock that contains a stated redemption feature that allows the holder to put the security to the issuer upon the occurrence of a specified event or circumstance that can be controlled by the vote of the entity's stockholders or by actions of the entity's board of directors.

Even if a convertible preferred stock instrument does not contain an explicit redemption feature (i.e., a stated call option or a stated put option), the instrument's liquidation provisions must still be considered, including whether those provisions are considered "ordinary liquidation" or "deemed liquidation" provisions. An ordinary liquidation provision does not trigger the requirement to classify the convertible preferred equity in temporary equity; a deemed liquidation provision will typically trigger the requirement to classify the convertible preferred equity in temporary equity. See [Chapter 9](#) of Deloitte's Roadmap *Distinguishing Liabilities From Equity* for additional guidance.

9.2.2.3 Measurement of Instruments Classified in Temporary Equity

If an instrument classified in temporary equity is currently redeemable, it should be adjusted to its maximum redemption amount as of the balance sheet date. However, if an instrument classified in temporary equity is not currently redeemable and the registrant determines that its redeemability is not probable, subsequent adjustment of the carrying amount is not necessary until it is probable that the security will become redeemable.⁷

9.2.3 Preferred Stock That Is Nonredeemable or Is Redeemable Solely at the Option of the Issuer

When securities are not redeemable or are redeemable solely at the option of the issuer, those securities are generally classified in permanent equity on the balance sheet. All relevant facts and circumstances should be considered in the determination of whether the redemption is solely at the option of the issuer.⁸ The SEC staff often emphasizes that issuers should examine the redemption provision of all securities classified in permanent equity to ensure their proper classification. For example, an instrument may not be redeemable for cash but may be convertible into another class of equity. Unless management can assert that it has the ability to settle the conversion with shares, it could be forced to redeem the instrument for cash, resulting in classification of that instrument outside of permanent equity. In addition, according to its terms, a security may be redeemable solely at the option of the issuer; however, if the holder of the security controls the issuer's board of directors, that security would be considered redeemable at the option of the holder and would be classified as temporary equity.⁹

If classification of securities as temporary equity is no longer appropriate because of a change in the redemption feature, the outstanding carrying amount of securities should be reclassified as permanent equity on the date of the event that causes the reclassification.

Even if the entire instrument should be classified in permanent equity under ASC 480-10-S99-3A, the issuer may be required to perform further analysis to determine whether the equity instrument contains embedded derivatives that must be bifurcated and accounted for separately as derivative instruments in accordance with ASC 815-15.

⁷ See ASC 480-10-S99-3A(15).

⁸ See ASC 480-10-S99-3A(4)-(11).

⁹ See ASC 480-10-S99-3A(7).

9.2.4 ASR Programs

Several life sciences companies have considered or executed ASR programs in recent years. As described in ASC 505-30-25-5, an ASR program is “a combination of transactions that permits an entity to repurchase a targeted number of shares immediately with the final repurchase price of those shares determined by an average market price over a fixed period of time. An accelerated share repurchase program is intended to combine the immediate share retirement benefits of a tender offer with the market impact and pricing benefits of a disciplined daily open market stock repurchase program.”

ASC 505-30 contains unit-of-account guidance that applies to ASR programs. Under ASC 505-30-25-6, an entity accounts for an ASR as two separate units of account: a treasury stock repurchase and a separate forward contract on the entity's shares. An entity should analyze the treasury stock repurchase and forward contract separately to determine whether ASC 480 applies.

The terms of ASRs vary. In a traditional ASR, an entity (1) repurchases a targeted number of its own shares at the current stock price up front for cash and (2) simultaneously enters into a net-settled forward sale of the same number of shares. Economically, the forward serves as a true-up mechanism to adjust the price ultimately paid for the shares purchased. The purpose is to reduce the number of outstanding shares immediately at a repurchase price that reflects the average stock market price over an extended period (e.g., the volume-weighted average price on each trading day during the contract period). On a combined basis, the initial share repurchase and the forward sale put the issuer in an economic position similar to that of having conducted a series of open market purchases of its own stock over a specified period.

Example 9-1

ASR Analysis — Determination of Units of Account

An entity makes an up-front cash payment and receives a specific number of shares from the counterparty (usually an investment bank). Upon settlement of the forward contract (typically within three to six months), the entity either (1) pays the counterparty an amount equal to any excess of the volume-weighted average daily market price (VWAP) of the entity's shares over the initial purchase price or (2) receives from the counterparty an amount equal to any excess of the initial purchase price over the VWAP. Often, the entity can choose to settle the forward contract with the counterparty in either cash or a variable number of shares. Under ASC 505-30, this transaction is analyzed as two units of account: a treasury stock repurchase and a net-settled forward contract to sell the entity's stock over the contract period.

In practice, the settlement of the treasury stock repurchase often takes place one or a few days after the execution of the ASR (e.g., the initial share delivery date may be three business days after the transaction date), at which time the issuer pays cash and receives an initial number of shares. If so, the obligation to repurchase shares in exchange for cash is classified as a liability under ASC 480-10-25-8 (see [Chapter 5](#) of Deloitte's Roadmap *Distinguishing Liabilities From Equity*) during the period between the ASR transaction date and the settlement date of the treasury stock repurchase (sometimes described as the “initial share delivery date” or the “prepayment date”). Note that in some ASR transactions, the payment of cash in the treasury stock repurchase occurs before the receipt of the initial shares, in which case ASC 480 may cease to apply once the obligation to pay cash has been settled.

In evaluating whether the forward component of an ASR is within the scope of ASC 480, the issuer should consider whether it embodies an obligation to transfer assets or a variable number of shares that meet the criteria in ASC 480-10-25-8 or ASC 480-10-25-14 (see [Chapters 5](#) and [6](#), respectively, of Deloitte’s Roadmap *Distinguishing Liabilities From Equity*). Usually, an issuer is not required to classify as a liability under ASC 480 the forward contract component in a traditional ASR because it does not embody an obligation to repurchase shares for assets and does not involve an obligation to deliver a variable number of shares with a monetary value that moves inversely with — or is based on something other than — the price of the issuer’s stock. However, an issuer cannot assume that the forward contract component of an ASR is outside the scope of ASC 480 without analyzing its specific terms and features.

In some ASR transactions, a portion of the prepayment amount on the initial share delivery date represents a premium paid by the issuer to increase the forward sale price that the issuer will receive in the forward component of the transaction (relative to an at-market forward) rather than a payment for the shares to be received in the initial treasury stock repurchase. For example, the issuer may apply 20 percent of the prepayment amount to the forward component to reduce the likelihood that the forward component will ever dilute earnings per share (EPS). In this case, the issuer may be required to account for the forward component as an asset or liability under ASC 480-10-25-8 in the period between the transaction date and the prepayment date (which may be the initial share delivery date) if the forward component permits net share settlement, because the forward component embodies an obligation to pay cash (on the initial share delivery date) to repurchase shares (the issuer will receive shares on the forward settlement date if the stock price is less than the forward price).

If the forward component is outside the scope of ASC 480, the issuer should evaluate it under ASC 815-40 to determine whether it must be accounted for as an asset or a liability. The terms of an ASR often include rights for the counterparty to end the ASR early upon termination events defined by reference to the International Swaps and Derivatives Association’s equity derivatives definitions (e.g., merger events, tender offers, nationalization, insolvency, delisting, change in law, failure to deliver, loss of stock borrowings, increased cost of stock borrowings, extraordinary dividends). Further, the contractual provisions often specify or permit the counterparty to make adjustments to the settlement terms upon the occurrence of such events (e.g., calculation agent adjustments, cancellation, and payment) and might require the entity to settle the contract net in cash. In evaluating an ASR’s forward-contract component under ASC 815-40, the entity should be mindful of the need to assess such terms under the indexation guidance and other equity classification conditions in ASC 815-40.

Example 9-2

ASR Analysis — Accounting Between Trade Date and Settlement Date

On December 30, 20X8, an issuer enters into an ASR transaction that requires it to transfer a fixed amount of cash (a prepayment amount of \$500 million) in exchange for a fixed number of its common shares (10 million initial shares) on the initial share delivery date (January 2, 20X9). On the transaction’s final settlement date (March 31, 20X9), the issuer will either deliver or receive shares. If the VWAP of the issuer’s common shares exceeds \$50, the issuer will deliver shares; if the VWAP is less than \$50, the issuer will receive shares. The number of shares that will be received or delivered is calculated as the prepayment amount (\$500 million) divided by the VWAP over the contract period less the initial shares (10 million) already delivered.

Example 9-2 (continued)

In these circumstances, the treasury stock repurchase must be accounted for as a liability under ASC 480-10-25-8. In accordance with ASC 480-10-30-3, the issuer recognizes the liability on the ASR transaction date, which was initially measured “at the fair value of the shares at inception, adjusted for any consideration or unstated rights or privileges.” Simultaneously, in accordance with ASC 480-10-30-5, equity is “reduced by an amount equal to the fair value of the shares at inception.” Because under ASC 480-10-35-3(a) both the amount to be paid (\$500 million) and the settlement date (January 2, 20X9) are fixed, the liability is measured at the present value of the amount to be paid at settlement (\$500 million), with interest cost accruing at the rate implicit at inception during the period from the transaction date to the initial share delivery date. (Further, if any part of the prepayment amount represents a premium payment for the forward component of the ASR transaction, that portion would be accounted for separately as a liability measured at fair value under ASC 480-10-35-1, ASC 480-10-35-4A, or ASC 480-10-35-5 between the transaction date and the initial share delivery date, as discussed above.)

On the initial share delivery date, the liability for the treasury stock repurchase is extinguished by delivery of the prepayment amount. After the initial share delivery date, the transaction is outside the scope of ASC 480 and is therefore evaluated under other GAAP (including ASC 815-10 and ASC 815-40; see [Section 3.2.5](#) of Deloitte’s Roadmap *Contracts on an Entity’s Own Equity*).

9.2.5 Derivatives

Common financing arrangements issued by life sciences entities in the form of debt or equity capital may be considered to be or may contain equity derivatives (i.e., equity derivatives may be freestanding or embedded). Examples of common equity derivatives are stock warrants, stock options, and forward contracts to buy or sell an entity’s shares. Equity derivatives may be classified as liabilities (or, in some cases, as assets) and measured at fair value on the balance sheet, with changes in fair value recognized in earnings. It is important to be aware of these instruments, how they are accounted for, and subsequent events that could affect such accounting. Sometimes, the measurement attribute for such instruments could be fair value as a result of an IPO or subsequent financing.

The first step in the analysis is to consider whether the equity derivative is a freestanding instrument or whether it is embedded in another instrument. If the instrument is freestanding, the guidance in ASC 815-40 will govern the classification and measurement of the instrument unless the instrument is a liability within the scope of ASC 480, as discussed above. It is important to note that the guidance in ASC 815-40 is applicable to freestanding contracts on an entity’s own equity regardless of whether those contracts meet the definition of a derivative in ASC 815-10. Contracts on an entity’s own equity may need to be classified as assets and liabilities (and remeasured at fair value every reporting period) even if they are not considered derivatives within the scope of ASC 815-10. Also, contracts that meet the conditions for classification in equity under ASC 815-40 are excluded from the scope of ASC 815-10 even if they meet the definition of a derivative.

If an equity derivative is embedded in a hybrid instrument, the guidance in ASC 815-40 will be applicable only to embedded features that meet the definition of a derivative and meet the other criteria for bifurcation. That is, if an embedded equity derivative is not clearly and closely related to the host contract, the hybrid instrument is not remeasured at fair value with changes in fair value recognized in earnings, and the embedded derivative meets the definition of a derivative in ASC 815-10, the guidance in ASC 815-40 will be relevant in the determination of whether the equity derivative needs to be bifurcated because of the scope exception in ASC 815-10, as discussed above.

9.2.5.1 ASC 815-40 — Contracts on an Entity's Own Equity

ASC 815-40 provides guidance on the accounting for contracts (and features embedded in contracts) that are indexed to, and potentially settled in, an entity's own equity (also known as contracts on own equity or equity-linked financial instruments). The analysis under ASC 815-40 can be complex; in performing this analysis, an entity often must consult with its legal counsel regarding the various terms associated with the contract. The SEC staff has noted common issues related to applying the guidance in ASC 815-40, including the following:

- Cash settlement provisions.
- Requirement to settle in registered shares.
- Insufficient number of authorized but unissued shares.
- No limit on the number of shares to be delivered.
- Incorrect conclusion regarding whether the instrument is indexed to an entity's own stock.

In general, a contract on an entity's own equity can be classified in equity (and not remeasured while it is classified in equity) as long as it is considered to be indexed to the entity's own stock **and** the issuer has the ability to settle the contract by issuing its own shares under all scenarios. This determination requires an evaluation of all events that could change the settlement value (e.g., adjustments to strike price) and all events that would affect the form of settlement. For additional guidance on ASC 815-40, see Deloitte's Roadmap [Contracts on an Entity's Own Equity](#).



