EFRAG

European Financial Reporting Advisory Group

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Identifying issues with variable consideration from examples Issues Paper

Objective

1 The objective of this paper is to:

(a) Discuss examples (an initial example and four modifications) of transactions involving variable consideration for which there is no (clear) accounting guidance and ask EFRAG TEG members on accounting issues relating to the examples and the possible accounting approaches to address the issues. When discussing EFRAG's discussion paper on variable consideration at the April 2021 EFRAG TEG meeting, the comment was made that it would facilitate EFRAG TEG's discussion, if examples of variable consideration could be discussed by EFRAG TEG. Also, the EFRAG Secretariat assesses that such discussion could be helpful in drafting the discussion paper, in particular in:

(i) Ensuring that the discussion paper identifies as precisely/specific as possible the current accounting issues with variable consideration;

(ii) Presenting possible solutions that could address these accounting issues;

(iii) Ensuring that the relevant factors that can affect either the accounting issues or the possible solutions are identified.

(b) Ask EFRAG TEG members whether the forthcoming project discussions should first focus on dealing with issues where there are currently no (clear) guidance and then at a later stage consider whether the fact that the guidance in different standards is dissimilar creates in practice risks of similar transactions being accounted for differently and if so, if the project should also deal with this issue.

2 It is not the intention that the examples presented in this paper will be included in the discussion paper.

3 The accounting issues considered by the examples in this paper are:

(a) Whether/when a liability for variable consideration should be recognised by a purchaser, when the variable payments are dependent on the purchaser's future activity.

(b) Whether/when subsequent adjustments in a liability to pay variable consideration should be reflected in the carrying amount of the acquired good or service.

Examples

Initial example

4 Below is an initial, fictious and simple example that is provided to initiate the discussion.

5 Entity B has developed a recipe that will make chocolate paste preserve its consistency at higher temperatures. It has sold the intellectual rights of this recipe to Entity A (the contract is thus non-executory). Entity A could resell the recipe to anybody else, but as the recipe only works for the products that Entity A is producing, this scenario is considered unlikely. Entity A will have to pay Entity B a one-off amount of CU 10 000 if it starts using the recipe. Entity A considers it more likely than not that it will use the recipe and based on its initial estimations, it expects that using the recipe could increase revenue by CU 5 000 per year.

Asset acquired: Intangible asset (outside business combination) measured at cost
Consideration: Cash – financial liability measured at amortised cost after initial recognition
Counter party: Third party
Variability: Whether or not the entity will use the asset (that is, purchaser's future activity)
Partly fixed consideration: No
Change in consideration: Increase only
Chance of additional consideration: More likely than not
Obligation type: Legal.

Accounting issues related to the initial example

6 The accounting issues that will be considered in this paper only relate to how Entity A should account for the acquisition of the recipe.

7 At the time of the transfer of the recipe, based on the discussions of the IASB, the IFRS Interpretation Committee (IFRS IC) and past discussions of EFRAG TEG, the main accounting issues related to variable consideration are:

(a) Should a liability be recognised?

(b) If/when a liability is recognised should any subsequent adjustment of the liability be recognised in profit or loss or be capitalised as part of the cost of the recipe?

Should a liability be recognised?

8 Previous discussions of the IFRS IC[1] show that there are differing views on whether a purchaser should recognise a liability for variable consideration for the purchase of a tangible or intangible asset when the variable payments are dependent on the purchaser's future activity (as in the initial example included above). The table below summarises some of the arguments presented by IFRS IC members on whether current requirements would require a financial liability to be recognised for such variable consideration.

Some of the arguments presented by IFRS IC members against and in favour of recognising a financial liability for variable consideration that depend on the purchaser's future activity.	
Arguments against recognising a financial liability	Arguments in favour of recognising a financial liability

[1] See for example, Agenda Paper 02A for the November 2015 IFRS IC meeting.

• IAS 37 by analogy – only recognise a liability that cannot be avoided. • IAS 32 guidance (see right side of table) is only related to the acquisition of financial assets.	• Not an executory contract as Entity B has delivered the recipe • IFRS 9 - Excluding some variable payments is not consistent with a fair value measurement • IAS 32 states that future revenues, net income or debt-to-equity ratio is beyond the control of both Entity A and Entity B. By analogy they argue that the issuer's future activity (or future performance) is also beyond the control of the issuer.

9 Some accordingly argue that when the variable payments are dependent on the purchaser's future activity the initial recognition criteria of a financial liability are not met until the activity requiring the payment is performed. Until then, the variable payments are avoidable. Proponents of this view, among other arguments, point to the guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. According to paragraph 19 of IAS 37 "[i]t is only those obligations arising from past events existing independently of an entity's future actions (ie the future conduct of its business) that are recognised as provisions".

