

# Accounting for variable consideration

EFRAG Discussion Paper

8 December 2022 – ASAF meeting



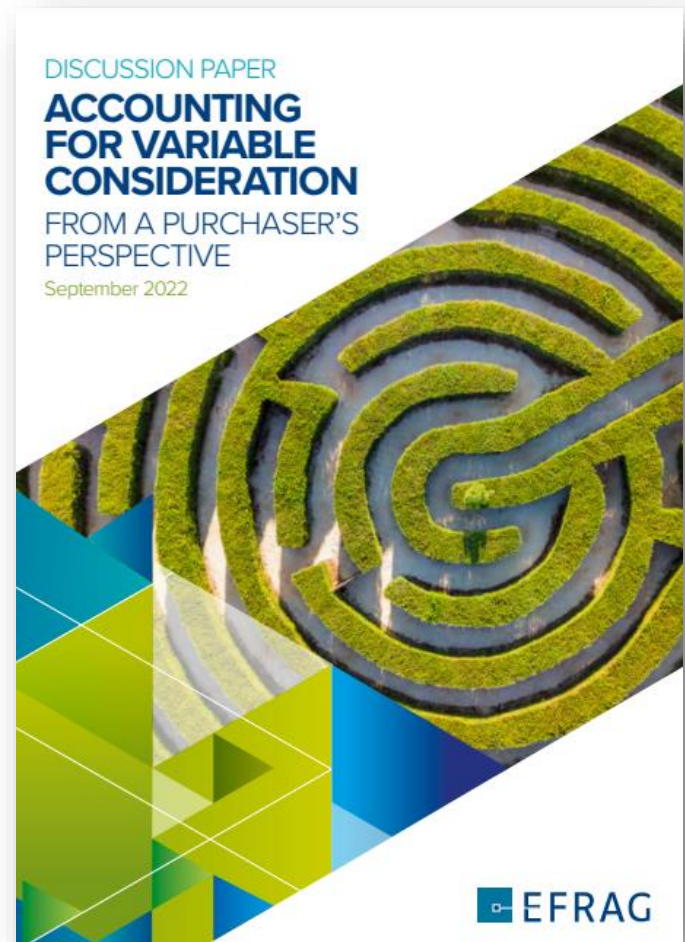
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[Discussion Paper](#) open for consultation until 31 May 2023.



# OVERVIEW

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## Background and objective

## Scope of the Discussion Paper

## The liability recognition issue

When to recognise a liability within the scope of IAS 32/IFRS 9 when variable consideration depends on the purchaser's future actions.

## The measurement of the acquired asset issue

Whether and when to update the cost measurement of an acquired asset for changes in estimates of variable consideration.

## General IFRS requirements and standard-setting implications

Whether a unified set of principles should be developed to align IFRS requirements.

## Questions included in the Discussion Paper





## Background, objective and scope

# Background and objective

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- Result of the 2018 EFRAG Research Agenda Consultation. It is an area where significant diversity in practice exists (also evidenced by IFRS Interpretation Committee discussions).
- Although a project on variable consideration has been removed from the IASB's research pipeline, the accounting challenges remain.
- The feedback to the DP may be useful for the IASB:
  - when deciding on its post 2026 workplan;
  - for a project on variable consideration after 2026;
  - amendments to standards that would include requirements related to variable consideration.

# DP's definition of variable consideration

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Consideration is variable when the purchaser of a good or service may have to transfer **additional assets**<sup>①</sup> in exchange for the good or service to **the seller**.<sup>② ③</sup>