Connecting the Dots

If a freestanding contract on an entity's own equity does not meet the conditions for being considered indexed to the entity's own stock under ASC 815-40-15, ASC 815-40 precludes classification of the contract as equity and instead requires the instrument to be classified as an asset or a liability. Entities should account for contracts classified as assets or liabilities under ASC 815-40-25 at fair value, with changes in fair value recorded in earnings in each reporting period (see ASC 815-40-15-8A and ASC 815-40-35-4).

9.2.5.2 Considerations Related to Embedded Derivatives

In addition to the considerations related to freestanding instruments (e.g., warrants or stock options) under ASC 815, an entity should evaluate whether other contracts, such as those involving preferred stock or convertible debt, contain embedded equity derivatives that may need to be bifurcated and accounted for separately from the host contract under ASC 815's bifurcation requirements. A reporting entity identifies the terms of each embedded feature on the basis of the feature's economic payoff profile (underlying)¹⁰ rather than on the basis of how the feature has been formally documented. In identifying the embedded features, the entity should consider all terms of the convertible instrument. Common examples of embedded features include conversion options and redemption provisions.

¹⁰ Although there is no explicit guidance under U.S. GAAP on how to determine the unit of account for embedded features in a hybrid instrument, the approach described herein is commonly applied. Under the payoff-profile approach, each embedded derivative feature in a hybrid instrument is defined on the basis of the monetary or economic value that the feature conveys to the instrument's counterparty upon settlement. This approach is consistent with the definition of an embedded derivative in ASC 815-15-20, which focuses on the effect of an implicit or explicit term on the cash flows or values of other exchanges required under a contract. For more information on the payoff-profile approach, see Deloitte's Roadmap [Derivatives](#).

An identified embedded feature generally¹¹ must be bifurcated and accounted for separately from the host contract if the following three conditions are met:

- The embedded feature is not clearly and closely related to the host contract.
- The host instrument (e.g., preferred stock or debt) is not remeasured at fair value, with changes in fair value recognized in earnings, under other applicable GAAP.
- A separate instrument with the same terms as the embedded feature meets the definition of a derivative instrument under ASC 815-10.¹²

9.2.5.2.1 Clearly and Closely Related to the Host Contract

9.2.5.2.1.1 *Determining the Nature of the Host Contract*

When determining whether the embedded feature being analyzed is clearly and closely related to the host contract, an entity must first decide whether the nature of the host contract is more debt-like or equity-like by using a “whole-instrument approach.” Under the whole-instrument approach, the nature of the host contract is the same for each embedded feature being analyzed. Determining the nature of the host contract under the whole-instrument approach involves the following steps:

- Identify all of the hybrid financial instrument’s stated and implied substantive terms and features.
- Determine whether the identified terms and features are more debt-like or equity-like.
- Consider the relative weight of the identified terms and features “on the basis of the relevant facts and circumstances.”¹³
- Reach a conclusion about the nature of the host contract.

Further, ASC 815-15-25-17A states, in part:

In evaluating the stated and implied substantive terms and features, the existence or omission of any single term or feature does not necessarily determine the economic characteristics and risks of the host contract. Although an individual term or feature may weigh more heavily in the evaluation on the basis of the facts and circumstances, **an entity should use judgment based on an evaluation of all of the relevant terms and features.** For example, an entity shall not presume that the presence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock contract, in and of itself, determines whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument. Rather, the nature of the host contract depends on the economic characteristics and risks of the entire hybrid financial instrument. [Emphasis added]

If a reporting entity is still unclear about the nature of the host contract after performing this analysis, it should consider the anticipated outcome for the holder of the hybrid financial instrument in reaching its final conclusion. Given the complexity of determining the nature of a host contract of a hybrid instrument with both conversion and redemption features, entities are encouraged to consult with their accounting advisers.

The method described above for determining the nature of the host contract applies only to hybrid instruments issued in the form of a share. A legal-form debt instrument will typically be considered to be a debt host contract.

¹¹ Subject to the scope exceptions in ASC 815-10.

¹² See ASC 815-10-15-83.

¹³ See ASC 815-15-25-17C.

9.2.5.2.1.2 *Determining Whether the Feature Is Clearly and Closely Related to the Host Contract*

Once the reporting entity has determined the nature of the host contract, it should, in accordance with ASC 815-15-25-1(a), evaluate each embedded feature separately to determine whether the economic characteristics and risks of the embedded feature are clearly and closely related to those of the host contract. If the embedded feature is clearly and closely related to the host contract, the embedded feature should not be bifurcated. If the embedded feature is not clearly and closely related to the host contract, the reporting entity must analyze the other two conditions described above to determine whether bifurcation of the embedded feature is required.

Commonly identified embedded features that an entity would evaluate to determine whether they are clearly and closely related to a debt or equity host contract include the following:

- *Redemption features* — A redemption feature enables the holder to receive cash to settle the equity instrument. A redemption feature may be held by the issuer or the holder and may be exercisable upon the occurrence of certain events or at any time. If an equity host contract has a redemption feature, the redemption is explicitly not considered clearly and closely related to that contract in accordance with ASC 815-15-25-20. Therefore, in such cases, an entity would need to perform additional analysis to determine whether it is required to bifurcate the redemption feature.

Under ASC 815-15-25-42, if a debt host contract has a redemption feature, an entity must perform a four-step test to determine whether the redemption feature is clearly and closely related to the debt host.

- *Conversion features* — Conversion features enable an entity to convert an existing instrument into another form of the entity's equity (e.g., convertible preferred stock, convertible debt). ASC 815-15-25-16 indicates that a conversion feature in an equity host contract would be clearly and closely related to the equity host contract since it provides the holder with another residual interest in the same entity. Accordingly, a conversion feature in an equity host contract would not be bifurcated and accounted for separately as a derivative instrument.

However, ASC 815-15-25-51 indicates that a conversion option in a debt host contract is not clearly and closely related to the contract. Therefore, the entity would have to perform further analysis to determine whether the other bifurcation criteria are met.

- *Changing interest/dividend rates* — Contracts may include provisions under which stated interest or dividend rates increase or decrease as a result of the occurrence or nonoccurrence of specific events. An embedded derivative that resets the interest rate of a debt host contract (i.e., a debt instrument or an equity instrument that was determined to represent a debt host) is generally clearly and closely related to the debt host if it is based on changes in interest rates,¹⁴ the issuer's creditworthiness, or inflation. However, if, for example, an entity's bonds include a provision under which the interest rate must be reset to a different rate if an unrelated party's credit rating is downgraded at any time during the term of the bonds, the reset feature is not clearly and closely related to the debt host. An embedded derivative that changes an instrument's interest rate because of changes to the rate of inflation in the economic environment for the currency in which a debt instrument is denominated would be considered clearly and closely related to the debt host. Further, changes to an interest rate based on changes in an entity's operating performance (e.g., EBITDA) may be considered clearly and closely related to the debt host if the operating performance metric is related to the entity's creditworthiness.¹⁵

¹⁴ See ASC 815-15-25-26.

¹⁵ See ASC 815-15-25-46 and 25-47.

Such interest rate reset provisions are generally not considered clearly and closely related to an equity host, however.

9.2.5.2.2 Separate Instrument With Same Terms Meets the Definition of a Derivative

An embedded equity derivative (e.g., a conversion option) that meets the first two conditions outlined above for bifurcating embedded equity derivatives would require further evaluation for an entity to determine whether the embedded feature should be separately accounted for as a derivative under ASC 815-10. ASC 815-10-15-83 defines a derivative as a financial instrument or other contract that (1) has an underlying as well as a notional amount or payment provision, (2) requires little or no initial net investment, and (3) can be net settled.

Equity instruments will generally meet the first and second criteria in the definition of a derivative but may not meet the third. For instance, a contract on a nonpublic entity's own stock (e.g., a warrant or stock option) may not qualify as a derivative because the entity's equity shares are not publicly traded. In such cases, unless the contract provides for net share settlement or cash settlement, the contract generally would not meet the net settlement criterion because the equity shares would not be readily convertible to cash. However, upon an IPO, the entity would need to reevaluate the contract under ASC 815 to determine whether the contract is or contains an accounting derivative now that the entity's shares are publicly traded. If the post-IPO shares or an embedded conversion feature is readily convertible to cash, the net settlement criterion would be met, resulting in an accounting derivative that may need to be recognized unless it qualifies for a scope exception to derivative accounting (discussed further below).

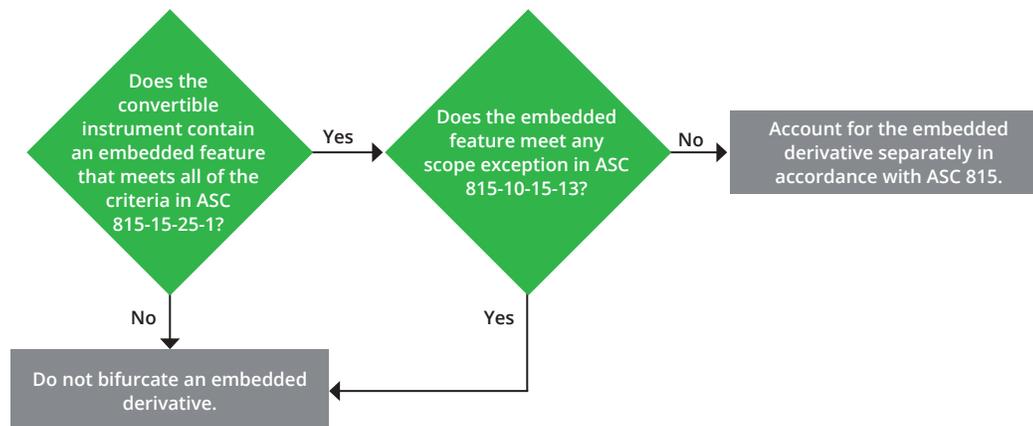
For example, a warrant to acquire common-stock shares that explicitly permits net settlement (e.g., cashless exercise) would meet the net settlement criterion. However, a warrant to acquire common-stock shares of a nonpublic entity for which gross exercise is required (i.e., the warrant holder pays the exercise price in cash to acquire common shares) would generally not meet the net settlement criterion since the contract would be settled in shares that are not readily convertible to cash. If that nonpublic entity went public, however, the warrant that previously did not meet the net settlement criterion might now satisfy the criterion since common-stock shares of a publicly traded entity are generally readily convertible to cash.

A contract that meets the definition of a derivative under the above criteria may not need to be accounted for as a derivative if it qualifies for any of the scope exceptions in ASC 815-10-15-13. One of these scope exceptions involves contracts on an entity's own equity. Generally, the value of an equity derivative is linked to the entity's own stock (i.e., the underlying of the derivative). If the derivative is indexed to the entity's own stock and would not require the entity to settle the derivative by paying cash or other assets, it would qualify for classification as equity and be outside of the scope of ASC 815.

Some equity derivatives may qualify for the scope exception in ASC 815-10-15-74(a) for certain contracts indexed to the company's own stock. If this scope exception applies, such equity derivatives would not have to be bifurcated. ASU 2020-06 removes certain conditions required for a contract to qualify for the scope exception. (For further discussion of other new guidance on financial instruments, see [Section 9.3.](#))

However, an embedded feature that meets the definition of a derivative and does not qualify for an explicit scope exception would need to be bifurcated from the host instrument and accounted for separately as a derivative (if the other two conditions for bifurcation are also met). A bifurcated derivative (e.g., a conversion feature) would be measured initially and subsequently at fair value, with changes in fair value recognized in earnings.

The accounting for convertible debt instruments and convertible preferred stock is complex, and the SEC staff frequently asks about the classification of such instruments in entities' registration statements. The flowchart below illustrates the multistep evaluation that entities are required to perform for any hybrid instrument with a conversion feature.



9.2.5.3 Tranche Preferred Stock Agreement

Example 9-3

Entity X enters into a preferred stock purchase agreement with unrelated investors to sell two tranches of convertible redeemable preferred stock (the "preferred stock"). The purchase agreement stipulates the following:

- On the first closing date, which is the date of the purchase agreement, the investors will acquire 50,000 shares of preferred stock for \$50 million.
- On the second closing date, the investors will acquire 25,000 additional shares of preferred stock for \$25 million subject to a specified condition. The second closing will occur only if (1) a specific milestone related to X's research and clinical development is achieved two years from the first closing date or (2) the specific milestone related to X's research and clinical development is not achieved two years from the first closing date but the holders waive the milestone requirement and elect to purchase the additional shares of preferred stock (the "contingent purchase option").

The purchase agreement stipulates that the holders of preferred stock issued in the first closing cannot transfer their contingent purchase options separately from the preferred shares acquired in the first closing (or vice versa). However, such holders have the right to convert those preferred shares into common stock before the date that is two years from the first closing date. The purchase agreement does not restrict the holders that convert preferred shares into common stock from selling those common shares. The only restrictions on selling common stock stem from restrictions under U.S. securities laws.