10 An argument of those who consider that a financial liability exists even when the variable payment is dependent on the purchaser's future activity, is that the contract is not executory as the other party (in this case Entity B), has performed/delivered the asset. They also note that IFRS 9 *Financial Instruments* requires financial liabilities to be measured at fair value on initial recognition (plus or minus transaction costs in certain cases) and think that excluding some variable payments from the initial measurement of the financial liability is not consistent with a fair value measurement. They argue that a market participant would consider those variable payments when estimating the fair value of the liability to make variable payments.

11 IAS 32 *Financial Instruments: Presentation* states in 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".

12 Those who consider that a financial liability exists even when the variable payment is dependent on the purchaser's future activity notes that paragraph 25 of IAS 32 states: "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)."

13 They thus observe that future revenues, net income or debt-to-equity ratio is considered to be beyond the control of the issuer according to IAS 32 and they think by analogy that the issuer's future activity (or future performance) is also beyond the control of the issuer. As a result, variable payments that depend on the purchaser's future activity should be recognised as financial liabilities on the date of purchase of the asset.

14 On the other hand, those who do not consider that a financial liability exists, note that paragraph 25 of IAS 32 was the result of the incorporation of SIC-5 *Classification of Financial Instruments — Contingent Settlement Provisions* into the revised version of IAS 32 (2003). SIC-5 stated that financial instruments such as shares or bonds for which the manner of settlement depends on the outcome of uncertain future events that are beyond the control of both the issuer and the holder are financial liabilities. SIC-5 did not address the accounting for financial liabilities that are related to the acquisition of a non-financial asset.

15 The discussions of the IFRS IC took place before the revised *Conceptual Framework for Financial Reporting* was in place and also before IFRS 16 *Leases* had been issued. The (dissimilar) guidance included in the revised Conceptual Framework and IFRS 16 relevant for the issue appears from paragraph 22 below.

Should any subsequent adjustment of the liability be recognised in profit or loss or be capitalised as part of the cost of the recipe?

16 Although the IFRS IC might *tentatively* have reached consensus on when to reflect subsequent adjustments in the measurement of a liability to pay variable consideration (see paragraph 23(b) below), the discussions of the IFRS IC, and the fact that the IFRS IC discussed this topic for several years, shows that current guidance can lead to different conclusions.

17 In the initial example, it is assumed that any liability to be recognised by Entity A would be measured at amortised cost after the initial recognition at fair value. It follows from paragraph B5.4.6 of IFRS 9 that:

"If an entity revises its estimates of payments or receipts (excluding modifications in accordance with paragraph 5.4.3 and changes in estimates of expected credit losses), it shall adjust the gross carrying amount of the financial asset or amortised cost of a financial liability (or group of financial instruments) to reflect actual and revised estimated contractual cash flows. The entity recalculates the gross carrying amount of the financial asset or amortised cost of the financial liability as the present value of the estimated future contractual cash flows that are discounted at the financial instrument's original effective interest rate (or credit-adjusted effective interest rate for purchased or originated credit-impaired financial assets) or, when applicable, the revised effective interest rate calculated in accordance with paragraph 6.5.10. **The adjustment is recognised in profit or loss as income or expense**."

18 On the other hand, IFRIC 1 *Changes in Existing Decommissioning Restoration and Similar Liabilities* states in paragraph 5 that for assets accounted for under the cost model under IAS 16 *Property, Plant and Equipment*, **changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period**. In the Basis for Conclusions, it is noted 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". The same could, accordingly, be argued to apply for the cost of an intangible asset under IAS 38 *Intangible Assets*.

19 From the input collected by the EFRAG Secretariat and (and the staff of the IFRS IC) it follows that there are differences in practice in relation to whether changes in variable consideration is reflected in the cost of an acquired asset.

Possible accounting approaches

20 As there is no (clear) guidance (and (hence) diversity in practice) on the issues of:

(a) whether a financial liability exists for consideration that depends on the purchaser's future activity;

(b) whether subsequent adjustment of any liability should be recognised in profit or loss or be capitalised as part of the acquired asset.

the EFRAG Secretariat has examined what current guidance/interpretations entities could currently use to develop accounting policies on the topics. As mentioned above in paragraph 15, since the discussions of the IFRS IC, the Conceptual Framework has been updated and IFRS 16 has been issued, which could add some additional approaches to those considered by the IFRS IC.

