

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## **Variable consideration Cover Note**

### **Objective**

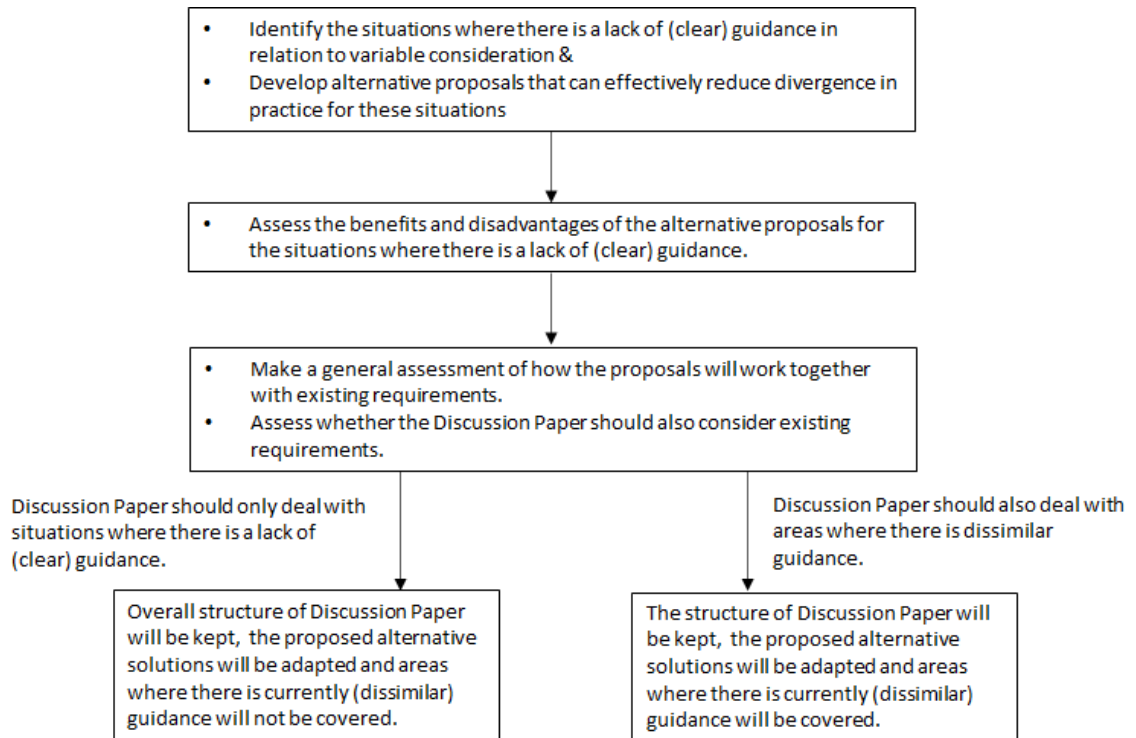
- 1 The objectives of this session are to:
  - (a) Consider the remaining issues of the issues paper presented at the July 2021 EFRAG TEG meeting, that EFRAG TEG was not able to discuss at that meeting:
    - (i) Discuss whether the next discussion(s) of EFRAG TEG on variable consideration should focus on areas where divergence in practice has arisen as a result of lack of (clear) guidance;
    - (ii) Discuss some simple examples of variable consideration where (clear) guidance may currently be lacking in order to:
      - Identify where guidance is needed;
      - Consider possible guidance to fill the gap;
      - Assess whether the possible guidance will be effective in providing guidance to reduce divergence in practice.
  - (b) Consider approaches to the two issues related to variable consideration that currently seems to cause the most problems in practice (/resulting in divergence in practice):
    - (i) When a purchaser has a liability related to variable consideration when the variability depends on the purchaser's future actions;
    - (ii) Whether/when changes in estimates of variable consideration should subsequently be reflected in the measurement of a tangible or intangible asset measured in accordance with the cost model in either IAS 16 or IAS 38.
- 2 The input from the session will be used to plan the next EFRAG TEG sessions on variable consideration and to advance on the drafting of the Discussion Paper.
- 3 The discussion on the objective mentioned in paragraph 1(a) will start where the discussion ended at the July 2021 meeting. EFRAG TEG members will first be asked whether they have any additional comments to 'Modification 1' to 'Modification 4' (paragraphs 29 – 50 of Agenda paper 06-04). (The comments made at the July 2021 EFRAG TEG meeting are summarised below in paragraph 15). Following that discussion EFRAG TEG will consider the scope of the next debates of EFRAG TEG on variable consideration (paragraphs 61-66 of Agenda paper 06-04).