In this example, the contingent purchase option would be considered a freestanding financial instrument because it meets the "legally detachable and separately exercisable" condition. The holders can "detach" the two instruments because they can convert the preferred stock into common stock and sell those shares while retaining the contingent purchase option (i.e., the two instruments are capable of being separated). This would be the case even if the contingent purchase option may not be separately transferred after the conversion into common stock of the preferred shares obtained in the first closing. It would not be appropriate to consider the preferred shares and the contingent purchase option a single combined financial instrument, because the contingent purchase option would not become embedded in the common shares received upon conversion of the preferred stock purchased in the first closing.

Example 9-3 (continued)

Note that the conclusion in this example would not change even if:

- The holders could not sell the common shares received upon conversion of the preferred stock purchased in the first closing before satisfaction or expiration of the contingent purchase option. At the inception of the arrangement, the two instruments still meet the legally detachable and separately exercisable condition because the contingent purchase option (1) cannot become embedded in the common shares received upon conversion of the preferred stock purchased in the first closing and (2) does not become freestanding only if the preferred stock purchased in the first closing is converted into common stock (instead, the ability to convert the preferred stock purchased in the first closing is evidence that the contingent purchase option is capable of being separated at the inception of the arrangement).
- The preferred stock purchased on the first closing date cannot be transferred or converted before the contingent purchase option is satisfied or expires and the holders have the right to acquire the additional shares related to the contingent purchase option at their option at any time before two years from the closing date. The two instruments still meet the legally detachable and separately exercisable condition because the investor can separate the two components by early exercising the contingent purchase option while retaining the preferred shares acquired on the first closing date.

As this example illustrates, and in a manner consistent with practice, an option or commitment to issue additional preferred shares is almost always a freestanding financial instrument because the separate exercisability of the option or commitment is sufficient to demonstrate that the feature is capable of being separated.

9.2.5.4 Multiple Freestanding Instruments in a Tranche Debt Issuance

Often, an entity will issue debt instruments that include tranche issuances (i.e., an initial debt issuance followed by subsequent debt issuances that are triggered by a debtor requisition right or contingent on the occurrence of certain events). It is common to see warrants contemporaneously issued to the creditor of such tranche financings as part of the transaction. These warrants may include terms such that upon the closing of the initial debt issuance, an initial warrant is issued, followed by the issuance of additional warrants upon the closing of subsequent debt issuances.

The first step in evaluating the debtor's accounting for a tranche debt arrangement with contemporaneously issued warrants is to understand whether the debt and the warrants are freestanding from one another as defined in ASC 480-10-20. As noted in [Section 9.2.1](#), ASC 480-10-20 defines a freestanding financial instrument as a financial instrument that either (1) "is entered into separately and apart from any of the entity's other financial instruments or equity transactions" or (2) "is entered into in conjunction with some other transaction and is legally detachable and separately exercisable." Typically, aside from the tranche debt arrangement and the contemporaneous warrants, the counterparties would not enter into any other concurrent transactions. However, since these instruments would be entered into at the same time and executed on the same date, it is necessary to evaluate whether they are legally detachable and separately exercisable and, therefore, are freestanding in accordance with the second condition above. The following are common indicators that the tranche debt arrangement and the contemporaneous warrants are legally detachable and separately exercisable:

- The warrants are transferable by the creditors in whole or in part in accordance with U.S. securities law.
- The expiration date of the warrants extends beyond the maturity date of the tranche debt arrangement.
- Repayment of the tranche debt arrangement does not result in termination of the warrants.

Upon a determination that the tranche debt arrangement and the contemporaneous warrants are freestanding instruments, the next step in evaluating how to account for these instruments is to determine whether the initial debt issuance is freestanding from the commitment related to subsequent debt issuances. Since the tranche debt arrangement encompasses both the initial debt issuance and the subsequent debt issuances, they are considered to have been entered into at the same time and executed on the same date. Consequently, they should also be evaluated to determine whether they are legally detachable and separately exercisable. The following are common indicators that the initial debt issuance and the commitment related to subsequent debt issuances are legally detachable and separately exercisable:

- The creditor has the right, without the consent of or notice to the debtor, to sell, transfer, assign, negotiate, or grant participation in all or any part of, or any interest in, such creditor's obligations, rights, and benefits.
- The debtor can repay any or all of the initial debt offering/issuance and the subsequent debt offerings/issuances without affecting the terms of any other outstanding debt offerings/issuances. That is, any portion of the initial debt offering/issuance and the subsequent debt offerings/issuances can be settled without terminating the other portions of the initial debt offering/issuance and the subsequent debt offerings/issuances. This suggests that the initial debt offering/issuance and the subsequent debt offerings/issuances are separately exercisable and can "be sold or traded separately from the contract."¹⁶

See [Example 3-2](#) in [Section 3.3.2.1.2](#) of Deloitte's Roadmap *Issuer's Accounting for Debt* for an illustration of how to account for debt issued with additional term loan commitments from a freestanding instrument perspective.

If the debtor determines that the initial debt issuance and the subsequent debt issuances are freestanding from one another, the next step is to evaluate the initial accounting for the commitments related to subsequent debt issuances and determine whether those commitments should be accounted for as derivatives under ASC 815-10 or qualify for any derivative accounting scope exceptions. In fact, the commitments would qualify for the derivative accounting scope exception in ASC 815-10-15-69, which states, in part, that "[f]or the holder of a commitment to originate a loan (that is, the potential borrower), that commitment is not subject to the requirements of [ASC 815-10]." The subsequent debt issuances represent a commitment to originate a loan (i.e., a loan commitment), and that commitment is held by the debtor.

There is no guidance under U.S. GAAP that directly addresses a debtor's accounting for a purchased loan commitment. However, a loan commitment meets the definition of a financial asset, and the loan commitments in this case represent proceeds from the issuance of debt (i.e., the initial debt issuance) and equity-linked instruments (i.e., the warrants). Consequently, the loan commitments should be initially recognized at fair value. Generally, when a debt transaction involves both the issuance of financial instruments and the receipt of noncash financial assets (e.g., tranche debt financings that include the issuance of debt and the receipt of loan commitments), the fair value of the noncash financial assets received may be treated as part of the total proceeds received.

¹⁶ Quoted from ASC 815-10-15-5.

Regarding the mechanics of the debtor's accounting for the loan commitment, it is generally appropriate for an entity to defer fees and costs it has paid for a commitment to obtain nonrevolving debt as an asset until the related debt is drawn. The potential debtor's deferral of loan commitment costs and fees as an asset is analogous to the creditor's treatment of fees received for a loan commitment under ASC 310-20-25-11, which generally requires commitment fees to be deferred. If all or a portion of the total commitment amount is funded, a proportionate amount of the commitment asset reduces the initial net carrying amount of the funded debt. See [Section 3.5.3.2](#) of Deloitte's Roadmap *Issuer's Accounting for Debt* for a discussion of the different methods for allocating fees/issuance costs in a bundled transaction such as this one.

The debtor is next required to determine how to account for the warrants that were issued contemporaneously with the tranche debt arrangement (under the assumption that the warrants are freestanding instruments). Note that before the issuance of the initial tranche of debt, the warrants (i.e., both the initial warrant and the additional warrants) would be viewed as one unit of account that would not qualify for equity classification since the number of shares of common stock that may be purchased under the warrants varies on the basis of debt issuances that have not yet occurred.

Once the initial debt issuance occurs, the first step in the debtor's accounting for the contemporaneously issued warrants is to determine whether the initial warrant, which is issued upon the closing of the initial debt issuance, is freestanding from the additional warrants, which are issued only upon the closings of the subsequent debt issuances. Since the warrant agreement most likely encompasses both the initial warrant and the additional warrants, all of the warrants are considered to have been entered into at the same time and executed on the same date. Consequently, the debtor should evaluate whether the initial warrant and the additional warrants are legally detachable and separately exercisable and, therefore, qualify as freestanding financial instruments under ASC 480-10-20. The following are common indicators that the initial warrant and the additional warrants are legally detachable and separately exercisable:

- The warrants are individually transferable by the warrant holders, subject to compliance with applicable federal and state securities laws. In other words, the warrants can be transferred separately from one another at the warrant holder's discretion.
- The warrant holders' choice to exercise the initial warrant does not cause the additional warrants to be automatically exercised or otherwise terminated.

Assuming that the initial warrants and the additional warrants are freestanding from one another, the debtor must determine whether the warrants should be classified as liabilities under ASC 480. ASC 480 describes three types of instruments that require liability classification:

- *Mandatorily redeemable financial instruments* — ASC 480-10-20 defines a mandatorily redeemable financial instrument as “[a]ny of various financial instruments issued in the form of shares that embody an unconditional obligation requiring the issuer to redeem the instrument by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur.” Warrants are not financial instruments in the form of shares (i.e., while they are financial instruments that will result in the delivery of shares, they are not shares themselves). Thus, warrants typically are not mandatorily redeemable financial instruments.

- *Obligations to repurchase issuer's equity shares by transferring assets (or financial instruments indexed to such obligations)* — Most commonly, if exercised, the warrants require the debtor to issue common shares, which are not redeemable in cash other than upon an ordinary liquidation of the debtor. Accordingly, upon exercise, the warrants require the debtor to deliver its equity shares. Further, there are typically no provisions in the warrants that could require the debtor to settle the warrants in cash or other assets because each situation that would result in such a settlement of the warrants (1) is within the control of the debtor or (2) occurs when all other holders of the common units will receive (or have the right to receive) cash or other assets for their units. Accordingly, the warrants most commonly do not obligate the debtor to settle by repurchasing common units for cash or other assets.
- *Certain obligations to issue a variable number of shares* — Warrants typically do not represent a conditional obligation that must or may be settled by issuing a variable number of shares.

In light of the above, warrants on common shares most commonly do not need to be classified as liabilities under ASC 480.

Next, the debtor must consider whether the warrants meet the definition of a derivative under ASC 815-10-15-83. As previously noted, ASC 815-10-15-83 defines a derivative as a financial instrument or other contract that (1) has an underlying as well as a notional amount or payment provision, (2) requires little or no initial net investment, and (3) can be net settled. Typically:

- Warrants have an underlying (the fair value of the debtor's common stock) and a notional amount (the number of shares of common stock issuable).
- Warrants require an initial net investment that is less, by more than a nominal amount, than the initial net investment that would be required to acquire the number of shares of common stock into which the warrants are exercisable.
- Warrant holders can elect net share settlement by cashless exercise.

In light of the above, warrants most commonly possess all three characteristics of a derivative.

Assuming that the initial warrant and the additional warrants meet the definition of a derivative, the debtor must then determine whether those warrants qualify for the equity scope exception in ASC 815-10-15-74(a), which states that contracts issued or held by a reporting entity that are both indexed to its own stock and classified in stockholders' equity in its statement of financial position are not considered to be derivative instruments under ASC 815.

Often, in arrangements in which warrants are issued contemporaneously with tranche debt arrangements, the initial warrant will be considered to be indexed to the debtor's own stock since it is (1) issued and outstanding immediately as of the execution of the arrangement (i.e., upon the closing of the initial debt issuance) and (2) exercisable for a fixed number of shares of common stock at a fixed exercise price (i.e., a fixed-for-fixed forward or option under ASC 815-40-15-7E). In addition, the initial warrant is likely to meet the conditions for equity classification under ASC 815-40-25. Accordingly, the initial warrant typically will qualify for the equity scope exception and be classified in the debtor's equity rather than as a derivative liability.

Conversely, the additional warrants will not be considered to be indexed to the debtor's own stock since the number of shares of common stock that may be purchased under the additional warrants varies on the basis of the amount of subsequent debt issuances that occur after funding of the initial debt issuance. Because subsequent debt issuances do not represent an input into the pricing of a fixed-for-fixed option on equity shares under ASC 815-40-15-7E, the additional warrants are not considered to be indexed to the debtor's stock and must be classified as derivative liabilities and initially measured, and subsequently remeasured, at fair value with changes in fair value recognized in earnings in accordance with ASC 815-10-35-1. Upon the occurrence of subsequent debt issuances, the additional warrants associated with such issuances would become fixed for fixed under ASC 815-40-15-7E in the same way as the initial warrant, as described above. Accordingly, as soon as the additional warrants qualify as fixed for fixed, they will be reclassified from derivative liabilities to equity instruments.