21 For the initial example considered in paragraph 5 above, the EFRAG Secretariat has thus identified the following possible approaches for recognition of a liability and the subsequent adjustment of any liability, respectively to deal with the current issues (paragraph 61(a) issues) for the initial example (dealing with paragraph 61(b) issues would require additional considerations).

Recognition

22 For recognition, the EFRAG Secretariat has identified the following existing guidance that could be the most relevant to consider[2]:

(a) *A Conceptual Framework approach*. Under the Conceptual Framework for Financial Reporting, a liability is defined as a present obligation of the entity to transfer an economic resource as a result of past events. For a liability to exist, three criteria must all be satisfied:

(i) the entity has an obligation;

(ii) the obligation is to transfer an economic resource; and

(iii) the obligation is a present obligation that exists as a result of past events.

For the first criteria, the supporting guidance in the Conceptual Framework explains that an obligation is a duty or responsibility that an entity has no practical ability to avoid. In the initial example, Entity A has a practical ability to avoid transferring a consideration (i.e., not using the recipe), therefore the first criterion is not met. Accordingly, if a Conceptual Framework approach would be applied to the initial example, Entity A should **not recognise a liability** when it would receive the recipe.

(b) *An IFRS 9 all-included-in-fair-value approach.* As mentioned above, in paragraph 10–13, some consider that all types of variable consideration are required to be recognised under IFRS 9. Under this approach, Entity A should **recognise a liability** when it would receive the recipe.

(c) *An IFRS 16 Leases approach*. The IFRS IC project on variable payments for asset purchases and payments made by an operator to a grantor in a service concession arrangement was put on hold for some time to await the IASB's thinking on how to account for variable payments in leases. Some would therefore argue that IFRS 16 represents the latest thinking/the way forward for accounting for variable consideration. Under IFRS 16 only variable payments that are dependent on an index or a rate or are, in-substance fixed payments (but structured as variable payments), would be included in the initial measurement of the liability on the date of purchase of an asset. Other variable payments (such as those dependent on future activity of the purchaser) would not be included in the initial measurement of the liability on the date of purchase of the asset. Accordingly, in the initial example, **no**

[2] IFRS 15 Revenue from Contracts with Customers also considers variable consideration. It is also a relatively new standard and could thus be considered to reflect the latest thinking on the topic. However, IFRS 15 deals with the perspective of the seller and does thus not deal with the issue of whether/when a liability for variable consideration should be recognised by a purchaser, when the variable payments that are dependent on the purchaser's future activity. In addition, the requirements in IFRS 15 reflect feedback from users saying that subsequent downward adjustments in reported revenue are not helpful.

liability would be recognised when the recipe is transferred (or a liability would be measured at zero).

(d) *An IAS 37 approach*. As mentioned in paragraph 9 above, some use the guidance in IAS 37 to interpret whether a liability would exist under IFRS 9. It appears that under this approach, Entity A should **not recognise a liability** when it receives the recipe.

Subsequent adjustment of any liability

23 On the issue of whether the subsequent adjustment of a liability that would be recognised, should be recognised in profit or loss or reflected in the measurement of the acquired asset, the following approaches could be considered:

(a) *An IFRS 9 approach* under which the subsequent adjustment of a liability would be **recognised in profit or loss** (see paragraph 17 above).

(b) *An IFRIC 1 approach* under which the subsequent adjustment of a liability should be added to, or deducted from, the **cost of the related asset.** While IFRIC 1 was issued to deal with a specific circumstance[3], a general application of the interpretation would result in all changes in a liability being recognised in the cost of the related asset (although this might not have been the intention (see also paragraph 18 above)).

(c) *An IFRS IC tentative decision approach*[4] under which (for liabilities that are not floating rate liabilities):

(i) adjustments of the financial liability resulting from the amortisation of the financial liability (using the original effective interest rate) correspond to an interest expense that is recognised in profit or loss;

(ii) adjustments of the financial liability that result from the revision of the estimates of payments that were included in the initial measurement of the financial liability should be recognised as an adjustment to the cost of the corresponding asset; and

(iii) adjustments of the financial liability that result from the recognition of variable payments that were excluded from the initial measurement of the financial liability should be recognised as corresponding adjustments to the cost of the asset, to the extent that those payments are associated with future economic benefits to be derived from the asset.

