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DISCUSSION PAPER

ACCOUNTING FOR VARIABLE CONSIDERATION

[MONTH AND YEAR OF PUBLICATION]

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While EFRAG is encouraging debate on the issues presented in the paper, it does not express an opinion on those matters at this stage.

Copies of the Discussion Paper are available from the EFRAG website. A limited number of copies of the Discussion Paper will also be made available in printed form, and can be obtained from EFRAG.

EFRAG welcomes comments on its proposals via the 'Questions to Constituents' at the end of each section. Such comments should be submitted through the EFRAG website by clicking [*here-insert hyperlink*] or should be sent by post to:

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Comments should arrive no later than [Comment Deadline Date]. EFRAG will place all comments received on the public record unless confidentiality is requested.

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This paper is part of EFRAG's research work. EFRAG aims to influence future standard-setting developments by engaging with European and international constituents and providing timely and effective input to early phases of the IASB's work. Four strategic aims underpin proactive work:

- engaging with European constituents to understand their issues and how financial reporting affects them;
- influencing the development of International Financial Reporting Standards ('IFRS Standards'), including through engaging with international constituents;
- providing thought leadership in developing the principles and practices that underpin financial reporting; and
- promoting solutions that improve the quality of information, are practical, and enhance transparency and accountability.

More detailed information about our research work and current projects is available on EFRAG's website.

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Executive Summary

ES1 [TO BE INCLUDED]

QUESTIONS TO CONSTITUENTS

[To be included]

Note to EFRAG TEG members

Chapter 1 is based on the assumption, that the Discussion Paper will only include three chapters. Should EFRAG TEG decide to include additional chapters (for example, Chapter 4 suggested in Paper 06-03) Chapter 1 will be amended to reflect the extended scope.

In many transactions, the consideration to be paid is not a fixed amount. Instead the amount to be paid — in cash or by transferring a non-cash asset — can be variable and can depend on various factors.

There is currently divergence in practice in relation to how to account for some types of variable consideration. The divergence in practice relates to:

- *When the purchaser should recognise a liability in relation to variable consideration that depends on the purchaser's future activities and has to be settled by transferring a financial instrument (most often cash); and*
- *Whether changes in the estimate of variable consideration should be reflected in the cost of the acquired asset recognised in the statement of financial position of the purchaser.*

This Discussion Paper explores the above areas where divergence in practice exists and examines the consequences, benefits and disadvantages of various approaches to accounting for variable consideration.

What are the accounting issues with variable consideration?

1.1 Variable consideration can be introduced for many different purposes. For example:

a) When the quality or value for the purchaser of a transferred asset, is unknown at the date of the transaction. An example would be where the price of a football player depends on the number of matches he/she will play for the buyer's team.

b) When a seller wants to stimulate sales and therefore offers a discount on all items purchased in a period if the number of items purchased exceed a given amount before the end of the period.

c) When either the purchaser or seller of a good or service wants or is obliged to bear certain risks related to the other party. For example, when an employer offers an employee a defined benefit pension scheme or a bonus that depends on the profit the employer generates in a period.

d) When one party wants to retain some of the risks and rewards related to a good sold. For example, when a seller cannot afford to maintain and/or develop the good, he/she can transfer the good to another party in return for a consideration that will depend on the performance of the good transferred (or the further developed goods). Another example can be when a seller wants to retain some risks and rewards related to the price development on properties by selling a property at a fixed price plus a variable part that will depend on the future market prices of properties.

1.2 The motivation for this Discussion Paper arises because current IFRS guidance on accounting for variable consideration is either interpreted differently, or is considered inconsistent, or is lacking clear guidance for how a purchaser of a good or service should account for:

a) A liability related to a possible future cash consideration a purchaser will have to pay to the seller in exchange for a transferred good or service ('the liability issue'). The main issue here is that current IFRS guidance (IAS 32 *Financial Instruments: Presentation*) is interpreted differently. Possible interpretations range from considering a commitment to pay variable consideration in cash that depends on the purchaser's future activities generally being a financial liability to considering it not being a liability. Furthermore, some may even interpret a commitment to pay variable consideration that depends on the purchaser's future activities as being an equity instrument.