9.2.5.5 Warrants With Settlement Provisions Related to Fundamental Transactions and Pro Rata Distributions

Warrants may be issued with settlement provisions only upon the occurrence of a "fundamental transaction," or a transaction that results in the change in control of the issuer. For example, the holders may receive some form of consideration (e.g., shares, cash) on an as-if-converted basis (as holders of common stock) should the entity undergo an IPO. In addition, holders may have the option to have the issuer redeem the warrants by paying them an amount of cash consideration equal to the Black-Scholes value of such warrants. Further, such warrants may contain provisions that, if the issuer declares or makes a distribution to shareholders, the holder will be entitled to participate in such distribution to the same extent that the holder would have participated therein if the holder had held the same number of common shares acquirable upon complete exercise of the warrant (a pro rata distribution feature).

An equity-linked instrument does not qualify as equity if the instrument's terms include an adjustment in response to the occurrence or nonoccurrence of a specified event that is inconsistent with an implicit assumption in a standard valuation model unless the adjustment is consistent with the effect that the occurrence or nonoccurrence of the specified event has on the fair value of the instrument. Thus, adjustments to neutralize or partially offset the effects of events that invalidate an implicit assumption in a valuation model do not preclude an equity-linked instrument from being considered indexed to the reporting entity's stock (i.e., such adjustments do not preclude equity classification for the instrument). In this context, "neutralize" means that the calculation of the adjustment to the settlement terms of the equity-linked instrument appropriately offsets the net gain or loss on the instrument that occurred as a result of the specified event.

Adjustments from implicit inputs do not necessarily have to result in a complete neutralization of the effect that the occurrence or nonoccurrence of a specified event has on the fair value of an equity-linked instrument (i.e., the net gain or loss on the instrument that occurs as a result of the specified event). However, an adjustment to the terms of an instrument to reflect more than 100 percent of the effect that the variable has on the fair value of a fixed-for-fixed forward or option on equity shares precludes an instrument from being indexed to the reporting entity's stock because the additional exposure is inconsistent with a fixed-for-fixed forward or option on equity shares.

For an equity-linked instrument to qualify as equity, the reporting entity's adjustment cannot compensate the counterparty for adverse changes in the reporting entity's share price that are not attributable to the effect of the specified event. This is because such an adjustment could "protect" the counterparty from an adverse price change that results from events other than an event that invalidates an implicit assumption. Similarly, an adjustment based on the difference between the pre-event share price and the post-event share price generally would preclude equity classification because the share price could have changed for reasons other than the event itself (ASC 815-40-55-42). The principle is

that an adjustment should be designed to capture only the theoretical effect of the event that invalidates an implicit assumption (e.g., a dilutive event).

Accordingly, when a reporting entity assesses whether a contract on its own stock is indexed to its own equity, it must evaluate the facts and circumstances to determine whether the feature is compensating the counterparty for any adverse changes in the share price that are not attributable to the fundamental transaction. Further, the reporting entity must consider any pro rata distribution features to determine whether the holder may have the ability to receive compensation in excess of what would be considered a neutralizing adjustment. In the case of an option or warrant holder, the holder should not receive any dividends before exercise of the option or warrant since doing so is inconsistent with implicit assumptions in an option pricing model.



Connecting the Dots

In a recent preclearance with the OCA, the OCA staff did not object to the classification of a warrant as either a liability or equity in a case in which the warrant included the greater of a prespecified volatility input or a historical volatility input to a Black-Scholes settlement calculation. In the fact pattern considered by the staff, the registrant asserted that the prespecified volatility input used at inception to price the warrant was within the range of possible volatilities that could be used to determine the Black-Scholes value at settlement (i.e., the prespecified volatility is within a reasonable range of volatility inputs at the time of the initial pricing of the instrument). Accordingly, two views are acceptable depending on an entity's policy regarding whether this type of provision precludes a warrant from being considered indexed to the entity's own stock.

Under one view, the warrant is precluded from being considered indexed to the entity's own equity since an input based on the greater of various amounts could result in a settlement amount that is greater than the settlement amount of a fixed-for-fixed option on the entity's equity shares. Under the other view, the warrant is not precluded from being considered indexed to the entity's own equity if the prespecified volatility is within a reasonable range of volatility inputs at the time of the initial pricing of the instrument. Once an entity adopts one of the two views as its accounting policy, it should consistently apply that policy. We encourage entities to consult with their accounting advisers when performing the accounting assessment for a warrant agreement that includes this type of provision.

9.2.5.6 Standby Equity Purchase Agreements

Financial instruments known as standby equity purchase agreements (SEPAs) have become more common in the life sciences industry as industry participants look for additional ways to provide liquidity while avoiding exposure to rising interest rates. A SEPA is an equity-linked instrument for which the issuing entity has the right, but not the obligation, to sell the entity's common stock to third-party investors over a specified period. In exchange for its access to capital through the SEPA, the entity typically provides up-front consideration to the investor in the form of cash or shares of the entity's common stock. Economically, before the entity has elected to sell shares, a SEPA represents a purchased put option on the entity's own equity. However, once the entity "draws" on the SEPA, the related number of shares issuable constitutes a forward contract to issue common stock. Thus, SEPAs contain both a purchased put option element and a forward share issuance element. Generally, neither element qualifies for equity classification under ASC 815. See [Section 6.2.5](#) of Deloitte's Roadmap *Contracts on an Entity's Own Equity* for a detailed description of an issuer's accounting for a SEPA.

Note that in practice, SEPAs may also be referred to as common stock purchase agreements or equity lines of credit (ELOCs).

9.2.6 Fair Value

Many Codification topics require or permit the subsequent measurement of assets or liabilities at fair value. ASC 820-10-35 provides guidance on the subsequent measurement of items at fair value and applies to both recurring and nonrecurring measurements. The definition of fair value is based on an exit price notion. An asset, liability, or equity instrument is measured at fair value on the basis of market-participant assumptions; such measurement is not entity-specific. Entities must consider all characteristics of the asset, liability, or equity instrument that a market participant would consider in determining an exit price in the principal or most advantageous market.

9.2.6.1 Restrictions on the Sale or Use of an Asset

In some cases, it is appropriate to consider a restriction on the sale or use of an asset as a characteristic of the asset that affects its fair value. Only a legal or contractual restriction on the sale or use of an asset that is specific to the asset (an instrument-specific restriction) and that would be transferred to market participants should be incorporated into the asset's fair value measurement. Thus, an entity should consider the effect of a restriction on the sale or use of an asset that it owns only if market participants would consider such a restriction in pricing the asset because they would also be subject to the restriction if they acquired the asset. Entity-specific restrictions that would not be transferred to market participants should not be considered in the determination of the asset's fair value, since doing so would be inconsistent with the exit price notion underlying the definition of fair value. The table below gives examples of restrictions on the sale of assets and addresses whether they are instrument-specific or entity-specific.

Examples of Restrictions on the Sale of Assets		
Nature of Restriction	Description of Restriction	Impact of Restriction on Fair Value
Restriction on the sale of securities offered in a private offering in accordance with Rule 144 of the Securities Act of 1933 ("Securities Act Rule 144") or similar rules (private placements)	Securities Act Rule 144 legally restricts the sale of certain securities to buyers that meet specified criteria.	<p>As discussed in ASC 820-10-55-52, this type of restriction is a characteristic of the security and would be transferred to market participants. Therefore, the fair value measurement of the security should take this instrument-specific restriction into account.</p> <p>An instrument-specific restriction on a security affects a fair value measurement by the amount that a market participant would demand because of the inability to access a public market for the security for the specified period. As discussed in ASC 820-10-55-52, that amount depends on the nature and duration of the restriction, the extent to which buyers are limited by the restriction, and qualitative and quantitative factors specific to both the instrument and the issuer. Quoted prices for such securities would reflect the resale restriction; therefore, there should be no further adjustment to reflect the restriction.</p>

(Table continued)

Examples of Restrictions on the Sale of Assets		
Nature of Restriction	Description of Restriction	Impact of Restriction on Fair Value
Founder's shares in an IPO of equity securities	Founders may be contractually restricted from selling their shares for a period after an IPO. Such restrictions may be outlined in the IPO prospectus.	<p>If this restriction is not embedded in the contractual terms of the shares (which it generally is not) and thus would not be transferred in a hypothetical sale of the shares, the restriction is specific to the founders and not a characteristic of the security. Therefore, the founders should not consider this restriction in determining fair value.</p> <p>Note that in June 2022, the FASB issued ASU 2022-03, which improves financial reporting for investors and other financial statement users by increasing comparability of financial information across reporting entities that have investments in equity securities measured at fair value that are subject to contractual restrictions preventing the sale of those securities.</p>
Security sale restriction related to a seat on the board of directors	An entity (Entity A) has an equity investment in another entity (Entity B) and is represented on its board of directors. Because officers of A are directors of B, A is restricted from selling any of its investment securities in B during each period that is two weeks before the end of each quarter through 48 hours after B's earnings are released (also referred to as a "blackout period").	Other market participants would not face this restriction. Because the restriction is entity-specific (i.e., it is not a characteristic of the security) and would not be transferred with the security, an entity should not consider the restriction in measuring the security at fair value.
Assets pledged as collateral	An entity has a borrowing arrangement in which assets must be pledged as collateral.	Other market participants would not face this restriction. Because the restriction is entity-specific (i.e., it is not a characteristic of the assets) and would not be transferred with the assets, an entity should not consider the restriction in measuring the assets at fair value.

The determination of whether a contractual or legal restriction on the sale or use of an asset is instrument-specific or entity-specific is sometimes straightforward; other times, an entity may need to exercise judgment or consult a legal specialist in making this determination.

9.2.6.2 Premiums or Discounts Based on Size of a Position

ASC 820-10-35-36B addresses when a fair value measurement should include a premium or discount as a result of the size of an asset, liability, or instrument classified in an entity's stockholders' equity. In a manner consistent with the guidance on transfer restrictions (see above), a fair value measurement includes a premium or discount that reflects the size of the item only if size is a characteristic of the asset, liability, or instrument classified in stockholders' equity. A fair value measurement cannot include "[p]remiums or discounts that reflect size as a characteristic of the . . . entity's holding" (i.e., a blockage factor) rather than as a characteristic of the asset, liability, or instrument classified in stockholders' equity that is determined on the basis of its unit of account under other Codification topics (e.g., a control premium or minority interest discount that is appropriate on the basis of its unit of account). ASC 820-10-35-36B indicates that when "there is a quoted price in an active market . . . for an asset or a liability" (i.e., a Level 1 input), an entity must "use that quoted price without adjustment when measuring fair value, except as specified in paragraph 820-10-35-41C." However, even if a fair value measurement is categorized within Level 2 or Level 3 of the fair value hierarchy in its entirety, the fair value measurement cannot include a premium or discount for size (e.g., a blockage factor) when this premium or discount results from the size of an entity's holding rather than from a characteristic of the item being valued.

9.2.6.2.1 Blockage Factors

As described in ASC 820-10-35-36B, a blockage factor represents a discount that "adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity." The basic principle in ASC 820-10-35-36B is that blockage factors are prohibited at all levels of the fair value hierarchy. An adjustment to a quoted price of an individual asset or liability to reflect a blockage factor is not permitted under ASC 820 when the unit of account for the asset or liability is the individual instrument (i.e., the unit of account for the holding under U.S. GAAP is aligned with the unit of account related to the quoted price). For example, if an entity holds a large position in a publicly traded common stock and would expect to sell the position in a single transaction (i.e., a large block), the price it would receive would reflect a discount to the product of the quoted market price and the number of shares held; however, that discount should not be reflected in a fair value measurement because it reflects the size of the entity's holding as opposed to a characteristic of the asset held.

However, if the unit of account for fair value measurement purposes is the entire holding (i.e., entire position), an adjustment to reflect the size of the holding may be appropriate. Further, if the unit of valuation reflects the entire holding, an adjustment to reflect the size of the holding may be appropriate even if the unit of account differs from the unit of valuation and application of a blockage factor at the unit-of-account level would be inappropriate. Thus, a discount that adjusts a quoted price of an asset or liability to reflect a blockage factor could, in certain circumstances, be consistent with the definition of fair value in ASC 820.

9.2.7 Simple Agreement for Future Equity

A simple agreement for future equity (SAFE), which is a type of contract that life sciences companies have increasingly considered or executed in recent years, gives the holder a right to obtain the issuer's shares in the future in exchange for an up-front payment. For example, the terms of a SAFE might specify that (1) the issuer will deliver to the holder a variable number of its shares if the issuer raises equity capital (i.e., an equity financing) and (2) the investor has a right to elect to receive either a cash payment equal to the purchase amount or a variable number of shares if there is a change of control or an IPO (i.e., a liquidity event). Typically, a SAFE is not in the legal form of an outstanding share. If the SAFE is in the legal form of debt, ASC 480 does not apply and the SAFE is classified as a liability. If the SAFE is not in the legal form of an outstanding share or debt, the issuer should evaluate whether the SAFE must

be classified as a liability under ASC 480-10-25-8 or, if not, under ASC 480-10-25-14. If the SAFE gives the holder an option to redeem the instrument for cash upon a change of control, the issuer would classify the SAFE as a liability under ASC 480-10-25-8 because a change of control is an event that is considered not under the sole control of the issuer.