The IFRS IC tentative decision approach may be consistent with IFRIC 1 – but applicable to additional circumstances than IFRIC 1. However, as the IFRIC 1 approach in this paper is used for an approach under which the adjustment of a liability is always reflected in the cost of the related asset, the more nuanced IFRS IC tentative decision approach is considered as a separate approach. For the initial example, the EFRAG Secretariat considers that this approach would mean that the subsequent adjustment of the liability should **adjust the measurement of the recipe (the intangible asset)**. To the extent that a liability is not recognised when the recipe is transferred, the adjustment of the financial liability can only be recognised to the extent the additional payments are associated with future economic benefits to be derived from the asset. In the initial example, this is, however, considered to

[3] The scope of IFRIC 1 is limited to changes in the measurement of any existing decommissioning, restoration or similar liability that is both: (a) recognised as part of the cost of an item of property, plant and equipment in accordance with IAS 16 or as part of the cost of a right-of-use asset in accordance with IFRS 16; and (b) recognised as a liability in accordance with IAS 37.

[4] See, for example, paragraph 2 of Agenda Paper 02B for the November 2015 IFRS IC meeting.

be the case as the payment is related to being able to use the asset and thus increase revenue by CU 5 000 per year.

(d) *An IFRS 3 approach* under which it is necessary to distinguish between:

(i) Changes resulting from additional information that the acquirer obtains after the date of the acquisition about facts and circumstances that existed at the acquisition date. For a period not exceeding one year from the acquisition date, such changes shall retrospectively adjust the amounts recognised at the acquisition date to reflect the new information obtained.

(ii) Changes resulting from events after the acquisition date (such as meeting an earnings target or reaching a milestone on a research and development project). Such changes shall be reflected in profit or loss (unless the contingent consideration is classified as equity – in which case the subsequent settlement shall be accounted for within equity).

For the initial example, the EFRAG Secretariat considers that this approach would mean that subsequent changes in the measurement of the liability would be recognised in **profit or loss** (including if Entity A would start using the recipe).

Questions for EFRAG TEG

Is there an issue?

24 Does EFRAG TEG agree that there could be valid different interpretations on how to account for the initial example presented in paragraph 5 in relation to whether Entity A should recognise a liability when it receives the recipe and whether subsequent changes in the liability should be reflected in the cost of the recipe if a liability is recognised when the recipe is received by Entity A?

25 Does EFRAG TEG consider that there would be other accounting issues related to variable consideration due to lack of (clear) guidance for the initial example presented in paragraph 5 than the issues listed in paragraph 7?

Approaches to deal with the issues

26 Does EFRAG TEG agree with the analysis of the EFRAG Secretariat on how the possible accounting approaches for recognition and the subsequent adjustment of any liability (paragraphs 22 and 23) would affect how the initial example presented in paragraph 5 would be accounted for?

When considering approaches to deal with lack of (clear) guidance in paragraphs 22 and 23, the EFRAG Secretariat has only considered current guidance that could be used (that is, approaches that could be used following the IAS 8 hierarchy of guidance to select an accounting policy or by interpreting current Standards). At a past EFRAG TEG meeting, the view was expressed that when consulting on how to account for variable consideration, there should be room to consider alternatives to existing guidance. In this regard it was noted that in relation to recognition the most useful information would reflect what the entity expected to do *('Based on what the entity expects to do approach')*. This approach may be similar to the approach suggested in the Exposure Draft *Lease Liability in a Sale and Leaseback.* For the initial example, such an approach would mean that a liability would be recognised as Entity A expects to use the recipe.

27 Does EFRAG TEG consider that the 'Based on what the entity expects to do approach' should also be considered and/or would there be other approaches that should also be considered when accounting for the initial example?

28 The EFRAG Secretariat assesses that the approaches listed in in paragraphs 22 and 23 (and also the 'Based on what the entity expects to do approach') would

provide sufficient guidance on how to account for the variable consideration in the initial example. Does EFRAG TEG agree?