b) An asset acquired for variable consideration: The issue is whether the cost of an acquired asset that is held by the purchaser should be updated to reflect changes in the estimate of variable consideration ('the measurement of the acquired good or service issue'). This issue can arise when the asset is acquired in exchange for either cash (or another financial instrument) or a non-financial asset – including if the purchaser will have to perform a service as part of the same purchase agreement. This issue arises as some guidance on liabilities (e.g., IFRS 9 *Financial Instruments*) would, require changes in the estimate of future outflows of a liability being recognised in profit or loss, while other guidance as an adjustment of the carrying amount of assets. For example, IFRIC 1 *Changes in Existing Decommissioning Restoration and Similar Liabilities* requires the cost of a related asset to be adjusted to reflect changes in a (decommissioning, restoration and similar) liability.

1.3 These two issues have arisen in past discussions of the IFRS Interpretations Committee[1] and are further explained in Chapters 2 ('the liability issue) and 3 ('the updating the measurement issue') of this Discussion Paper.

1.4 In addition to the above noted issues on the liability and measurement of the acquired good or service, guidance in different IFRS standards on how to account for variable consideration is different (as also illustrated in the issue described in paragraph 1.2b) above). The different guidance is summarised in the following Chapters below.

Objective and scope of this Discussion Paper

1.5 The objective of this Discussion Paper is to explore various approaches to possible guidance on the areas mentioned in paragraph 1.1 where there is currently divergence in practice. The Discussion Paper considers the benefits and disadvantages of the approaches explored.

[1] See, for example, IFRIC Update January 2011 (contingent pricing of PPE and intangible assets); IFRIC Update March 2011 (contingent pricing of PPE and intangible assets); IFRIC Update May 2011 (contingent pricing of PPE and intangible assets); IFRIC Update March 2012 (variable concession fees); IFRIC Update May 2012 (contingent pricing of PPE and intangible assets); IFRIC Update September 2012 (contingent pricing of PPE and intangible assets); IFRIC Update November 2012 (contingent pricing of PPE and intangible assets/variable concession fees); IFRIC Update January 2013 (contingent pricing of PPE and intangible assets/variable concession fees); IFRIC Update March 2013 (variable payments for PPE and intangible assets); IFRIC Update May 2014 (benefit plans with a guaranteed return); IFRIC Update September 2015 (variable payments for PPE and intangible assets and variable concession fees); IFRIC Update November 2015 (variable payments for PPE and intangible assets and variable concession fees) and IFRIC Update March 2016 (variable payments for asset purchases – agenda decision).

1.6 As noted, the Discussion Paper focuses on the purchaser's accounting, as the two issues mentioned in paragraph 1.1 both relate to how a purchaser should account for variable consideration.

1.7 The Discussion Paper does not address the accounting for variable consideration from the seller perspective. This is because, to the extent that the good or service transferred is an output of the seller's ordinary activity, the seller should generally account for the variable consideration in accordance with IFRS 15 *Revenue from Contracts with Customers.* IFRS 15 includes explicit guidance on how that should be done. Thus, the concerns noted related to the accounting for variable consideration by purchasers of goods and services do not arise for sellers.

Definition of variable consideration

1.8 The Discussion Paper considers that a consideration is variable when the purchaser of a good or service may have to transfer additional assets in exchange for the goods or services. This definition is based on the definition of contingent consideration included in IFRS 3 *Business Combinations.*

1.9 Whether the acquirer will have to transfer additional assets depends on one or several factors for which the outcome is not known at the time the good or service is acquired. The factors can both be within or outside the control of the purchaser.

1.10 This discussion paper refers to 'variable consideration' instead of 'contingent consideration'. This is done as 'contingent consideration' could be interpreted as meaning that the additional assets that may have to be transferred in exchange for a good or service received would be a fixed amount. The term 'variable consideration' not only includes those circumstances, but also includes situations under which the additional amount would be variable (for example, if it depends on the development in the market price of the transferred good or service).

1.11 Under this definition, the consideration to be exchanged does not have to be an amount in the functional currency of the entity. It can be any type of asset the purchaser will transfer (including a service it will provide). When the consideration to be exchanged for a good or service is not the functional currency of the entity, the consideration is only viewed as being variable to the extent the quantity of assets to be provided is not fixed. Accordingly, the assessment of when consideration would be deemed variable depends only on whether the quantity (and not the value) of assets the entity would have to transfer could change.