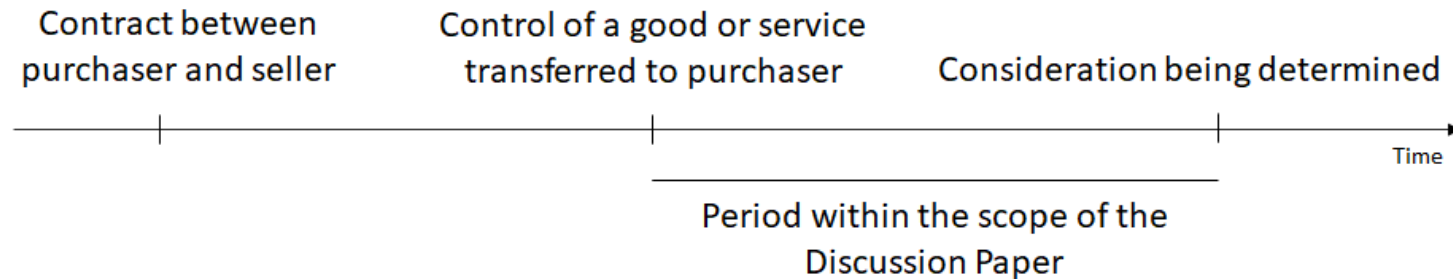
- ① Changes in the value of the assets due to changes in unit price (for example, caused by a change in a foreign currency exchange rate) is not considered to be variable consideration. Also, the DP does not consider payments in own shares.
- ② Uncertain transfers to third parties (for example in the case of a decommissioning liability) are not considered to be variable consideration.
- ③ Based on the definition of contingent consideration included in IFRS 3 *Business Combinations*.

# Scope

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## Non-executory contracts

Scenario covered by the DP:



## Focus on purchaser

The DP only deals with how to account for variable consideration by the purchaser (obligor).

## Substance of transaction known

The DP assumes that a transaction is for variable consideration following the definition used.



# Scope

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## Liability recognition issue

When to recognise a liability within the scope of IAS 32/IFRS 9 for variable consideration **that depends on the purchaser's future actions.**

## Measurement of the acquired asset issue

Whether and when to update the **cost measurement** of an acquired asset for changes in estimates of variable consideration.

- Also variable consideration that does not depend on the purchaser's future actions.
- To simplify the DP the only changes in liabilities covered by IAS 32/IFRS 9 are covered.



# The liability recognition issue

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# The liability recognition issue

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## One cause of the issue

Different interpretations of IAS 32.

IAS 32 *Financial Instruments: Presentation*, paragraph 19:

If an entity does not have an *unconditional right to avoid* delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability, except for those instruments classified as equity instruments [...]

IAS 32, paragraph 25:

A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are *beyond the control* of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate or taxation requirements, or the *issuer's future revenues, net income or debt to equity ratio*. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer [...]

# The liability recognition issue

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## One cause of the issue

### Interpretations

### Reasons

Recognise liability when asset is received

- Purchaser does not have a right to avoid paying cash as it is a non-executory contract.
- The purchaser's future action is beyond the control of the purchaser since IAS 32 considers this to be the case for the purchaser's future revenues, net income or debt to equity ratio.

Recognise liability when event that triggers the variable payment occurs

- The event of the occurrence or non-occurrence of uncertain future events is within the control of the purchaser so recognise only when the event occurs.

# The liability recognition issue

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## Basing requirements on the definition of a liability in the Conceptual Framework for Financial Reporting

- Definition of a liability in the Conceptual Framework:
  - The entity has an obligation.
    - When does the entity have a duty or responsibility that it has no practical ability to avoid?
  - The obligation is to transfer an economic resource. ✓
  - The obligation is a present obligation that exists as a result of a past event.
    - When is the relevant past event? (When the entity receives the asset or when it performs the activity that triggers the variable consideration)?

### Conceptual Framework guidance interpreted differently

Most of the current requirements reflect that a liability is recognised when goods or services are received. These requirements do not distinguish between whether the variability is linked to the purchaser's future actions or not.

# The liability recognition issue

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## Alternatives based on the Conceptual Framework

### Alternative 1

- Recognise a liability when the asset is received and purchaser does not have a practical ability to avoid the payment.