9.3 New Accounting Standards

9.3.1 Reference Rate Reform (ASU 2020-04)

In response to the market-wide migration away from the London Interbank Offered Rate (LIBOR) and other interbank offered rates, the FASB initiated a project on reference rate reform. The Board held several meetings in 2019 to discuss the project and to consider hedge accounting relief and broader transition implications.

As a result of the meetings, in March 2020, the FASB issued [ASU 2020-04](#). The relief provided by the ASU (in ASC 848, added by the ASU) is elective and applies “to all entities, subject to meeting certain criteria, that have contracts, hedging relationships, and other transactions that reference LIBOR or another reference rate expected to be discontinued because of reference rate reform.” The ASU establishes a general contract modification principle that entities can apply in other areas that may be affected by reference rate reform, as well as (1) elective contract modification expedients for specific areas of the Codification, (2) certain elective hedge accounting expedients, and (3) held-to-maturity debt security classification relief.

For an in-depth discussion of the application of ASC 848, see [Chapter 8](#) of Deloitte’s Roadmap [Hedge Accounting](#).

9.3.2 Simplifying the Accounting for Convertible Instruments and Contracts on an Entity’s Own Equity (ASU 2020-06)

9.3.2.1 Background

In August 2020, the FASB issued [ASU 2020-06](#), which simplifies the accounting for certain financial instruments with characteristics of liabilities and equity, including convertible instruments and contracts on an entity’s own equity. In addition, the ASU affects the diluted EPS calculation for (1) instruments that may be settled in cash or shares and (2) convertible instruments.

For PBEs other than SRCs, ASU 2020-06 is effective for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years. For all other entities, the ASU is effective for fiscal years beginning after December 15, 2023, including interim periods within those fiscal years.

9.3.2.2 Earnings per Share

ASU 2020-06 provides the following clarifications to improve the consistency of EPS calculations:

- Entities must apply the if-converted method to all convertible instruments; the treasury stock method is no longer available.
- If the financial instrument can be settled in shares or cash, an entity must presume that the instrument will be settled in shares when calculating diluted EPS. ASU 2020-06 removes an entity’s ability to rebut the presumption of share settlement, thus affecting the diluted EPS calculation for both convertible instruments and contracts on an entity’s own equity.

- ASU 2020-06 extends the scope of the recognition and measurement guidance in ASC 260 on financial instruments that include down-round features to include equity-classified convertible preferred stock that contains such features. If the down-round feature is triggered, its effect “is treated as a dividend and as a reduction of income available to common shareholders in basic EPS.” However, the scope of this guidance does not include convertible debt with down-round features.
- ASU 2020-06 clarifies that the “average market price should be used to calculate the diluted EPS denominator” when the exercise price or the number of shares that may be issued is variable, except for certain contingently issuable shares.



Connecting the Dots

ASC 260 contains specific diluted EPS guidance that applies to contracts that may be settled in cash or stock. This guidance applies regardless of whether the option to elect the form of settlement is controlled by the entity or by the counterparty to the contract. Before the adoption of ASU 2020-06, if certain conditions were met, an entity could overcome the presumption of share settlement for contracts that may be settled in cash or stock. In such cases, the entity would not include the dilutive effect of such contracts in the denominator of diluted EPS. However, after the ASU’s adoption, except for certain share-based payment arrangements, an entity must assume that in the calculation of diluted EPS, any contract that allows for settlement in shares will be settled in shares. As a result, the entity would include potential common shares in the denominator of diluted EPS by using the treasury stock method, reverse treasury stock method, if-converted method, or contingently issuable share method, as applicable. In some situations, the entity may also need to adjust the numerator in the calculation of diluted EPS.

Arrangements that commonly allow for settlement in cash or shares include convertible instruments and warrants on common stock. However, ASC 260-10-45-45 applies to all contracts that allow for settlement in cash or shares at the option of the entity or the counterparty. Therefore, other contracts, such as redeemable noncontrolling interests that may be settled in parent shares or lease agreements that permit rent to be paid in shares, are also subject to this guidance.

Even if share settlement is unlikely, the guidance in ASC 260-10-45-45 applies. That is, the intent of the party that may elect the form of settlement is not relevant in the application of this guidance. Therefore, to comply with ASC 260-10-45-45, entities will need to inventory all of their contracts that allow for settlement in shares.

For an in-depth discussion of the application of ASC 260, see Deloitte’s Roadmap [Earnings per Share](#).

9.3.3 Issuer’s Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options (ASU 2021-04)

In May 2021, the FASB issued [ASU 2021-04](#), which addresses an issuer’s accounting for certain modifications and exchanges of freestanding equity-classified written call options. Under the ASU, an entity accounts for a modification or exchange of a freestanding equity-classified written call option that remains equity classified after the modification or exchange by recognizing “the excess, if any, of the fair value of the modified or exchanged written call option over the fair value of that written call option immediately before it is modified or exchanged . . . on the basis of the substance of the transaction, in the same manner as if cash had been paid as consideration.” Accordingly, an entity accounts for any incremental fair value provided to the counterparty in a modification or exchange of an equity-classified written call option.

The accounting applied depends on the reason for the modification or exchange (e.g., whether other transactions were entered into contemporaneously or in contemplation of the modification or exchange of the option, and whether any other rights or privileges were exchanged). An entity therefore accounts for the effect of the modification or exchange in the same manner as if cash had been paid as consideration. Such effect is measured as the difference between the option's fair value immediately before and immediately after the modification or exchange. The table below summarizes how to apply this guidance in different scenarios.

Transaction	Accounting for Incremental Fair Value	Guidance
Financing transaction to issue equity (ASC 815-40-35-17(a))	Treat the amount as equity issuance cost.	ASC 340-10-S99-1
Financing transaction to issue debt (ASC 815-40-35-17(b))	If the instrument is held by the creditor, treat the amount as a debt discount. If the instrument is held by a third party, treat the amount as a debt issuance cost.	ASC 835-30
Nontroubled debt modification or exchange (ASC 815-40-35-17(c))	If the instrument is held by the creditor, treat the amount as day 1 cash flow in the performance of the 10 percent test and as a fee paid to the creditor in the accounting for the modification or exchange. If the instrument is held by a third party, treat the amount as a third-party cost in the accounting for the modification or exchange.	ASC 470-50
Troubled debt restructuring (ASC 815-40-35-17(c))	If the instrument is held by the creditor, treat the amount as a fee paid to the creditor. If the instrument is held by a third party, treat the amount as a third-party cost.	ASC 470-60
Other	Treat the amount in accordance with other GAAP (e.g., ASC 606 or ASC 718). If the transaction is not within the scope of other GAAP, recognize as a dividend under ASC 260-10.	Other relevant topics or subtopics

ASC 815-40-35-17 (as added by ASU 2021-04) specifies that an entity should recognize as a dividend the effect of a modification or exchange that is not related to a financing transaction and is not within the scope of other GAAP (e.g., ASC 606 or ASC 718). An entity cannot assume that dividend recognition is appropriate for a transaction that is not specifically mentioned in ASC 815-40-35-17. Rather, it must carefully consider the related facts and circumstances and the substance of the transaction. Generally, the recognition of an expense is appropriate if the modification or exchange of the option represents compensation for other stated or unstated transaction elements (e.g., a standstill agreement or settlement of litigation). Paragraph BC19 of ASU 2021-04 states:

Additionally, the [EITF] noted that if a modification or an exchange is executed in exchange for an agreement by the holder of the written call option to abandon certain acquisition plans, forgo other planned transactions, settle litigation, settle employment contracts, or voluntarily restrict its purchase of shares of the issuing entity or the issuing entity's affiliates within a stated time period, those rights and privileges obtained, both stated and unstated, or other elements of the transaction should be accounted for according to their substance (that is, as a cost to the issuing entity) rather than as a dividend distribution.

If the modification or exchange involves more than one of the categories identified above (i.e., it involves multiple elements), the amount is allocated among those categories.

9.3.3.1 Effective Date and Transition

ASU 2021-04 is effective for all entities for fiscal years beginning after December 15, 2021, including interim periods within those fiscal years, with early adoption permitted. The ASU is applied on a prospective basis.

9.3.4 Induced Conversions of Convertible Debt Instruments (ASU 2024-04)

In November 2024, the FASB issued [ASU 2024-04](#), which amends ASC 470-20 to clarify the requirements related to accounting for the settlement of a debt instrument as an induced conversion. More specifically, the ASU provides guidance on (1) when to apply the induced conversion accounting model to account for the settlement of a debt instrument and (2) how to apply that model in certain scenarios.

Entities apply the induced conversion accounting model when they have induced debt holders to promptly convert convertible debt into equity shares under changed conversion terms that are effective for a limited period and involve additional consideration. Under this approach, the issuer must recognize an inducement expense upon the conversion.

The amendments in ASU 2024-04 are effective for annual reporting periods beginning after December 15, 2025 (and interim reporting periods within those annual reporting periods). Early adoption is permitted as of the beginning of a reporting period if the entity has also adopted ASU 2020-06 for that period.

Entities may apply the new guidance prospectively to settlements of convertible debt instruments that take place during annual reporting periods (and interim reporting periods within those annual reporting periods) beginning after the ASU's effective date. The nature of and reason for the change in accounting principle must be disclosed.

Retrospective application may be elected as of the beginning of the first comparative reporting period in which the entity has also applied ASU 2020-06. If such an election is made, transition disclosures must be provided in accordance with ASC 250.

See [Section 12.3.4](#) of Deloitte's Roadmap *Issuer's Accounting for Debt* for more comprehensive discussion of the scope and application of the induced conversion model.

9.3.5 Derivatives Scope Refinements and Scope Clarification for Share-Based Noncash Consideration From a Customer in a Revenue Contract (ASU 2025-07)

9.3.5.1 Background

In September 2025, the FASB issued [ASU 2025-07](#), which (1) refines the scope of the guidance on derivatives in ASC 815 (Issue 1) and (2) clarifies the guidance on share-based payments from a customer in ASC 606 (Issue 2). The ASU is intended to address concerns about the application of derivative accounting to contracts that have features based on the operations or activities of one of the parties to the contract and to reduce diversity in the accounting for share-based payments in revenue contracts.

The ASU was issued on the basis of feedback received from stakeholders on the FASB's June 2021 *ITC*. Citing the “broad and evolving application” of the definition of a derivative, some stakeholders noted the difficulties associated with applying that definition as well as the derivatives scope exceptions to certain transactions, including those involving (1) financial instruments linked to sustainability matters and (2) other operations-specific activities, such as R&D funding arrangements and litigation funding arrangements.

In addition, there has been uncertainty in the accounting for share-based payments from customers under ASC 606, prompting the need for clarification. Specifically, stakeholders have questioned which guidance an entity should apply to recognize share-based payments that are received from a customer as consideration in exchange for the transfer of goods or services.

9.3.5.2 Derivatives Scope Refinement for Contracts With Specific Underlyings

The ASU adds a new scope exception in ASC 815-10-15-59(e) for certain contracts that are not traded on an exchange and have “[a]n underlying that is based on operations or activities specific to one of the parties to the contract.” Contracts that may qualify for this exception include those in which the underlying is linked to the “occurrence or nonoccurrence of an event,” such as achieving specified financial operating results or sustainability metrics, obtaining regulatory approval, or reaching specified product development milestones. In addition, the scope exception may apply to certain R&D funding arrangements as well as certain litigation funding arrangements.

The term “parties to the contract” as used in ASC 815-10-15-59(e) is not limited to the legal entity that entered into the contract. As discussed in paragraph BC32 of ASU 2025-07, the “Board decided that the scope exception should capture not only the activities of the legal entity that is the party to the contract but also the activities of the parent, subsidiaries, and other entities consolidated by the parent for the purposes of both consolidated financial statements and the standalone financial statements of individual entities within the consolidated group.” This broader interpretation of the term “parties to the contract” should be applied only in the context of the scope exception in ASC 815-10-15-59(e) and should not be applied by analogy in other areas of GAAP.

Further, when evaluating a contract to determine whether it meets this scope exception, an entity does not need to consider whether the outcome is within its control. For example, in a litigation funding arrangement, the outcome of a legal case is typically dependent upon decisions made by a judge or jury and therefore is not within the entity's control. However, this should not affect an entity's assessment of the contract under this scope exception.

Case A of Example 14A in ASC 815-10-55-143B and 55-143C (added by ASU 2025-07) is reproduced below.