Modifications

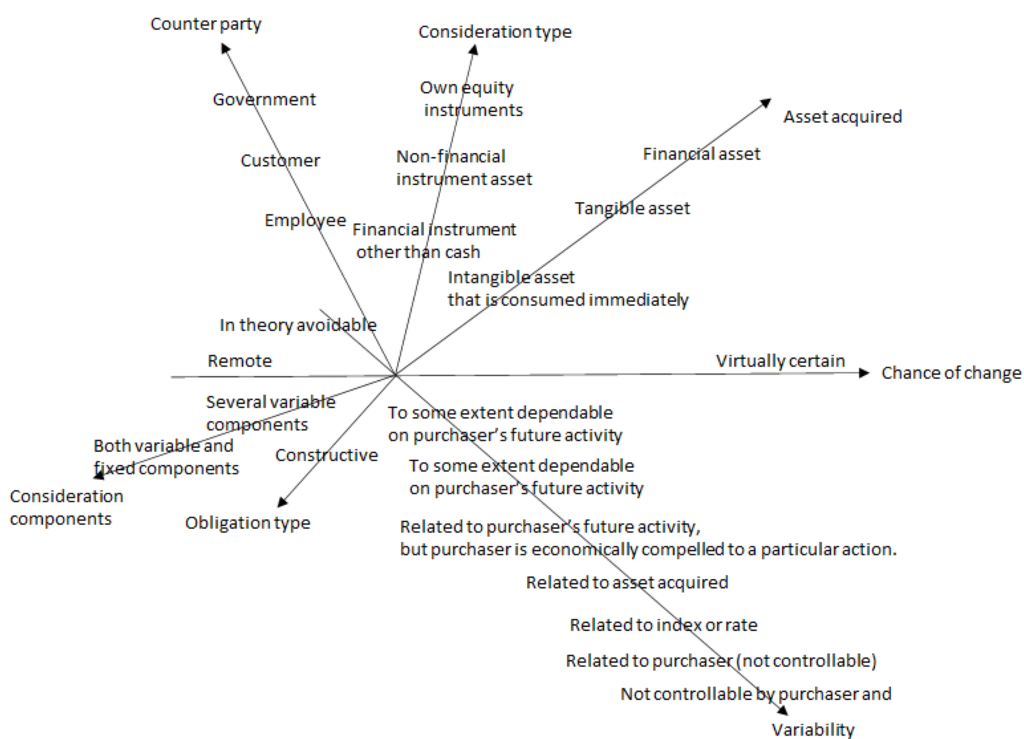
29 The following subsections will consider how modifications to the initial example presented in paragraph 5 could affect:

(a) The identification of issues with variable consideration (that is, the issues listed in paragraph 7);

(b) The outcome of applying and the effectiveness (that is, whether the approaches would remove diversity in practice) of the approaches listed in paragraphs 22 and 23;

(c) Possible approaches to consider for accounting for variable consideration.

30 A long list of possible modifications to the initial example could be considered. The figure below illustrates some of the parameters that could be changed (the categories on the axes corresponds to the categories of the box next to paragraph 5 above) and the following subsections consider a limited number of modifications (other modifications are expected to be considered at a subsequent meeting of EFRAG TEG).



Modification 1 (variability based on sales)

Asset acquired: Intangible asset (outside business combination)

Consideration: Cash

Counter party: Third party

Variability: Based on sales of Entity A (that is, to some extent dependable on purchaser's future activity)

Partly fixed consideration: No

Change in consideration: Increase only

Chance of additional consideration: More likely than not

Obligation type: Legal.

31 The first modification to be considered is if the consideration for the recipe would not depend on whether or not the entity would use the recipe but on the sales that Entity A makes.

32 In the modified example, the consideration to be paid to Entity B is thus CU 1 per jar of chocolate paste that Entity A will sell above a threshold 10 000 jars over the next five years. That is, if Entity A will sell 50 000 jars over the next five years, it will have to pay Entity B CU 40 000. Last year, Entity A sold around 20 000 jars.

33 The EFRAG Secretariat considers that in principle the arguments for and against recognising a liability for the consideration when the recipe is transferred would be similar to the arguments presented in relation to the initial example above. However, the EFRAG Secretariat would expect that some of those who would not recognise a liability in the initial example when the recipe is transferred might want to do so under Modification 1. This is because under Modification 1, it may seem less avoidable for Entity A not to pay any consideration to Entity B unless it would reduce it sale of chocolate paste significantly (which could have significant economic impact). The EFRAG Secretariat notes that when the IFRS IC considered the issue, the distinction was between variable consideration that depended on the purchaser's future activity and variable consideration that was not dependent on the purchaser's future activity. However, some of the arguments presented for not recognising a liability for variable consideration that depends on the purchaser's future activity related to whether the purchaser could avoid making the payment (through its future activity) and not so much on the future activity. In the initial example, whether the focus was on purchaser's future activity or the possibility to avoid the payment (through its future activity) did not matter. However, under Modification 1 it may.

34 The EFRAG Secretariat considers that the possible solutions identified in paragraphs 22 and 23 could be considered under Modification 1. Under the proposed Conceptual Framework approach suggested in paragraph 22(a), it could, however, be questioned whether a liability should be recognised when Entity A receives the recipe. As indicated above, the question is whether it is practically unavoidable for the entity to sell below 10 000 jars of chocolate paste over the next five years. On the one hand this will depend on fact and circumstances. On the other hand, in order for the Conceptual Framework approach to remove divergence in practice on this issue, additional guidance may be necessary on when something is unavoidable. Under the Conceptual Framework approach, there may also be differing views on whether the relevant 'past event' to consider is the transfer of the recipe or when Entity A sells jar 10 001 of chocolate paste.