### Alternative 2

- Recognise a liability when the purchaser performs the actions that would trigger the variable consideration (considered that the purchaser has no practical ability to avoid payment at this time).

# The liability recognition issue

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## Qualitative characteristics of useful information for the Alternatives considered

- Relevance
  - Would the Alternative result in variable consideration being reflected in the initial measurement of the acquired asset?
  - Could the Alternative result in the same timing for the recognition of liabilities for variable payments irrespective of whether these variable payments depend on the purchaser's future actions?
  - Could the Alternative result in a counterintuitive accounting outcome?
- Faithful representation
  - Would the Alternative result in a liability being recognised when the purchaser has no practical ability to avoid taking the action that would trigger the variable consideration?
  - Could the Alternative result in a liability being recognised that the purchaser has a practical ability to avoid?
  - Could the Alternative result in significant measurement uncertainty?
- Costs for preparers
  - Alternative 2 would be less costly for preparers to apply than Alternative 1.

# The liability recognition issue

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## Possible criteria/thresholds for 'no practical ability to avoid'

Possible criteria for assessing when the purchaser would not have a practical ability to avoid paying the variable consideration:



- Entity ceasing its activities to avoid the payments.
- Significant unfavourable economic impact for the entity.
- Significant unfavourable economic impact related to the acquired asset.
- The asset would have to be used in a manner that would not reflect the initial economic purpose of acquiring the asset.
- Marginally economically unfavourable for the entity not to perform the activities that would trigger the variable payments.





## The measurement of the acquired asset issue

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# The measurement of the acquired asset issue

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## Causes of the issue

No explicit/clear requirements on the issue. The requirements that do exist are interpreted differently and/or are conflicting.

For example, some refer to paragraph B5.4.6 of IFRS 9 *Financial Instruments* (changes in an estimate of variable consideration should be recognised in profit or loss) while others apply IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* by analogy.

## Basing requirements on:

- Guidance in the Conceptual Framework on measurement at historical cost.
- The definition of cost in existing IFRS requirements – and supporting requirements.

Both are interpreted differently

# The measurement of the acquired asset issue

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## Illustration of different interpretations of the definition of 'cost'

a

The amount of cash or cash equivalents paid or

b

the fair value of the other consideration given to acquire an asset

a+b

at the time of its acquisition

a

The amount of cash or cash equivalents paid or

b

the fair value of the other consideration given to acquire an asset

at the time of its acquisition

# The measurement of the acquired asset issue

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## Alternatives proposed in the DP

### Alternative 1

- Never update cost.

### Alternative 2

- Always update cost.

### Alternative 3

- Update cost sometimes.
- Possible criteria (multiple can be chosen):
  - a) Update if liability included in original measurement.
  - b) Update until the asset is ready for its intended use.
  - c) Update if variable payments associated with future economic benefits.
  - d) Update if variability is linked to the initial quality of the asset.

# The measurement of the acquired asset issue

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## Qualitative characteristics of useful information for the Alternatives considered

- Relevance
  - Under what circumstances will changes in variable consideration that depends on factors relating to a particular period be recognised in that period?
  - Under what circumstances will changes related to future cash flows expected from the acquired asset be matched with in subsequent periods after the cost of the acquired asset is updated for remeasurements of the liability for variable consideration?
  - Could the Alternative result in counterintuitive information (i.e., recognising a gain/loss due to the decrease/increase in the estimate of a liability for variable payment when there is a decline/improvement in the expected future cash flows of an acquired asset)?
- Faithful representation/ verifiability/ comparability
  - Would the Alternative require the use of significant judgement?
- Costs for preparers
  - Alternative 1 would be least costly.