- 4 Although EFRAG TEG at the session will be asked for directions on the next discussions, it will not be asked to make decisions about changes to the scope of EFRAG's Discussion Paper. Such a discussion is only envisaged at a later stage.
- 5 The discussion on the objective mentioned in paragraph 1(b)(i) will focus on an approach to recognise a liability based on guidance in the *Conceptual Framework for Financial Reporting* (the 'Conceptual Framework'). EFRAG's Discussion Paper on variable consideration will include various approaches that could be applied for determining when a purchaser should recognise a liability to pay variable consideration that depends on the purchaser's future actions. One of these approaches will be based on the guidance included in the Conceptual Framework. However, as the Conceptual Framework does not include explicit guidance on variable consideration, EFRAG TEG will have to agree on a (possible) interpretation of the Conceptual Framework to be presented in EFRAG's Discussion Paper. At the July 2021 EFRAG TEG meeting, it was suggested that the guidance on liabilities in the Conceptual Framework – particular the guidance on 'no practical ability to avoid' and 'as a result of a past event' should be discussed by EFRAG TEG.
- 6 The discussion on the objective mentioned in paragraph 1(b)(ii) will focus on what 'cost' means in existing IFRS literature. At the July 2021 EFRAG TEG meeting, it was suggested to discuss this guidance. The guidance – if interpreted consistently – could provide directions on when the measurement of an asset acquired for variable consideration, that is measured under a cost model, should be updated to reflect changes in the estimate of variable consideration that will have to be paid in exchange for the asset.

#### Next steps

- 7 Based on the discussions at the July 2021 EFRAG TEG meeting, the EFRAG Secretariat has noted that at EFRAG TEG at a forthcoming meeting should discuss whether the following approaches should be added to the section in the Discussion Paper considering when a purchaser should recognise a liability for variable consideration:
  - (a) An approach based on IFRS 15 *Revenue from Contracts with Customers*; and
  - (b) An approach where the purchaser might recognise an equity component before a liability is recognised.
- 8 The EFRAG Secretariat will also prepare a paper on whether EFRAG should do some follow-up research on risk-sharing and collaborative arrangements. The description of the IASB's project on variable consideration includes such a consideration once the IASB has considered the topic. In that regard, the EFRAG Secretariat notes that some members of the IFRS Interpretations Committee have considered that an contracts with variable consideration include a separate risk-sharing component (
- 9 Should EFRAG TEG, when discussing Agenda paper 06-04, agree to focus the next discussions on areas where divergence has arisen as a result of lack of (clear) guidance, the next steps of the project could be as illustrated in the flow chart below. It is worth noting that the flow chart does not illustrate the decision to be taken at the September 2021 EFRAG TEG meeting, but does only illustrate the suggested further process, should EFRAG TEG agree that the next discussion(s) should focus on areas where divergence in practice has arisen. In case EFRAG TEG would decide not to focus the next discussion(s) on areas where divergence in practice has arisen, the EFRAG Secretariat will also prepare discussions on how to account for variable consideration in a consistent manner in areas where (clear) guidance already exists.

## Variable consideration – Cover Note



- 10 As it appears from the flow chart, discussions of situations where there is currently a lack of (clear) guidance is assessed to be helpful for “fine-tuning” and assessing advantages and disadvantages of approaches to account for variable consideration also in the case where EFRAG’s Discussion Paper will deal with areas of dissimilar guidance.