35 Under the Conceptual Framework approach, it may also be necessary to specify whether the liability to be recognised when the recipe is transferred should be based on the 'unavoidable' numbers of jars to be sold or on the expected number of jars to be sold (or something else).

36 In relation to how to account for subsequent changes in a liability, Modification 1 illustrates the difference between the IFRIC 1 approach and the IFRS IC tentative decision approach. If a liability for the expected variable payment is recognised

when the recipe is transferred, both approaches would result in subsequent changes in that liability to be reflected in the measurement of the recipe. However, if a liability is not recognised at the transfer, the subsequent changes would be accounted for differently. Under the IFRIC 1 approach each additional sale of a jar of chocolate paste would increase the carrying amount of the recipe. Under the IFRS IC tentative decision approach, these costs would be recognised in profit or loss (as the payments are not associated with future economic benefits to be derived from the asset (but instead related to past benefits derived from the asset)).

37 The EFRAG Secretariat does not consider that the outcome for any of the other approaches mentioned in paragraphs would change as a result of Modification 1. The EFRAG Secretariat does also not consider that Modification 1 would result in any additional issues in relation to how to account for subsequent adjustments in any liability or in relation to the possible solutions identified in paragraph 23.

Questions for EFRAG TEG

38 Does EFRAG TEG agree with the assessment of the EFRAG Secretariat as explained in paragraphs 33 - 36 in relation to Modification 1, that is:

(a) Although there may be divergence in practice relating to the recognition of a liability to all types of variable consideration (in a non-executory contract) that would depend on an entity's future activity, it should be further considered whether there is only lack of (clear) guidance in relation to the variable consideration that to some extent are avoidable.

(b) In order for the Conceptual Framework approach to be able to reduce divergence in practice in relation to the recognition of a liability that depends on the entity's future actions, it would be necessary to provide guidance on:

(i) When an entity has a practical ability to avoid transferring a consideration;

(ii) What would be the relevant past event in relation to variable consideration that depends on the entity's future activity;

(iii) Whether any liability that would be recognised should be based on the amount Entity A consider it is not practically possible to avoid or on, for example, the expected amount Entity A expects to transfer.

(c) Apart from the issues above, Modification 1 does not result in:

(i) Additional issues relating to variable consideration being identified (compared to the initial example);

(ii) Additional proposals for how to account for variable consideration. (The EFRAG Secretariat notes that outreach performed by the IFRS IC staff showed that in the pharmaceutical sector most types of variable payments that depend on the purchaser's future activities are not recognised as liabilities until the future action has occurred (which would result in the same outcome as, for example, the IAS 37 approach). However, sales-based milestone payments are typically recognised when it is *highly-probable* that the threshold will be met[5]. An approach resulting in this outcome is not among the proposals listed in paragraph 22. Accordingly, EFRAG TEG should notify the EFRAG Secretariat if it wants such an approach to be included as a possible solution.)

[5] See, for example, paragraph 29 of Agenda Paper 06A for the September 2015 IFRS IC meeting

(iii) Changes in the assessment of the effectiveness of the proposals for how to account for variable consideration for removing divergence in practice resulting from the lack of (clear) guidance.

Modification 2 (inclusion of a fixed consideration)

Asset acquired: Intangible asset (outside business combination)
Consideration: Cash
Counter party: Third party
Variability: Whether or not the entity will use the asset (that is, purchaser's future activity)
Partly fixed consideration: Yes
Change in consideration: Increase only
Chance of additional consideration: More likely than not
Obligation type: Legal.

39 The second modification to be considered is if Entity A, in addition to the conditional consideration (as per the base-case example), would have to pay a fixed consideration to receive the recipe. So, Entity A will have to pay Entity B CU 5 000 when it receives the recipe and additional CU 10 000 if it starts using the recipe.

40 During the outreach to audit firms performed as part of this project, it appeared that *if* the fixed consideration and the variable consideration are not considered separately (that is, as a separate units of account), there would be no issues in relation to recognition, as a financial liability would then be recognised for the (entire) consideration to be transferred. The variability would be reflected in the measurement. However, if the variable consideration should be considered separately from the fixed payment, there would be differing views on whether a financial liability should be recognised for the variable payment (as noted in relation to the initial example).