# General IFRS requirements and standard-setting implications

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## Key findings

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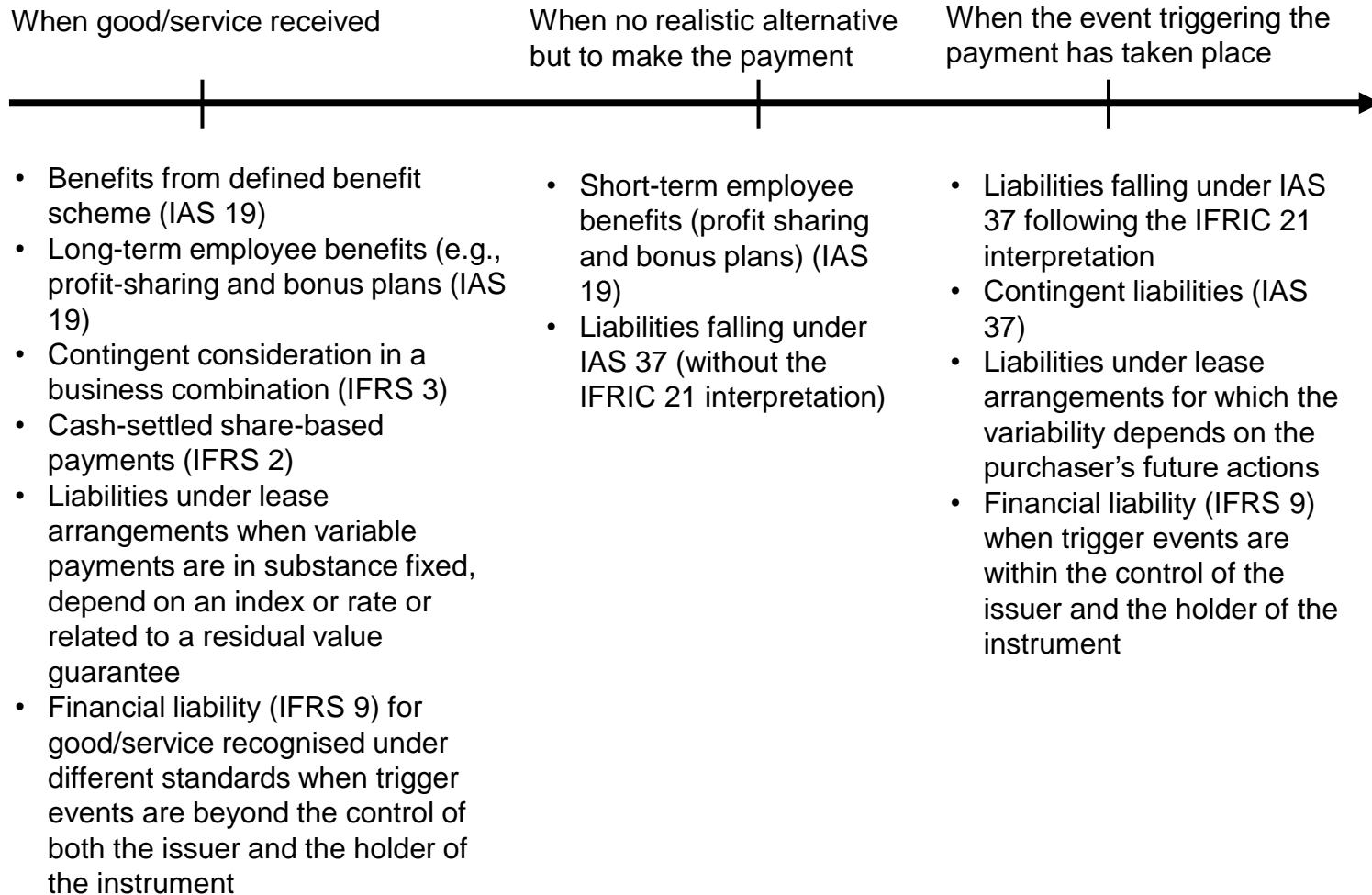
Current requirements on variable consideration (also variable consideration included in transactions outside the scope of the issues considered) are different and the reasons for the differences are seldom explained.