ASC 815-10

Pending Content (Transition Guidance: ASC 815-10-65-8)**Example 14A: Certain Contracts That Are Not Traded on an Exchange — Underlyings Based on Operations or Activities Specific to One of the Parties to the Contract**

Case A: Research and Development Funding Arrangement — Underlyings Based on the Occurrence of Regulatory Approval and Achieving an Earnings Target

55-143B Entity A and Entity B enter into a research and development funding arrangement. Under the arrangement, Entity B provides funding of \$50 million so that Entity A may develop and commercialize a drug compound. The arrangement has no clawback feature. Upon regulatory approval of the drug, Entity A pays \$20 million to Entity B. Once the drug is commercialized, Entity A pays an additional \$80 million to Entity B when gross profit related to the drug exceeds \$500 million.

55-143C The arrangement contains 2 underlyings: the occurrence of regulatory approval and an earnings measure (gross profit related to the drug exceeding \$500 million). Because the occurrence of regulatory approval and gross profit relate to the drug that Entity A is developing, both of the underlyings are based on the operations or activities of Entity A. Whether the occurrence of regulatory approval is within the control of Entity A does not impact the conclusion that the underlying qualifies for the scope exception. Neither underlying is based on a market rate, market price, market index, or the price or performance (including default) of a financial asset or financial liability of one of the parties to the contract as described in paragraph 815-10-15-59(e)(1) and (e)(2). Also, the exclusions related to contracts involving an entity's own equity or call options and put options on debt instruments as described in paragraph 815-10-15-59(e)(3) and (e)(4) do not apply. Therefore, those two underlyings each qualify for the scope exception in paragraph 815-10-15-59(e).

Under ASU 2025-07, an entity that is evaluating a contract to determine whether it meets the scope exception should remain vigilant in identifying underlyings that are based on market rates, market prices, market indexes, or the “price or performance (including default) of a financial asset or financial liability of one of the parties to the contract.” Underlyings that have these characteristics are not eligible for the scope exception. In addition, contracts that involve either (1) an entity's own equity or (2) call or put options on debt instruments also do not qualify for the scope exception.

There may be instances in which a contract or arrangement has multiple underlyings with different eligibilities for the scope exception (e.g., one underlying that is based on a market index and one underlying that is based on an EBITDA target). If a contract or arrangement has multiple underlyings, an entity will need to perform a predominant characteristics assessment in accordance with ASC 815-10-15-60. If the underlyings, in combination, are highly correlated with the behavior of the components that do not qualify for the scope exception, the contract does not qualify for the scope exception.

After the initial assessment of a contract or arrangement is complete, entities should continue to monitor for any modifications that may affect the applicability of the scope exception or new agreements related to the original agreement. For example, in the case of an R&D or litigation funding arrangement, a financial investor that has acquired rights to future contingent payments from the arrangement may sell those rights to a third party via a forward contract or similar mechanism. We believe that in such a case, the sale of the rights might not qualify for the scope exception since the payments are based on the performance of a financial asset (i.e., the rights to receive future payments under the original funding arrangement).

Case I of Example 14A in ASC 815-10-55-143P and 55-143Q, which is added by ASU 2025-07 and reproduced below, exemplifies an arrangement that does not qualify for the scope exception.

ASC 815-10

Pending Content (Transition Guidance: ASC 815-10-65-8)**Example 14A: Certain Contracts That Are Not Traded on an Exchange — Underlyings Based on Operations or Activities Specific to One of the Parties to the Contract****Case I: Variable Payment Arrangement — Underlying Based on Stock Price Differential**

55-143P Entity A acquires Entity B (which does not meet the definition of a business) in exchange for two million shares of Entity A's common stock. As part of the acquisition agreement, Entity A agrees to pay cash to the sellers of Entity B if the quoted market price of Entity A's common stock is less than \$100 on the 1-year anniversary of the acquisition date. Specifically, if the quoted market price of Entity A's common stock is less than \$100 on the 1-year anniversary of the acquisition date, the total amount paid in cash to the sellers of Entity B is equal to \$100 minus Entity A's common stock price on the 1-year anniversary of the acquisition date multiplied by 2 million shares.

55-143Q The arrangement contains 1 underlying: the common stock price differential (\$100 less Entity A's common stock price at the 1-year anniversary of the acquisition date). The underlying is based on a market price as described in paragraph 815-10-15-59(e)(1). Therefore, the underlying does not qualify for the scope exception in paragraph 815-10-15-59(e).

9.3.5.3 Scope Clarification for Share-Based Payments From a Customer in a Revenue Contract

ASU 2025-07 clarifies that when an entity has a right to receive a share-based payment from its customer in exchange for the transfer of goods or services, the share-based payment should be accounted for as noncash consideration within the scope of ASC 606. That is, the ASU specifies that the guidance in ASC 815 or ASC 321 does not apply to share-based payments from a customer “unless and until the entity's right to receive or retain the share-based noncash consideration is unconditional” in accordance with ASC 606. ASC 606-10-45-4 states that a “right to consideration is unconditional if only the passage of time is required before payment of that consideration is due.”

Further, ASU 2025-07 clarifies that (1) the estimated fair value of a share-based payment as of contract inception should be included in the transaction price and (2) any changes in the fair value, as determined under other Codification topics, should not be accounted for until the right to consideration is unconditional and should not be included in the transaction price and recognized as revenue.

Under ASU 2025-07, timing differences between (1) when an entity performs by transferring goods or services to a customer and (2) when the entity's right to receive or retain the share-based payment from a customer becomes unconditional should be accounted for as a contract asset or liability. In a manner consistent with the guidance on noncash consideration, the share-based payment should be initially measured at the estimated fair value at contract inception. Once the entity's right to receive and retain the share-based payment is no longer contingent on the entity's future performance under the contract, the share-based payment would be subject to other GAAP (e.g., ASC 321 or ASC 815), and the entity should look to such other GAAP for subsequent measurement guidance, which might result in the recognition of an immediate gain or loss.

Example 9-4

Entity X enters into a revenue contract on January 1, 20X1, with Customer Y, a publicly traded company, to transfer 100 widgets; 50 widgets will be delivered on June 30, 20X1, and the remaining 50 widgets will be delivered on September 30, 20X1. Entity X determines that delivery of each widget is a performance obligation that is satisfied at a point in time. Under the contract, Y promises to transfer 100 shares of its common stock to X upon the delivery of all 100 widgets. In accordance with ASU 2025-07, X measures the fair value of the share-based payment (noncash consideration) at contract inception. The fair value of Y's shares on January 1, 20X1, is \$10 per share, so X determines the transaction price for the contract with the customer to be \$1,000 ($\10×100 shares).

Between January 1, 20X1, and September 30, 20X1, the fair value of Y's shares increases to \$15 per share. Under the ASU, X does not account for the change in fair value (i.e., changes in the fair value of X's right to receive Y's shares upon satisfaction of its performance obligations are not reflected in X's interim financial statements until its right to receive or retain the shares is unconditional).

On June 30, 20X1, X delivers 50 widgets to Y and recognizes revenue and a contract asset of \$500.

On September 30, 20X1, X delivers the remaining 50 widgets to Y and recognizes revenue and a contract asset of \$500.

After all 100 widgets are delivered, X determines that its right to receive 100 shares of stock is considered unconditional since only the passage of time is required before payment is due. Therefore, X derecognizes the contract asset of \$1,000 and applies the guidance in ASC 321 to the share-based payment. This is likely to result in the recognition of a gain of \$500 on September 30, 20X1, under ASC 321 because of the increase in the fair value of Y's shares between January 1, 20X1, and September 30, 20X1.

**Connecting the Dots**

Note that in the above example, the accounting treatment would be different if the shares had been received in exchange for cash rather than in exchange for the sale of goods. For example, assume that on January 1, 20X1, Entity X had instead entered into a physically settled forward contract to purchase 100 shares of Customer Y's common stock for \$10 per share on September 30, 20X1 (i.e., payment for the shares is in cash rather than in \$1,000 worth of widgets). Unlike the right to receive shares in connection with a contract with a customer within the scope of ASC 606, a contract to acquire equity shares on a future date for a fixed price that must be physically settled would have been recognized at fair value under ASC 815 regardless of whether the forward contract meets the definition of a derivative; as a result, the forward contract would be marked to fair value at each reporting period before settling on September 30, 20X1.

9.3.5.4 Interaction Between the Guidance Amended by ASU 2025-07 and Impairment of Contract Assets

Contract assets need to be assessed for impairment, as noted in ASC 606-10-45-3, which states, in part, that an "entity shall assess a contract asset for credit losses in accordance with Subtopic 326-20 on financial instruments measured at amortized cost." This requirement is reiterated in Example 31 of ASC 606 — specifically, ASC 606-10-55-250 states, in part, that "the entity assesses any related contract asset or receivable for impairment." Although the explicit reference to ASC 326-20 in ASC 606-10-45-3 clearly indicates that contract assets need to be assessed for credit losses, contract assets that will be settled by the transfer of noncash consideration (as in the example above) might be subject to impairment risks other than credit loss (or counterparty nonperformance risk). An entity that records contract assets related to a right of the entity to noncash consideration that is dependent on something other than the passage of time will need to apply judgment when assessing these contract assets for impairment.

ASU 2025-07 clarifies that an entity's right to receive a share-based noncash payment from a customer is accounted for under ASC 606 unless and until the entity's right to receive or retain the share-based noncash consideration is unconditional under ASC 606. If an entity has a right to receive share-based noncash consideration (e.g., shares) in a contract with a customer but such right is conditional and based on the entity's performance under the contract (e.g., delivering a quantity of goods), the entity may record a contract asset (on the basis of the fair value of the share-based noncash payment at contract inception) when or as the entity satisfies its performance obligation. If the value of the noncash consideration changes as a result of the form of the consideration (e.g., a decline in the share price since contract inception), the transaction price (and the initial measurement of any contract asset recorded when or as the entity satisfies its performance obligation) is not adjusted. However, as noted in ASC 606-10-55-250C, the contract asset recorded in these instances would need to be assessed for impairment. Regardless of any impairment assessment, the revenue recognized should be based on the fair value of the asset at contract inception; any impairment losses would be recognized separately from the revenue recognized (i.e., revenue would not be reduced as a result of any impairment losses).

Entities will need to carefully evaluate what impairment model is appropriate for contract assets when impairment could result from changes in conditions other than counterparty credit or nonperformance risk. The impairment model selected should be applied consistently to similar facts and circumstances, and appropriate disclosure should be provided if material.

9.3.5.5 Effective Date and Transition

ASU 2025-07 is effective for annual reporting periods beginning after December 15, 2026, including interim reporting periods within those annual reporting periods. Early adoption of the standard is permitted in an interim or annual reporting period for which financial statements have not been issued or made available for issuance. If an entity elects to early adopt the standard in an interim period, the entity must apply the standard as of the beginning of the fiscal year that includes the interim period. Further, an entity that elects to early adopt the ASU is required to early adopt the guidance for both Issue 1 and Issue 2 in the standard.

Entities may apply the new guidance prospectively to new contracts entered into during annual and interim reporting periods after the date of adoption. Alternatively, entities may apply the guidance on a modified retrospective basis by making 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 that time.

With regard to the derivatives scope exception, ASC 815-10-65-8(d) (added by the ASU) specifies that if an entity (1) applies the new guidance on a modified retrospective basis and (2) has contracts or embedded features that were accounted for as derivatives but now qualify for the new scope exception, the entity has an option as of the beginning of the annual reporting period of adoption to "elect to apply the fair value option on an instrument-by-instrument basis and measure the contract in its entirety at fair value with changes in fair value recognized in earnings if that instrument is within the scope of paragraph 825-10-15-4." In addition, ASC 815-10-65-8(d) specifies that "[f]or financial liabilities, an entity shall present separately in accumulated other comprehensive income the portion of the total change in the fair value of the liability that results from a change in the instrument-specific credit risk." It further notes that "[i]f an entity had previously elected the fair value option for contracts that contained embedded derivatives that otherwise would have been bifurcated but are no longer required to be bifurcated" under the new scope exception, it may elect as of the beginning of the annual reporting period of adoption to revoke the fair value option on an instrument-by-instrument basis and measure the contract in accordance with other GAAP. The effects of electing or revoking the fair value option in accordance with the new ASU should be reported as a cumulative-effect adjustment directly to the opening balance of retained earnings as of the beginning of the annual reporting period of adoption.

Under either transition model, entities must disclose the nature of and reason for the change in accounting principle. If an entity applies the amendments on a modified retrospective basis, disclosure of the cumulative effect of the change to retained earnings and a description of the financial statement line items affected are also required.

9.3.6 Hedge Accounting Improvements (ASU 2025-09)

9.3.6.1 Background

In November 2025, the FASB issued [ASU 2025-09](#), which amends certain aspects of the hedge accounting guidance in ASC 815. In addition to addressing stakeholder concerns, the amendments are intended to more closely align hedge accounting with the economics of an entity's risk management activities.