41 For the subsequent adjustments, Modification 2 would not result in any changes in the outcome of the various approaches considered. However, if Modification 2 had been applied on top of Modification 1 (that is the entity would have to pay CU 5 000 when receiving the recipe and then CU 1 per jar of chocolate paste it would sell above a threshold 10 000 jars over the next five years), there would be a change if the variable component would not be considered separately. Under the IFRS IC approach, the changes should then, in all cases, be included in the carrying amount of the recipe (which would then, from the day it would be recognised, also include the (expected) variable payment).

42 As the outcome of the example about could change depending on whether the variable component is considered separately or not, the suggested approaches listed in paragraphs 22 and 23 would only be effective in addressing the issues identified in paragraph 20 above if guidance on whether variable consideration should be considered separately is provided (that is guidance on the unit of account should be provided)

Questions for EFRAG TEG

43 Does EFRAG TEG consider that Modification 2 results in additional accounting issues related to variable consideration being identified?

44 Does EFRAG TEG consider that Modification 2 results in additional proposals (than those listed in paragraphs 22 and 23 (and any additional proposals identified when considering the previous examples)) for how to account for variable consideration should be considered?

45 Does EFRAG TEG agree with the analysis of the EFRAG Secretariat on the outcome of applying the approaches listed in paragraphs 22 and 23 to Modification 2?

46 Does EFRAG TEG agree that in order for the proposals listed in paragraphs 22 and 23 to be effective in reducing divergence in practice, it would be necessary to provide guidance on whether variable consideration should be considered separately (that is, the unit of account)?

47 Are there other issues related to Modification 2, EFRAG TEG considers is necessary to address in order for the suggested approaches to be effective in reducing divergence in practice?

Modification 3 (variability based on quality of asset)

Asset acquired: Intangible asset (outside business combination)

Consideration: Cash

Counter party: Third party

Variability: Based on quality of asset

Partly fixed consideration: No

Change in consideration: Increase only

Chance of additional consideration: Not likely

Obligation type: Legal.

48 The third modification to be considered is if the consideration for the recipe would not depend on whether or not the entity would use the recipe but on whether the recipe in fact works.

49 In the modified example, Entity A will have to pay Entity B CU 10 000 if the recipe will actually work. The recipe is transferred before it is known whether it will work.

50 Under Modification 3, the EFRAG Secretariat notes that IFRS IC, when discussion variable consideration, only had differing views on whether a liability would exist when the variability depended on the purchaser's future activity. Accordingly, the EFRAG Secretariat has not identified any accounting issues in relation to recognition under Modification 3. It is thus considered that a liability should be recognised in accordance with IFRS 9. The initial measurement would reflect the likelihood that the recipe will work. The approaches listed in paragraph 22 would therefore not be necessary under Modification 3. The EFRAG Secretariat, however, notes that the IFRS 16 approach would result in a different outcome (under that approach no liability would be recognised when the recipe is transferred)[6].

51 The EFRAG Secretariat considers that the issues in relation to the subsequent adjustment of any liability would be similar to the issues identified for the initial example and that the possible solutions identified in paragraph 23 would also work under Modification 3. The EFRAG Secretariat, however, notes that, unlike under the initial example, under Modification 3, subsequent adjustments would be reflected in the measurement of the recipe under the IFRS 3 approach (if the adjustment happens within one year). This is because whether or not the recipe works would be a fact that existed at the acquisition date.

Questions for EFRAG TEG

52 Does EFRAG TEG agree that under Modification 3, a financial liability should be recognised when the entity receives the recipe (see paragraph 50 above)?

53 Does EFRAG TEG agree that the issues in relation to the subsequent adjustment of any liability would be similar to the issues identified for the initial example (see paragraph 51 above)?

54 Are there other issues related to Modification 3, EFRAG TEG considers is necessary to address in order for the suggested approaches to be effective in reducing divergence in practice?

[6] As previously mentioned, some IASB members supported the approach of IFRS 16 for practical reasons.

Modification 4 (consideration in Bitcoin)

> Asset acquired: Intangible asset (outside business combination)
>
> Consideration: Bitcoins
>
> Counter party: Third party
>
> Variability: Whether or not the entity will use the asset (that is, purchaser's future activity)
>
> Partly fixed consideration: No
>
> Change in consideration: Increase only
>
> Chance of additional consideration: More likely than not
>
> Obligation type: Legal.

55 Under the fourth modification, the consideration should not be paid in cash, but in Bitcoins. That is, the entity will have to pay 10 Bitcoins if it starts using the recipe.

56 It is assumed under Modification 4 that a liability to transfer Bitcoins would be accounted for in accordance with IAS 37.