There is incremental complexity in accounting for variable consideration transactions paid through the transfer of a non-financial asset including by performing a service and the related non-financial liabilities. Nonetheless, the Discussion Paper's alternatives for requirements for the recognition of liabilities and measurement of acquired assets could be applicable for these transactions.

The Discussion Paper outlines high-level advantages and disadvantages of developing unified principles versus standard-by-standard amendments. It seeks constituents' views on these two options taking into account the usefulness of information, timeliness of solutions and cost-benefit considerations.

# How should the issues be solved?

## Different requirements for the recognition of a liability





# Reason (lack of reasons) underpinning liability recognition requirements

Current guidance	Reasons in the Basis for Conclusions
<b>Requirements under which a liability is recognised when a good or service is received</b>	
IAS 19 (Long-term employee benefits)	An obligation exists even if a benefit is not vested (paragraph BC55).
IFRS 2	To be consistent with the requirements in IAS 19 (paragraph BC245).
IFRS 3	An acquirer's agreement to make contingent payment is the obligation event in a business combination transaction (paragraph BC346).
IFRS 16	<p>Residual value guarantees and variable lease payments that are either in-substance fixed payments or depend on an index or rate are included in the lease liability in the initial measurement at the commencement of the lease for the following reasons:</p> <p>IFRS 16.BC164 notes that variable lease payments that are in-substance fixed lease payments are payments that, despite their variability, are unavoidable and, thus, are economically indistinguishable from fixed lease payments. IFRS 16. BC165 notes the IASB decided to include variable lease payments that depend on an index or a rate in the measurement of lease liabilities because they are unavoidable and do not depend on any future activity of the lessee. Any uncertainty relates to the measurement of that liability and not to its existence. IFRS 16.BC170 notes that residual value guarantees are similar to variable lease payments that depend on an index or rate.</p>
<b>Requirements under which a liability is not recognised when a good or service is received</b>	
IAS 37	No reasons are found in the Basis for Conclusions for the requirements in IAS 37.
IAS 19 (short-term benefits)	<p>For simplification purposes.</p> <p>The IASB thus considered that short-term benefits could be accounted for under a simplified measurement approach without resulting in measuring those benefits at an amount different from the general measurement requirements of IAS 19 (paragraph BC17).</p>
IFRS 16	<p>Exclusion of variable lease payments linked to future performance for the following reasons:</p> <ul style="list-style-type: none"> <li>- For some IASB members, this decision was made solely for cost-benefit reasons.</li> <li>- Other IASB members did not think that variable lease payments linked to future performance or use meet the definition of a liability for the lessee until the performance or use occurs.</li> </ul> <p>(paragraph BC169).</p>

## How should the issues be solved?

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Different requirements on whether the cost of an asset should be updated  
To reflect changes in the related liability

Requirement	Situation	Update?
IAS 2/IAS 16/IAS 38	Rebates/discounts	Yes
IAS 16/IFRS 16/IFRIC 1	Dismantling/removing/ restoring	Yes
IFRS 16	Lease payments depending on index, rate or in- substance fixed	Yes
IFRS 16	Residual value guarantees	Yes
IFRS 16	Other variable lease payments	No
IFRS 9	Cashflow changes of amortised cost liabilities	No
IFRS 2	Cash-settled share-based payments	No
IFRS 3	Payment for business	No

(Simplified content)