In November 2019, the FASB issued a [proposed ASU](#) to clarify various aspects of the hedge accounting guidance, but stakeholders indicated that the proposed amendments would not sufficiently resolve certain issues and that the guidance needed further clarification. In addition, respondents to the FASB's June 2021 [ITC](#) expressed concerns that the current guidance in U.S. GAAP was negatively affecting the decision-usefulness of financial information provided to investors. On the basis of this and other stakeholder input, the Board issued ASU 2025-09, which provides guidance on those issues. As noted in the ASU, the purpose of the amendments is to better enable "entities to achieve and maintain hedge accounting for highly effective economic hedges" while reducing the occurrence of missed forecasted transactions and unintuitive hedge dedesignation events.

9.3.6.2 Key Provisions

The key provisions of the ASU are related to the following:

- Similar risk assessment for cash flow hedges.
- Hedging forecasted interest payments on choose-your-rate (CYR) debt instruments.
- Cash flow hedges of nonfinancial forecasted transactions.
- Net written options as hedging instruments.
- Foreign-currency-denominated debt instrument as hedging instrument and hedged item (dual hedge).

See Deloitte's November 25, 2025, [Heads Up](#) for detailed information about ASU 2025-09 and its provisions.

9.3.6.3 Effective Dates and Transition

For PBEs, the amendments in ASU 2025-09 are effective for fiscal years beginning after December 15, 2026, and interim periods therein. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2027, and interim periods therein. Entities are permitted to early adopt the new guidance in any interim or annual period after the ASU's issuance.

The new guidance in ASU 2025-09 should be applied prospectively for all hedging relationships as of the date of adoption. Entities must disclose the nature of and reason for the change in accounting principle, as well as the method of applying the change, in both the interim reporting period and the annual reporting period in which they adopt the ASU. In addition, "entities are permitted to modify certain critical terms of certain existing hedging relationships without dedesignating the hedge." Such permitted modifications upon transition are summarized below and apply to cash flow hedges that exist as of the date of adoption.

When using cash flow hedge accounting for a group of individual forecasted transactions, entities may:

- Modify their method for assessing similar risk exposure to ensure that it is one of the methods described in ASC 815-20-55-23A (e.g., either (1) determine whether each hedged risk related to a forecasted transaction hedged in a group is similar to each other hedged risk in the group or (2) determine whether the designated hedging instrument is highly effective against each risk in the group). Alternatively, entities can change from one method to the other method.
- Change their method for assessing hedge effectiveness if the revised method leverages their method for assessing similar risk exposure in determining that the hedging relationship is highly effective.
- Modify hedging relationships to add another risk or risks to an existing pool.
- Migrate forecasted transactions from an existing pool to another existing pool, a newly created pool, or any combination thereof.
- Reassign existing derivatives to new or existing pools or change their order within those pools.

On the date they adopt ASU 2025-09, entities should reassign gains and losses reported in accumulated other comprehensive income (AOCI) by using a systematic and rational manner to align with the pools that result from performing the actions discussed above. This includes amounts still reported in AOCI related to hedges that were discontinued before the adoption date.

When hedging changes in the overall price or the contractually specified component of forecasted purchases or sales of nonfinancial assets, entities may “modify the hedging relationship to designate the hedged risk as variability in cash flows attributable to changes in a component (or subcomponent) . . . in accordance with paragraph 815-20-25-22C.”

Entities that are hedging forecasted interest payments on an existing CYR debt instrument may:

- Amend the relationship to allow for replacement debt.
- Document the quantitative hedge effectiveness method to be used if they are currently assessing hedge effectiveness on a qualitative basis.
- If they are including interest payments on an existing CYR debt instrument in a hedge of a group of forecasted transactions under the first-payments-received technique, amend the hedging relationship to include only interest payments on the individual CYR instrument and replacement debt.

If an entity's transition method results in a change to the designated hedged risk, the instrument used to estimate the change in value of the hedged risk in the assessment of hedge effectiveness should be modified “on the basis of market data as of the inception of the hedging relationship.” An entity should also “amend hedge documentation upon adoption, including documentation of critical terms, the hedged forecasted transactions, hedge effectiveness assessments, and similar risk assessments, as needed to apply the pending content . . . for all existing and discontinued hedging relationships.”

9.4 Proposed ASU on the Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock

In September 2025, the FASB issued a [proposed ASU](#) that would amend ASC 505 to add guidance on how an issuer should measure paid-in-kind (PIK) dividends on equity-classified preferred stock. Under the proposed amendments, entities would be required to measure such dividends by multiplying the PIK dividend rate by the liquidation preference of the shares. The proposal is limited to the measurement of PIK dividends and does not address recognition.

The proposed guidance began as a project of the EITF on the measurement of PIK dividends on equity-classified preferred stock. Under current GAAP, there is no guidance on how an issuer should measure PIK dividends on such stock; accordingly, there is diversity in practice related to the accounting for these transactions.

Under the proposed ASU, ASC 505-10-15 would be amended to:

- Define PIK dividends as “dividends that an issuer satisfies either by delivering to the holder additional preferred stock with the same terms as the original preferred stock or . . . by increasing the original preferred stock’s liquidation value.”
- State that the proposed guidance applies to PIK dividends on preferred stock classified as equity, including preferred stock classified as temporary equity in accordance with the SEC staff announcement in ASC 480-10-S99-3A.
- Clarify that the guidance applies when the monetary value of the PIK dividends varies on the basis of the value of the preferred stock issued (i.e., when the issuer does not satisfy dividend obligations by issuing a variable number of shares with a fixed monetary value).

For more information about the proposed ASU, see Deloitte’s September 30, 2025, [Heads Up](#).

Appendix B — Titles of Standards and Other Literature

AICPA Literature

Accounting and Valuation Guides

Assets Acquired to Be Used in Research and Development Activities

Valuation of Privately-Held-Company Equity Securities Issued as Compensation

Clarified Statements on Auditing Standards

AU-C Section 501, "Audit Evidence — Specific Considerations for Selected Items"

AU-C Section 620, "Using the Work of an Auditor's Specialist"

FASB Literature

ASC Topics

ASC 105, *Generally Accepted Accounting Principles*

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 220, *Income Statement — Reporting Comprehensive Income*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 260, *Earnings per Share*

ASC 270, *Interim Reporting*

ASC 275, *Risks and Uncertainties*

ASC 280, *Segment Reporting*

ASC 310, *Receivables*

ASC 320, *Investments — Debt Securities*

ASC 321, *Investments — Equity Securities*

ASC 323, *Investments — Equity Method and Joint Ventures*

ASC 326, *Financial Instruments — Credit Losses*

ASC 330, *Inventory*

ASC 340, *Other Assets and Deferred Costs*

ASC 350, *Intangibles — Goodwill and Other*

ASC 360, *Property, Plant, and Equipment*

ASC 405, *Liabilities*

ASC 410, *Asset Retirement and Environmental Obligations*

ASC 420, *Exit or Disposal Cost Obligations*

ASC 440, *Commitments*

ASC 450, *Contingencies*

ASC 460, *Guarantees*

ASC 470, *Debt*

ASC 480, *Distinguishing Liabilities From Equity*

ASC 505, *Equity*

ASC 605, *Revenue Recognition*

ASC 606, *Revenue From Contracts With Customers*

ASC 610, *Other Income*

ASC 705, *Cost of Sales and Services*

ASC 710, *Compensation — General*

ASC 712, *Compensation — Nonretirement Postemployment Benefits*

ASC 715, *Compensation — Retirement Benefits*

ASC 718, *Compensation — Stock Compensation*

ASC 720, *Other Expenses*

ASC 730, *Research and Development*

ASC 740, *Income Taxes*

ASC 805, *Business Combinations*

ASC 808, *Collaborative Arrangements*

ASC 810, *Consolidation*

ASC 815, *Derivatives and Hedging*

ASC 820, *Fair Value Measurement*

ASC 825, *Financial Instruments*

ASC 830, *Foreign Currency Matters*

ASC 832, *Government Assistance*

ASC 835, *Interest*

ASC 840, *Leases*

ASC 842, *Leases*

ASC 845, *Nonmonetary Transactions*

ASC 848, *Reference Rate Reform*

ASC 852, *Reorganizations*

ASC 855, *Subsequent Events*

ASC 860, *Transfers and Servicing*

ASC 905, *Agriculture*

ASC 915, *Development Stage Entities*

ASC 930, *Extractive Activities — Mining*

ASC 944, *Financial Services — Insurance*

ASC 946, *Financial Services — Investment Companies*

ASC 954, *Health Care Entities*

ASC 958, *Not-for-Profit Entities*

ASC 960, *Plan Accounting — Defined Benefit Pension Plans*

ASC 962, *Plan Accounting — Defined Contribution Pension Plans*

ASC 965, *Plan Accounting — Health and Welfare Benefit Plans*

ASC 970, *Real Estate — General*

ASC 985, *Software*

ASUs

ASU 2010-27, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Pharmaceutical Manufacturers — a consensus of the FASB Emerging Issues Task Force*

ASU 2011-06, *Other Expenses (Topic 720): Fees Paid to the Federal Government by Health Insurers — a consensus of the FASB Emerging Issues Task Force*

ASU 2014-09, *Revenue From Contracts With Customers (Topic 606)*

ASU 2014-10, *Development Stage Entities (Topic 915): Elimination of Certain Financial Reporting Requirements, Including an Amendment to Variable Interest Entities Guidance in Topic 810, Consolidation*

ASU 2014-15, *Presentation of Financial Statements — Going Concern (Subtopic 205-40): Disclosure of Uncertainties About an Entity's Ability to Continue as a Going Concern*

ASU 2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*

ASU 2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

ASU 2016-02, *Leases (Topic 842)*

ASU 2016-10, *Revenue From Contracts With Customers (Topic 606): Identifying Performance Obligations and Licensing*

ASU 2016-12, *Revenue From Contracts With Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients*

ASU 2016-13, *Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments*

ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-16, *Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other Than Inventory*

ASU 2016-17, *Consolidation (Topic 810): Interests Held Through Related Parties That Are Under Common Control*

ASU 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash* — a consensus of the FASB Emerging Issues Task Force

ASU 2016-20, *Technical Corrections and Improvements to Topic 606, Revenue From Contracts With Customers*

ASU 2017-01, *Business Combinations (Topic 805): Clarifying the Definition of a Business*

ASU 2017-04, *Intangibles — Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*

ASU 2018-08, *Not-for-Profit Entities (Topic 958): Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*

ASU 2018-10, *Codification Improvements to Topic 842, Leases*

ASU 2018-11, *Leases (Topic 842): Targeted Improvements*

ASU 2018-17, *Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities*

ASU 2018-18, *Collaborative Arrangements (Topic 808): Clarifying the Interaction Between Topic 808 and Topic 606*

ASU 2019-01, *Leases (Topic 842): Codification Improvements*

ASU 2019-10, *Financial Instruments — Credit Losses (Topic 326), Derivatives and Hedging (Topic 815), and Leases (Topic 842): Effective Dates*

ASU 2020-02, *Financial Instruments — Credit Losses (Topic 326) and Leases (Topic 842): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 119 and Update to SEC Section on Effective Date Related to Accounting Standards Update No. 2016-02, Leases (Topic 842)*

ASU 2020-03, *Codification Improvements to Financial Instruments*

ASU 2020-04, *Reference Rate Reform (Topic 848): Facilitation of the Effects of Reference Rate Reform on Financial Reporting*

ASU 2020-05, *Revenue From Contracts With Customers (Topic 606) and Leases (Topic 842): Effective Dates for Certain Entities*

ASU 2020-06, *Debt — Debt With Conversion and Other Options (Subtopic 470-20) and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Accounting for Convertible Instruments and Contracts in an Entity's Own Equity*

ASU 2021-04, *Earnings per Share (Topic 260), Debt — Modifications and Extinguishments (Subtopic 470-50), Compensation — Stock Compensation (Topic 718), and Derivatives and Hedging — Contracts in Entity's Own Equity (Subtopic 815-40): Issuer's Accounting for Certain Modifications or Exchanges of Freestanding Equity-Classified Written Call Options* — a consensus of the FASB Emerging Issues Task Force

ASU 2021-05, *Leases (Topic 842): Lessors — Certain Leases With Variable Lease Payments*

ASU 2021-08, *Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities From Contracts With Customers*

ASU 2021-09, *Leases (Topic 842): Discount Rate for Lessees That Are Not Public Business Entities*

ASU 2022-03, *Fair Value Measurement (Topic 820): Fair Value Measurement of Equity Securities Subject to Contractual Sale Restrictions*

ASU 2023-01, *Leases (Topic 842): Common Control Arrangements*

ASU 2023-05, *Business Combinations — Joint Venture Formations (Subtopic 805-60): Recognition and Initial Measurement*

ASU 2023-07, *Segment Reporting (Topic 280): Improvements to Reportable Segment Disclosures*

ASU 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*

ASU 2024-02, *Codification Improvements — Amendments to Remove References to the Concepts Statements*