57 It follows from the interpretation of IAS 37 in IFRIC 21 *Levies* that a liability for the variable consideration should not be recognised when the recipe is transferred to Entity A, as it is avoidable to pay the consideration. For Modification 4 it would therefore not be necessary to consider the approaches mentioned in paragraph 22. However, both the Conceptual Framework approach, the *IFRS 9 all-included-in-fair-value approach* and the based-on-what-the-entity-expects-to-do approach would not be consistent with the IFRIC 21 outcome.

58 The EFRAG Secretariat considers that similar issues as in the initial example arises for Modification 4 in relation to subsequent adjustments. In principle also the approaches mentioned in paragraph 23 could be considered. However, as the liability would not be covered by IFRS 9, it may be less obvious to apply this approach than under the initial example. The outcome of applying the approaches mentioned in paragraph 23 would be similar to the initial example in the case no liability would be recognised under the initial example when the recipe is transferred.

> **Questions for EFRAG TEG**
>
> 59 Does EFRAG TEG agrees that if the liability related to transfer variable consideration falls under IAS 37, the current guidance is clear in relation to whether that liability should be recognised or not?
>
> 60 Does EFRAG TEG consider that Modification 4 gives rise to other comments?

Forthcoming project discussions

61 The drafted discussion paper considered at the April 2021 EFRAG TEG meeting considered both:

(a) Current issues/divergence in practice on how to account for variable consideration;

(b) Differences between requirements in current Standards which could result in similar transactions being accounted for differently.

62 Following a recommendation made by the IASB member observing the April 2021 EFRAG TEG meeting, EFRAG TEG could consider whether the discussion paper, to be most useful for the IASB, should focus on the areas where guidance is currently missing or also should focus on having similar transactions being accounted for similarly. Previously, the EFRAG User Panel has expressed a preference for both considering (a) and (b). Similarly, EFRAG in response to the IASB Exposure Draft resulting in IFRS 16 *Leases* noted:

"The issue of variable payments is surfacing in other projects; for instance contingent consideration is addressed in the revenue recognition project and the IFRS Interpretation Committee is currently discussing contingent payments on the

acquisition of tangible and intangible assets. We recommend that the IASB should reach consistent conclusions on the treatment of contingent and variable payments across different projects."

63 However, **the EFRAG Secretariat suggests that the forthcoming project discussions first focus on current issues/divergence in practice, that is (a) in paragraph 3. EFRAG TEG can then, at a later stage, consider whether also to include (b) in the discussion paper.**

Scope of the discussion paper

64 Despite the initial limitation described above in paragraph 63, the scope of the project is unchanged regarding:

(a) The focus is limited to transactions in which one party acquires an identified good or a service in exchange for a (partly) variable consideration.

(b) The focus is on the accounting issues from the perspective of the entity that will have to pay a variable consideration in exchange for a non-financial good or service.

(c) The discussion paper is not limited to variable consideration (to be) paid in cash. It thus also covers situations under which an entity will have to transfer another (non-cash) type of asset(s) or economic benefits – including providing a service – in the exchange.

(d) The discussions on how to measure a good or service acquired for variable consideration only applies to goods and services that are measured at cost initially and subsequently.

(e) The discussion paper only considers transactions that are carried out on market terms.

(f) Variable consideration related to the acquisition of a business is outside the scope of the discussion paper. This is because of the special issue of allocating changes in variable consideration to the assets acquired. However, some of the guidance included in IFRS 3 is considered when developing proposals and alternatives for how to account for variable consideration.

(g) The discussion paper considers that a consideration is variable when the acquirer of a good or service may have to transfer additional assets in exchange for the good or service.

65 In addition, the purpose of the Discussion Paper is not to present one single suggestion for how to account for variable consideration, but to examine different alternatives.

Question for EFRAG TEG

66 Does EFRAG TEG agree with the proposed approach for EFRAG's forthcoming discussions as stated in paragraph 63 above?

Next session

67 For the next session on variable consideration, the EFRAG Secretariat plans to discuss additional examples, any additional approaches identified by EFRAG TEG to be considered and issues with the approaches suggested in this issues paper that are identified by EFRAG TEG (for example, if more guidance is needed in relation to one of the suggested approaches in order for that approach to be effective in reducing divergence in practice (at the April 2021 TEG meeting it was, for example, noted that it should be discussed what 'practical ability to avoid' would mean)).

Question for EFRAG TEG

68 Does EFRAG TEG have any suggestions on examples to consider at future sessions that would be within the scope of the project and could be useful for the objectives stated in paragraph 1 above.