Accounting for variable consideration—From a purchaser's perspective

Feedback received in response to Discussion Paper

ASAF meeting, 26 March 2024

DISCLAIMER

The views expressed in this presentation are those of the presenter, except where indicated otherwise. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances

DISCUSSION PAPER OVERVIEW

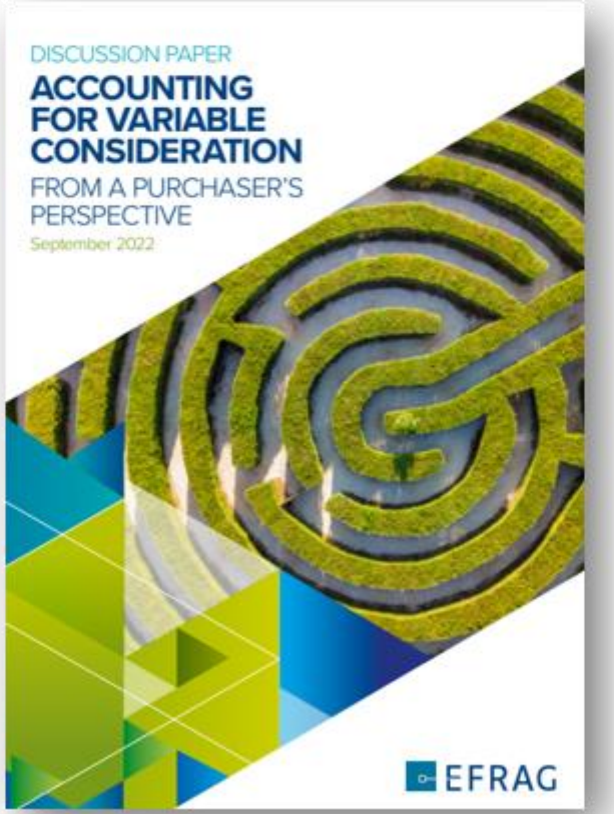
Discussion Paper (accessible through this link) was published in September 2022 and was open for consultation from September 2022 to the end of November 2023.

MOTIVATION

- 2018 EFRAG agenda consultation and to inform the then-pipeline (IASB) research project on variable consideration.
- Evidence of diversity in practice by purchaser entities.
- Remains an issue (see November 2023 Footnote Analyst article- Footballer player transfers highlights wider reporting issues).

FEEDBACK

- 13 comment letters received (accessible at EFRAG website).
- Targeted outreach including through the December 2022 ASAF presentation, a February 2023 EFRAG-Business Europe hosted multi-stakeholder webinar (see link to detailed report), May 2023 EAA-EFRAG seminar, and meetings with user, preparer and accountancy professional organisations.



PERVASIVENESS OF TRANSACTIONS

EFRAG's outreach confirmed that variable consideration transactions

- Are common in the pharmaceutical (e.g., acquired compound with several milestones before approval), extractive, entertainment and media (e.g., in relation to broadcasting rights) industries and in service concession arrangements.
- Arise, for example, when there is uncertainty on value of asset exchanged (e.g. depends on future actions or usage) and when there is information asymmetry between the buyer and seller.
- Also arise in risk-sharing arrangements.

OVERALL TAKEAWAYS

- Feedback received affirms the accounting challenges related to two issues in the scope of the Discussion Paper (i.e., **timing of liability recognition**, and **whether to true up the cost of the acquired asset for the liability remeasurement**).
- Diversity in views expressed on the possible solutions related to the two issues.
- On balance, there is a preference for Standard-by-Standard amendments over the development of a unified set of principles.
- Standard setting would also require consideration of other issues that were not in the scope of the DP (i.e., disclosures, measurement of the liability, and the economic substance of the transaction).
- Discussion Paper findings have relevance for different active and pipeline IASB workplan projects including Equity Method, Provisions—Targeted Improvements and Intangible Assets.