ASU 2024-03, *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses*

ASU 2024-04, *Debt — Debt With Conversion and Other Options (Subtopic 470-20): Induced Conversions of Convertible Debt Instruments*

ASU 2025-01, *Income Statement — Reporting Comprehensive Income — Expense Disaggregation Disclosures (Subtopic 220-40): Clarifying the Effective Date*

ASU 2025-03, *Business Combinations (Topic 805) and Consolidation (Topic 810): Determining the Accounting Acquirer in the Acquisition of a Variable Interest Entity*

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*

ASU 2025-06, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*

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*

ASU 2025-09, *Derivatives and Hedging (Topic 815): Hedge Accounting Improvements*

ASU 2025-10, *Government Grants (Topic 832): Accounting for Government Grants Received by Business Entities*

Concepts Statements

No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

No. 8, *Conceptual Framework for Financial Reporting — Chapter 4, Elements of Financial Statements*

Invitations to Comment

No. 2021-004, *Agenda Consultation*

No. 2025-ITC100, *Agenda Consultation*

Proposed ASUs

No. 2019-790, *Derivatives and Hedging (Topic 815): Codification Improvements to Hedge Accounting*

No. 2024-ED910, *Environmental Credits and Environmental Credit Obligations (Topic 818)*

No. 2025-ED300, *Equity (Topic 505): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock*

TRG Agenda Papers

TRG Agenda Paper 6, *Customer Options for Additional Goods and Services and Nonrefundable Upfront Fees*

TRG Agenda Paper 11, *October 2014 Meeting — Summary of Issues Discussed and Next Steps*

TRG Agenda Paper 41, *Measuring Progress When Multiple Goods or Services Are Included in a Single Performance Obligation*

TRG Agenda Paper 44, *July 2015 Meeting — Summary of Issues Discussed and Next Steps*

TRG Agenda Paper 48, *Customer Options for Additional Goods and Services*

TRG Agenda Paper 49, *November 2015 Meeting — Summary of Issues Discussed and Next Steps*

TRG Agenda Paper 54, *Considering Class of Customer When Evaluating Whether a Customer Option Gives Rise to a Material Right*

TRG Agenda Paper 55, *April 2016 Meeting — Summary of Issues Discussed and Next Steps*

Other

FASB Staff Revenue Recognition Implementation Q&As

IFRS Literature

IFRS 2, *Share-Based Payment*

IFRS 3, *Business Combinations*

IFRS 9, *Financial Instruments*

IFRS 10, *Consolidated Financial Statements*

IFRS 11, *Joint Arrangements*

IFRS 12, *Disclosure of Interests in Other Entities*

IFRS 15, *Revenue From Contracts With Customers*

IFRS 16, *Leases*

IAS 1, *Presentation of Financial Statements*

IAS 7, *Statement of Cash Flows*

IAS 10, *Events After the Reporting Period*

IAS 12, *Income Taxes*

IAS 17, *Leases*

IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*

IAS 21, *The Effects of Changes in Foreign Exchange Rates*

IAS 27, *Separate Financial Statements*

IAS 29, *Financial Reporting in Hyperinflationary Economies*

IAS 32, *Financial Instruments: Presentation*

IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*

IAS 38, *Intangible Assets*

IAS 40, *Investment Property*

Lease Liability in a Sale and Leaseback: Amendments to IFRS 16

IRC

Section 78, "Gross Up for Deemed Paid Foreign Tax Credit"

Section 162(a), "Trade or Business Expenses; General"

Section 163(j), "Interest; Limitation on Business Interest"

Section 197, "Amortization of Goodwill and Certain Other Intangibles"

Section 250, "Foreign-Derived Deduction Eligible Income and Net CFC Tested Income"

Section 382, "Limitation on Net Operating Loss Carryforwards and Certain Built-In Losses Following Ownership Change"

Section 409A, "Inclusion in Gross Income of Deferred Compensation Under Nonqualified Deferred Compensation Plans"

Section 422, "Incentive Stock Options"

Section 423, "Employee Stock Purchase Plans"

PCAOB Literature

Auditing Standard 3101, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion*

Release No. 2017-001, *The Auditor's Report on an Audit of Financial Statements When the Auditor Expresses an Unqualified Opinion and Related Amendments to PCAOB Standards*

SEC Literature

Final Rule Releases

No. 33-10786, *Amendments to Financial Disclosures About Acquired and Disposed Businesses*

No. 33-11126, *Listing Standards for Recovery of Erroneously Awarded Compensation*

No. 33-11265, *Special Purpose Acquisition Companies, Shell Companies, and Projections*

No. 33-11275, *The Enhancement and Standardization of Climate-Related Disclosures for Investors* [stayed]

FRM

Topic 1, "Registrant's Financial Statements"

Topic 2, "Other Financial Statements Required"

Topic 3, "Pro Forma Financial Information"

Topic 5, "Smaller Reporting Companies"

Topic 7, "Related Party Matters"

Topic 10, "Emerging Growth Companies"

Topic 12, "Reverse Acquisitions and Reverse Recapitalizations"

Interpretive Releases

No. 33-9106, *Commission Guidance Regarding Disclosure Related to Climate Change*

No. 33-10403, *Updates to Commission Guidance Regarding Accounting for Sales of Vaccines and Bioterror Countermeasures to the Federal Government for Placement Into the Pediatric Vaccine Stockpile or the Strategic National Stockpile*

Regulation S-K

Item 10(e), "General: Use of Non-GAAP Financial Measures in Commission Filings"

Item 101, "Description of Business"

Item 103, "Legal Proceedings"

Item 201, "Market Price of and Dividends on the Registrant's Common Equity and Related Stockholder Matters"

Item 302, "Supplementary Financial Information"

Item 303, "Management's Discussion and Analysis of Financial Condition and Results of Operations"

Item 305, "Quantitative and Qualitative Disclosures About Market Risk"

Item 308, "Internal Control Over Financial Reporting"

Item 402, "Executive Compensation"

Item 404, "Transactions With Related Persons, Promoters and Certain Control Persons"

Item 407, "Corporate Governance"

Item 503, "Prospectus Summary"

Regulation S-X

Rule 1-02(w), "Definitions of Terms Used in Regulation S-X (17 CFR part 210); Significant Subsidiary"

Article 2, "Qualifications and Reports of Accountants"

Rule 3-01, "Consolidated Balance Sheets"

Rule 3-02, "Consolidated Statements of Comprehensive Income and Cash Flows"

Rule 3-03, "Instructions to Statement of Comprehensive Income Requirements"

- Rule 3-04, "Changes in Stockholders' Equity and Noncontrolling Interests"
- Rule 3-05, "Financial Statements of Businesses Acquired or to Be Acquired"
- Rule 3-06, "Financial Statements Covering a Period of Nine to Twelve Months"
- Rule 3-09, "Separate Financial Statements of Subsidiaries Not Consolidated and 50 Percent or Less Owned Persons"
- Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"
- Rule 3-12, "Age of Financial Statements at Effective Date of Registration Statement or at Mailing Date of Proxy Statement"
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Appendix C — Abbreviations

Abbreviation	Description
AETR	annual effective tax rate
AFSI	adjusted financial statement income
AI	artificial intelligence
AICPA	American Institute of Certified Public Accountants
AIN	AICPA Accounting Interpretation of an APB Opinion
AMT	alternative minimum tax
ANDA	abbreviated new drug application
AOCI	accumulated other comprehensive income
APB	Accounting Principles Board
API	active pharmaceutical ingredient
ARO	asset retirement obligation
ASC	FASB Accounting Standards Codification
ASR	accelerated share repurchase
ASU	FASB Accounting Standards Update
AUD	Australian dollar(s)
BC	Basis for Conclusions
BEAT	base erosion anti-abuse tax
BEMTA	base erosion minimum tax amount
BPD	branded prescription drug
C&DI	Compliance and Disclosure Interpretation
CAM	critical audit matter
CAQ	Center for Audit Quality
CARB	California Air Resources Board
CARES Act	Coronavirus Aid, Relief, and Economic Security Act

Abbreviation	Description
CFC	controlled foreign corporation
CIMA	Chartered Institute of Management Accountants
CMO	contract manufacturing organization
CMS	Centers for Medicare & Medicaid Services
CODM	chief operating decision maker
CPU	central processing unit
CRO	contract research organization
CSRD	Corporate Sustainability Reporting Directive
CYR	choose-your-rate
DD&A	depreciation, depletion, and amortization
DEI	deduction-eligible income
DISE	disaggregation of income statement expenses
DTA	deferred tax asset
DTL	deferred tax liability
EBITDA	earnings before interest, taxes, depreciation, and amortization
EC	European Commission
ED	exposure draft
EDGAR	SEC's Electronic Data Gathering, Analysis, and Retrieval system
EFRAG	European Financial Reporting Advisory Group
EGC	emerging growth company
EITF	Emerging Issues Task Force
ELOC	equity line of credit
EPS	earnings per share

Abbreviation	Description
ESA	energy service agreement
ESPP	employee stock purchase plan
ESRS	European Sustainability Reporting Standards
E.U.	European Union
EUR	euros
EU Taxonomy	EU Taxonomy for Sustainable Activities
Exchange Act	Securities Exchange Act of 1934
FAQ	frequently asked question
FASB	Financial Accounting Standards Board
FAST Act	Fixing America's Surface Transportation Act
FDA	U.S. Food and Drug Administration
FDDEI	foreign-derived deduction-eligible income
FDII	foreign-derived intangible income
FinREC	AICPA Financial Reporting Executive Committee
FOB	free on board
FPI	foreign private issuer
FRM	SEC Division of Corporation Finance Financial Reporting Manual
FVO	fair value option
FVTOCI	fair value through other comprehensive income
GAAP	generally accepted accounting principles
GDP	gross domestic product
GHG	greenhouse gas
GILTI	global intangible low-taxed income
GloBE	Global anti-Base Erosion
GPO	group purchasing organization
GPU	graphics processing unit
GWP	global warming potential
HAFWP	how and for what purpose
HFI	held for investment

Abbreviation	Description
HFS	held for sale
HHS	U.S. Department of Health and Human Services
HVAC	heating, ventilation, and air conditioning
IAS	International Accounting Standard
IASB	International Accounting Standards Board
ICFR	internal control over financial reporting
IEEPA	International Emergency Economic Powers Act
IFRS	International Financial Reporting Standard
IIR	investigator-initiated research
IOSCO	International Organization of Securities Commissions
IP	intellectual property
IPCC	Intergovernmental Panel on Climate Change
IPO	initial public offering
IPR&D	in-process research and development
IRA	Inflation Reduction Act of 2022
IRC	Internal Revenue Code
IRS	Internal Revenue Service
ISO	incentive stock option
ISSB	International Sustainability Standards Board
IT	information technology
ITC	invitation to comment
JOBS Act	Jumpstart Our Business Startups Act
LCD	liquid-crystal display
LIBOR	London Interbank Offered Rate
LIFO	last in, first out
LLM	large language model
M&A	merger and acquisition

Abbreviation	Description
MD&A	Management's Discussion & Analysis
MFN	most-favored-nation
MNE	multinational enterprise
MSL	medical science liaison
NCTI	net CFC tested income
NDA	new drug application
NFP	not-for-profit (entity)
NIH	National Institutes of Health
NLP	natural language processing
NOL	net operating loss
NOPA	notice of proposed adjustment
NQSO or NSO	nonqualified stock option
OCA	SEC Office of the Chief Accountant
OCI	other comprehensive income
OECD	Organisation for Economic Co-operation and Development
OEM	original equipment manufacturer
PBE	public business entity
PCAOB	Public Company Accounting Oversight Board
PCC	Private Company Council
PIE	public interest entity
PIK	paid-in-kind
PIPE	private investment in public equity
PP&E	property, plant, and equipment
PRV	priority review voucher
PTRS	probability of technical and regulatory success
Q&A	question and answer
QIP	qualified improvement property
R&D	research and development
R&E	research and experimental

Abbreviation	Description
RAM	random-access memory
REIT	real estate investment trust
REMS	risk evaluation and mitigation strategy
ROU	right-of-use
S&P 500	Standard & Poor's 500 Index
SaaS	software as a service
SAB	SEC Staff Accounting Bulletin
SAFE	simple agreement for future equity
SASB	Sustainability Accounting Standards Board
SEC	U.S. Securities and Exchange Commission
Securities Act	Securities Act of 1933
SEPA	standby equity purchase agreement
SG&A	selling, general, and administrative
SOX	Sarbanes-Oxley Act of 2002
SPAC	special-purpose acquisition company
SPPI	solely payments of principal and interest
SRC	smaller reporting company
TCFD	Task Force on Climate-Related Financial Disclosures
TD	Treasury Decision
TRG	transition resource group
TSA	transition services agreement
USD	U.S. dollar(s)
UTB	unrecognized tax benefit
VCO	voluntary carbon offset
VIE	variable interest entity
VWAP	volume-weighted average daily market price



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