### Background

- 11 Following the public EFRAG 2018 Research Agenda consultation, EFRAG added a project on variable and contingent consideration to its research agenda (since renamed variable consideration). The original objectives of the project were to:
- Identify the accounting issues around variable consideration;
  - Outline the information needs of users of financial statements in regard to variable consideration based on the objectives of general purpose financial reporting as stated in the IASB’s revised Conceptual Framework for Financial Reporting and after consultation with the EFRAG User Panel;
  - Compare the guidance across different IFRS Standards and assess the rationale (or lack thereof) for any differences in the requirements;
  - Develop alternative accounting approaches and illustrate their strengths and limitations; and
  - Consider potential improvements in presentation and disclosure.
- 12 Since 2019, EFRAG TEG and the EFRAG Board discussed the issues to be considered in the research at several meetings. The EFRAG User Panel has also been consulted on the project. The project only considers variable consideration from the perspective of the party that has to transfer variable consideration in exchange for an asset, i.e., the ‘buyer/acquirer’ perspective.
- 13 During some of its first discussions, EFRAG TEG agreed to consider consideration to be variable when the acquirer of a good or service may have to transfer additional assets in exchange for the good or service. It was also agreed not to focus the discussion on identifying the goods or services acquired for variable consideration are. Such a discussion was included in a draft discussion paper prepared by the FRC that EFRAG TEG has previously considered. The starting point of the

## *Variable consideration – Cover Note*

Discussion Paper is therefore that it has been identified that a good or service has been acquired for a consideration that is variable.

- 14 Based on comments received at its April 2021, EFRAG TEG discussed at its July 2021 meeting some examples involving variable consideration in order to:
- (a) Ensuring that the Discussion Paper identifies as precisely/specific as possible the current accounting issues with variable consideration;
  - (b) Presenting possible solutions that could address these accounting issues;
  - (c) Ensuring that the relevant factors that can affect either the accounting issues or the possible solutions are identified.
- 15 At its July 2021 meeting, EFRAG TEG did not discuss all the examples provided, but the following conclusions and comments were made:
- (a) It was confirmed that there were different interpretations on how to account for variable consideration that was within the control of the purchaser.
  - (b) It should be considered whether in some examples the acquirer would have an equity component that would then become a liability when the entity would start using the intangible asset. In that case, the liability would not be included in the cost of the asset as the debit would go to equity.
  - (c) The notion of 'cost' in IFRS should be considered.
  - (d) The view was expressed that the Discussion Paper should not consider an approach based on what the entity expects to do, as such an approach would not be compatible with the Conceptual Framework.
  - (e) It should be further considered whether the Conceptual Framework could provide guidance on when to recognise a liability. In this regard it should be considered what 'no practical ability to avoid' in the Conceptual Framework could mean in the case where an asset had been acquired, but an additional consideration had to be paid to use the asset. The view was presented that in such a case, the entity would not have a practical ability to avoid (unless the entity did not intend to use the asset – e.g. because it would just keep competitors from using it). It should also be considered what should be 'the past event': the transfer of the asset or the future action (or both). In this regard the IASB's conclusions on the regulatory asset and liability project could be considered. In this project, it seemed that the IASB considered that if you had two possible 'past events' it was the first event that should be taken into account.
  - (f) It should be considered whether the manner the purchaser of an asset for variable consideration should account for the transaction could be based on how the seller would account for it.
  - (g) It should be considered whether IFRS 16 *Leases* would be a good candidate as its requirements on variable consideration were not based on conceptual arguments.
  - (h) If the variability was outside the control of the purchaser, the view was expressed that a liability should be recognised.
  - (i) It should be kept in mind that although no liability would be recognised, there could still be direct costs related to acquiring an asset, that should be capitalised.

### **Agenda papers**

- 16 In addition to this cover note, agenda papers for this session are:

*Variable consideration – Cover Note*

- (a) Agenda paper 06-02 – *Identifying issues with variable consideration from examples. This paper is unchanged from Agenda paper 11-02 uploaded for the 15-16 July 2021 EFRAG TEG meeting.*
- (b) Agenda paper 06-03 – *Conceptual Framework guidance on when the definition of a liability is met* (Issues Paper); and
- (c) Agenda paper 06-04 – *What does ‘cost’ mean?* (Issues Paper);