STRUCTURE OF REST OF PRESENTATION

- How to account for the liability
  - When to recognise a liability for variable consideration
  - How to assess that an entity has no practical ability to avoid taking an action
- How to account for the assets
  - Interpretations of the definition of cost
  - Possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration
- Standard-setting approach
  - Unified principles versus standard-by-standard amendments
- Other points of note
  - Applying an IFRS 15 mirroring approach
  - Relevance for IASB workplan
  - What could be further addressed
- EFRAG FR TEG and FRB discussions and decisions on feedback received

How to account for the liability

When to recognise a liability for variable consideration

Alternatives considered in EFRAG's DP

- **Alternative 1:** Recognise a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration.
- **Alternative 2:** Recognise a liability when the purchaser performs the actions that trigger the variable consideration.

When to recognise a liability for variable consideration

Additional alternatives for requirements on when to recognise a financial liability for variable consideration that depends on the purchaser's future actions

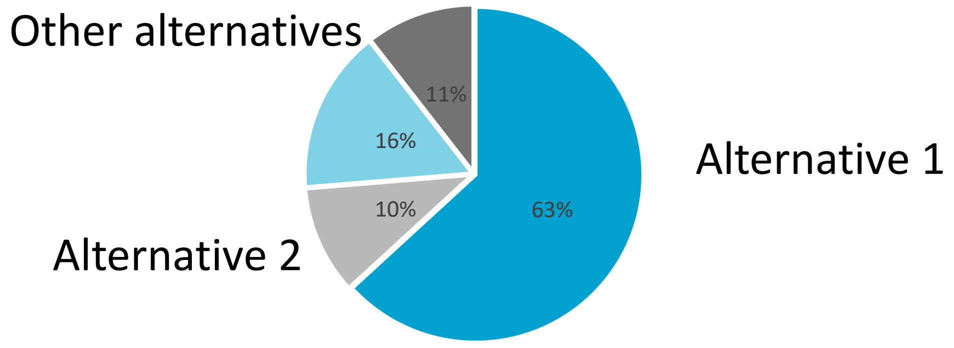
- Recognise a liability when the purchaser obtains control of the asset acquired.
- Recognise a liability when the purchaser obtains control of the asset acquired and it is probable that the action triggering the variable consideration will happen.
- Recognise a liability when the purchaser obtains control of the asset acquired unless the variable consideration is sales- or usage-based (similar to IFRS 15 for the seller).
- Recognise a liability when the purchaser obtains control of the asset acquired, it is probable that the action triggering the variable consideration will happen and the variable payment can be estimated reliably.
- Recognise a liability when the purchaser obtains control of the asset acquired and it is reasonably certain that the variable consideration will be triggered.
- Recognise a liability when the payment is unavoidable.
- Recognising a liability when the purchaser obtains control of the asset acquired and the asset is able to operate in the manner intended by the management unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration.

When to recognise a liability for variable consideration

Comment letter respondents

	Support for Alternative 1 (Recognise a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration)	**Support for Alternative 2** (Recognise a liability when the purchaser performs the actions that trigger the variable consideration)
Comment letter respondents	7	1
Participants at outreach events (speakers)	5	5
Arguments in favour included	Conceptual arguments, relevance	Reliability, costs

Poll at outreach



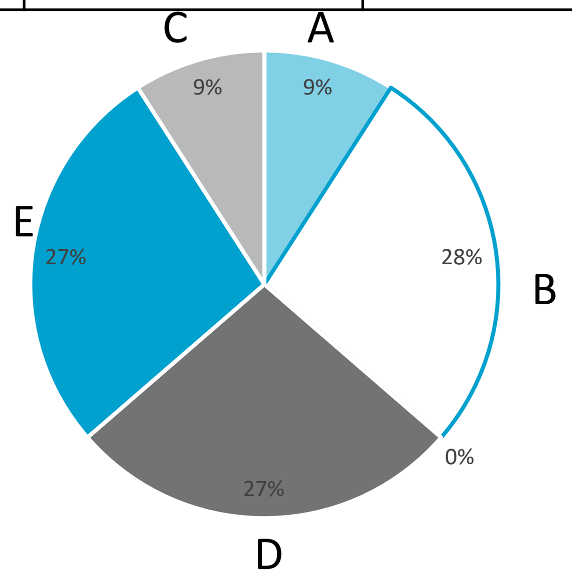
How to assess that an entity has no practical ability to avoid taking an action

- **Criterion A:** When avoiding taking an action would mean that the purchaser would have to cease its activities.
- **Criterion B:** When avoiding taking an action would have a significant unfavourable economic impact on the entity.
- **Criterion C:** When avoiding taking an action would have a significant unfavourable economic impact in the context of the acquired asset.
- **Criterion D:** When avoiding taking an action would result in using an acquired asset in a manner that would not reflect the economic purpose of acquiring the asset.
- **Criterion E:** When avoiding taking an action would have marginal economically unfavourable consequences for the entity.