# Reasons underpinning asset measurement requirements

Current and possible future requirements	Reasons in the Basis for Conclusions
<b>Reasons provided for updating the cost of the acquired asset for changes in estimates of variable consideration</b>	
<p><b>IAS 16 / IFRIC 1</b>  <b>Changes in Existing Decommissioning, Restoration and Similar Liabilities</b></p> <p>(There is a view that these are generally not variable consideration components as defined in this Discussion Paper but it could be if it is an obligation to the seller of the PPE that arose at acquisition)</p>	<p>In relation to updating the measurement of an asset to reflect changes in the estimated costs of dismantling and removing the item and restoring the site on which it is located, the IASB observed that whether the obligation is incurred upon acquisition of the item or while it is being used, its underlying nature and its association with the asset are the same. Therefore, the IASB decided that the cost of an item should include the costs of dismantlement, removal or restoration (paragraph BC15 of IAS 16).</p> <p>In the related interpretation (IFRIC 1) the IFRS IC took the view that revisions to the estimates of those costs [decommissioning costs], whether through revisions to the estimated outflows of resources embodying economic benefits or revisions to the discount rate, ought to be accounted for in the same manner as the initial estimated cost (paragraph BC11).</p>
<p><b>IFRS 16</b></p>	<p>In relation to variable consideration included in the lease liability (variable lease payments that are either in-substance fixed payments or those that depend on an index or rate and residual value guarantees), the IASB decided that a lessee should recognise the remeasurement as an adjustment to the right-of-use assets for the following reasons:</p> <ul style="list-style-type: none"> <li>(a) a change in the assessment of extension, termination or purchase options reflects the lessee's determination that it has acquired more or less of the right to use the underlying asset. Consequently, that change is appropriately reflected as an adjustment to the cost of the right-of-use asset.</li> <li>(b) a change in the estimate of the future lease payments is a revision to the initial estimate of the cost of the right-of-use asset, which should be accounted for in the same manner as the initial estimated cost.</li> <li>(c) the requirement to update the cost of the right-of-use asset is similar to the requirements in IFRIC 1.</li> </ul> <p>(paragraph BC192).</p>
<p><b>Regulatory Assets and Regulatory Liabilities IASB Exposure Draft</b></p>	<p>The IASB selected modified historical cost as the measurement basis because in the IASB's view, using that measurement basis would provide useful information about an entity's regulatory assets and regulatory liabilities, and about regulatory income and regulatory expense recognised as a result (paragraph BC132).</p>
<b>Reasons provided for not updating the cost of the acquired assets for changes in estimates of variable consideration</b>	
<p><b>IFRS 3</b></p>	<p>The IASB concluded that subsequent changes in the fair value of a liability for contingent consideration do not affect the acquisition-date fair value of the consideration transferred (paragraph BC357).</p>
<b>No reasons provided</b>	
<p><b>IAS 2/ IAS 16 / IAS 38</b></p> <p>Variable consideration only relates to rebates and trade discounts under IAS 2/ IAS 16 /IAS 38</p>	<p>No reasons are included in the Basis for Conclusions.</p>
<p><b>IFRS 9</b></p>	<p>No reasons are included in the Basis for Conclusions.</p>

# Possible standard-setting responses

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## Developing unified set of principles

- Advantages (can address two issues and inconsistencies in definition of cost; can inform narrow scope amendments).
- Disadvantages (a one-size fit all solution is unlikely to be implementable, unlikely to be justified from a cost-benefit standpoint).

## Standard-by-standard review

- Advantages (specific amendments might be easier to address than a comprehensive review, takes account of transaction-specific features).
- Disadvantages (may fail to address both liability recognition and asset measurement issues; may perpetuate diverse approaches across IFRS Standards).



# Questions

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# Questions

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Q1: When should a liability for variable consideration that depends on the purchaser's future actions be recognised?

Q 2: When should it be considered that an entity has no practical ability to avoid taking an action?

Q3: How do you interpret the current requirements on whether/when the measurement at cost of an asset covered by IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets* should be updated to reflect changes in estimates of variable consideration?

## Questions - continued

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Q4: When do you think it should be required to update measurement at cost to reflect changes in estimates of variable consideration?

Q5: Do you think that accounting for variable consideration should be based on a unified set of principles or is it an issue that should be considered standard by standard?

Q6: Do you think that the requirements in IFRS 15 *Revenue from Contracts with Customers* could be mirrored (with the exception of the constraint to only include in the transaction price the amount of variable consideration that is highly probable not to result in a significant reversal in the amount of cumulative revenue recognised)?

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THANK YOU!





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