How to assess that an entity has no practical ability to avoid taking an action

<table>
<tr><th></th><th>Criterion A
(Cease activities)</th><th>Criterion B
(Significant economic impact on entity)</th><th>Criterion C
(Significant economic impact in context of acquired asset)</th><th>Criterion D
(Other use than planned)</th><th>Criterion E
(Marginal consequences)</th></tr>
<tr><td rowspan="2">Comment letter respondents</td><td rowspan="2"></td><td rowspan="2">3</td><td colspan="2">1</td><td rowspan="2"></td></tr>
<tr><td>1</td><td></td></tr>
<tr><td>Participants at outreach events (speakers)</td><td>1</td><td></td><td></td><td></td><td></td></tr>
</table>

Poll at outreach



Observation: Only if the criterion is linked to the contract, the same contract will be accounted for similarly by different entities.

How to account for the asset

Interpretations of the definition of cost

Arguments related to the interpretation of current requirements on whether ‘cost’ should be updated to reflect changes in (the estimate of) variable consideration

Arguments for updating

- It is consistent with IFRIC 1.
- It would be consistent with the Conceptual Framework (par. 6.5).
- The reference to ‘the time of acquisition’ only relates to ‘the fair value of other consideration given’.
- It is consistent with certain changes in lease agreements.
- It reflects what is paid for the asset.
- The transaction price is part of the cost of an asset. Accordingly, changes in the transaction price should be included in the cost.

Arguments for not updating

- It would be consistent with the Conceptual Framework (par. 6.5).
- It would follow from a plain English reading of the definition.
- ‘At the time of acquisition or construction’ applies to both the cash or cash equivalent paid and the fair value of other consideration.

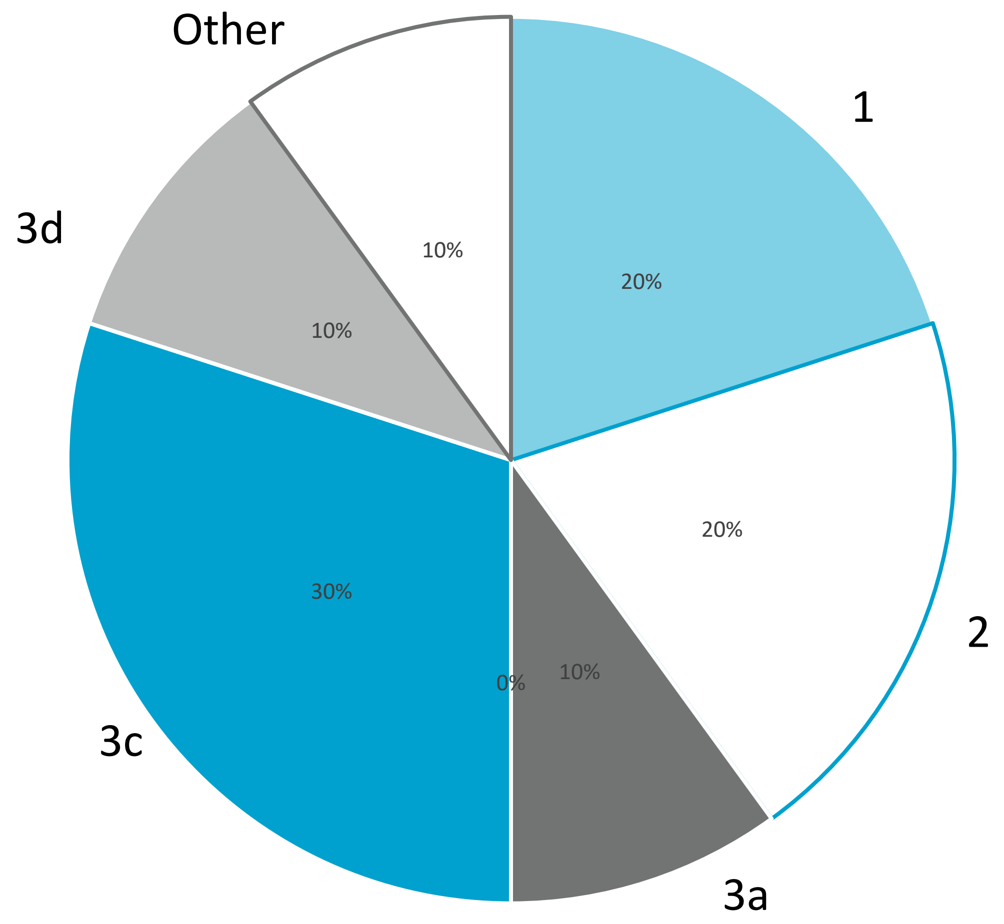
Possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration

- **Alternative 1:** Not updating the cost estimate.
- **Alternative 2:** Updating the cost to reflect all subsequent changes in estimates of variable consideration.
- **Alternative 3:** Sometimes updating:
  - **Alternative 3a:** If estimates of variable consideration are included in the measurement of the asset's cost at initial recognition.
  - **Alternative 3b:** If the change in estimate of variable consideration takes place before the asset is ready for its intended use.
  - **Alternative 3c:** If variable payments are associated with future economic benefits to be derived from the asset.
  - **Alternative 3d:** If variable consideration is linked to the initial quality of the asset.

Possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration

<table>
<tr><th></th><th>Alternative 1
(Never update)</th><th>Alternative 3a
(If included in initial measurement)</th><th>Alternative 3b
(If takes place before ready to use)</th><th>Alternative 3c
(If associated with future economic benefits from the asset)</th><th>Alternative 3d
(If linked to initial quality)</th><th>Alternative 2
(Always update)</th></tr>
<tr><td rowspan="3">Comment letter respondents</td><td colspan="5">1</td><td></td></tr>
<tr><td></td><td colspan="4">2</td><td></td></tr>
<tr><td>1</td><td>1</td><td>1</td><td>3</td><td></td><td>1</td></tr>
<tr><td rowspan="3">Participants at outreach events (speakers)</td><td colspan="5">1</td><td></td></tr>
<tr><td></td><td colspan="4">3</td><td></td></tr>
<tr><td>4</td><td></td><td></td><td>2</td><td>2</td><td>1</td></tr>
</table>

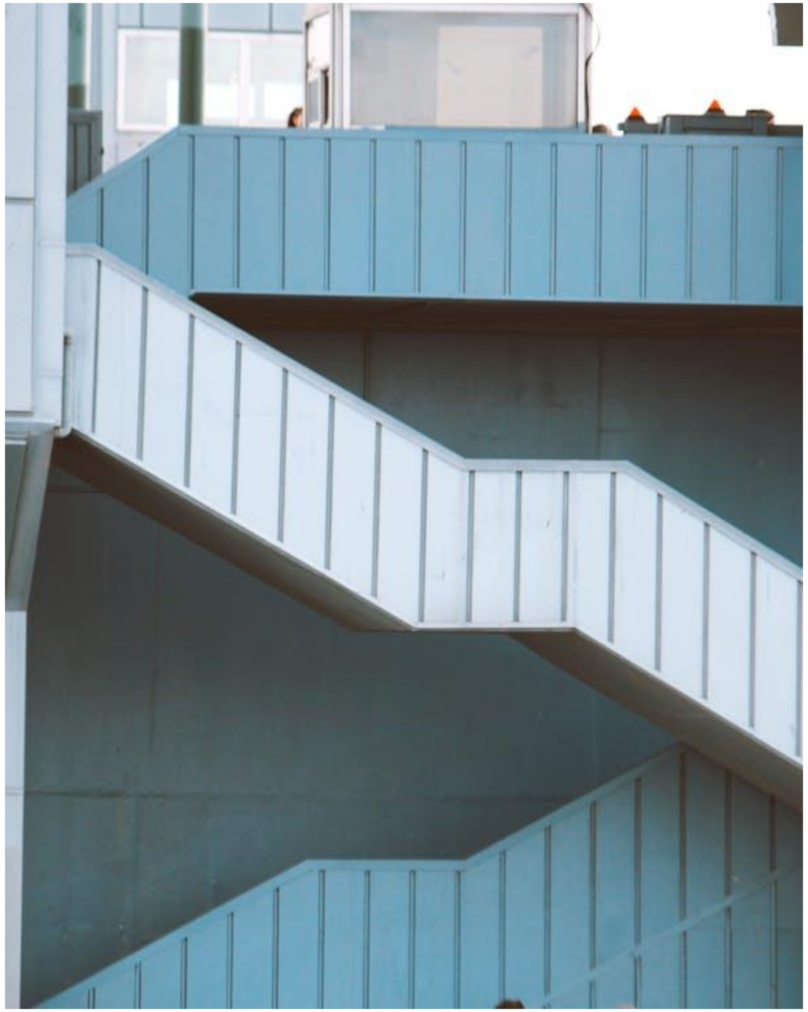
Possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration



Standard setting approach

Standard-by-Standard amendments vs. developing unified principles

- The majority of the feedback received favoured Standard-by-standard amendments over the development of a unified set of principles.
- The **differing nature of transactions** make a one-size-fit all approach to the topic inappropriate
- It was also suggested a combination might be used under which the existing issues would be addressed using an agreed conceptual basis (i.e. the two approaches are not necessarily mutually exclusive).



Other points of note

Applying an IFRS 15 mirroring approach

- The majority of the feedback received an IFRS 15 mirroring approach.
- Arguments included that some IFRS 15 requirements are designed to create an outcome in the statement of financial performance rather than accurately estimating the cost of an asset.

Relevance of findings for current and potential IASB workplan

- Feedback indicates relevance of the DP analysis and findings for the following IASB workplan projects:
  - Provisions—Targeted Improvements (discussion and feedback related to determining 'no practical ability to avoid').
  - Intangible Assets (discussion and feedback related to the definition of cost and whether, and if so when, cost should be updated).
  - Equity Method (discussion on the recognition of a liability for variable consideration and how to account for changes in (estimates of) variable consideration).
  - FICE project (discussion and feedback related to what depends on an entity's future actions).
- The implications of the DP analysis and findings for IFRS 3 and IFRS 16 (e.g., to the extent variable lease payments issues arise during the forthcoming PIR) should be considered.
- There is a need to distinguish collaborative, risk-sharing arrangements that are not an acquisition of an asset from acquisition of assets within the scope of the DP.
- DP analysis and findings are relevant for any future work by the IASB related to variable consideration.

What could be further addressed

- **Scope and focus of the DP**:
  - Several respondents noted DP should have considered disclosures, measurement issues, and the substance of a contract (particularly whether one or several assets are transferred).
  - A respondent noted issues raised in DP arise for assets measured at fair value.
  - A couple of comments noted that the DP focused on examples where additional amounts of consideration would be transferred. Situations where the purchase price would be reduced should also be considered.
  - It should be considered whether the starting point should be what the most useful measurement of the asset would be—instead of whether a liability for variable consideration exists.

EFRAG FR TEG and FRB discussions and decisions on the feedback received

EFRAG FR TEG and FRB reactions

- Unlike for the intangible and crypto-assets Discussion Papers, EFRAG will not be issuing specific recommendations for standard setting for this Discussion Paper.
- EFRAG will publish a summary of feedback.
- The importance of determining what cost means was underscored and seen as a cross cutting issue across different asset standards.
- There was agreement with the feedback that the Discussions Papers findings are useful for the current IASB workplan and any future projects focused on or encompassing variable consideration.
- The diversity in views and interpretations reflect that the issues can only be solved by standard setting.

Follow us

35 Square de Meeûs, B-1000 Brussels
info@efrag.org - www.efrag.org

EFRAG is co-funded by the European Union through the Single Market Programme in which the EEA-EFTA countries (Norway, Iceland and Liechtenstein), as well as Kosovo participate. Any views and opinions expressed are however those of the presenter only and do not necessarily reflect those of the European Union, the European Commission or of countries that participate in the Single Market Programme. Neither the European Union, the European Commission nor countries participating in the Single market Programme can be held responsible for them.

THANK YOU

EFRAG
Financial reporting