Non-executory contracts

1.12 The Discussion Paper only considers variable consideration in non-executory contracts[2] because the purchaser has received the good or service to which the variable consideration relates. The Discussion Paper accordingly only considers scenarios of the type illustrated below.

Timeline illustrating the scenarios covered by the Discussion Paper

[2] As per the Conceptual Framework, an executory contract is a contract where neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

1.13 If a contract is executory the combined right and obligation constitute a single asset or liability[3]. Unless the combined asset or liability would be a financial asset, the combined asset is normally not recognised unless the contract is onerous. IAS 37 *Provisions, contingent liabilities and contingent assets* includes guidance on onerous contracts.

Unit of account

1.14 The price of a good or service may consist of both a fixed part and an additional variable part (or several variable parts). When discussing the issue in paragraph 1.2a) above on when a liability should be recognised, the conclusion could be affected by whether the fixed and variable part is considered as one unit of account in relation to recognition or as separate units of account. In this Discussion Paper, the variable amount is considered as a separate unit of account and the Discussion Paper only considers the accounting issues for that separate unit of account. That is, if the price of a good or service consists of a fixed and variable part, the fixed part (being the minimum amount the purchaser will have to pay for the good or service) is not taken into consideration in the Discussion Paper. The reason for considering the variable consideration as a separate unit of account is to ensure that variable consideration is accounted for similarly no matter whether the total consideration includes a fixed component or not.

Scope of the Discussion Paper discussions

Liability issue

1.15 The discussion on 'the liability issue' (see paragraph 1.2a) above) is not limited to transactions under which 'the purchaser' will receive a good or a service that is measured at cost at initial recognition and subsequently. However, the discussion is limited to transactions under which 'the purchaser' will transfer cash or another financial asset, as the 'liability issue' is related to the interpretation of IAS 32.

Measurement of the acquired good or service issue

1.16 The discussion on how to measure a good or service acquired for variable consideration ('the measurement of the acquired good or service issue') (see paragraph 1.2b)) only applies to goods and services that are measured at cost at initial recognition and subsequently. This, for example, means that the discussion does not apply to situations where the purchaser acquires a financial instrument (which would be measured at fair value at the initial recognition). The reason why the discussion only applies to assets measured at cost initially and subsequently is that there is only a link between the consideration paid for an asset and the measurement of the asset, when the asset is measured at cost. Accordingly, variable consideration could only affect the measurement of an acquired asset, if the asset is measured at cost.

1.17 However, as mentioned in paragraph 1.1b, the discussion on how to measure a good or service acquired for variable consideration ('the measurement of the acquired good or service issue') covers the transfer of both financial and non-financial assets as consideration (for example, if the purchaser in exchange for a plot with an old factory building accepts to remove the building and clean the ground).

[3] See the Conceptual Framework paragraph 4.57.

Transactions that are carried out on market terms in exchange for an asset

1.18 The Discussion Paper only considers arm's length transactions that are carried out on market terms. This is to avoid discussions on whether part of a consideration paid (or not paid) could be a capital distribution or contribution. In addition, the Discussion Paper only considers transactions under which the purchaser has to deliver assets (including services) in exchange for the acquired good or service. The Discussion Paper does thus not consider situations where the purchaser pays by means of own shares. This is because a discussion about acquisitions by means of own shares would need to take into account the special nature of own shares, which would broaden the scope of this Discussion Paper.

Business combinations

1.19 Variable consideration related to the acquisition of a business is outside the scope of this Discussion Paper. When assets are acquired in a business combination a special issue arises as the consideration should be allocated to the various assets acquired and liabilities assumed. This also means that if changes in the estimate of variable consideration should be reflected in the measurement of the acquired assets, this change would have to be allocated to the various assets acquired and liabilities assumed. Such an allocation would result in additional issues having to be considered and it might therefore be preferable to have a different approach for variable consideration in relation to a business combination.

1.20 Although variable consideration in relation to business combinations are outside the scope of this Discussion Paper, some of the guidance included in IFRS 3 *Business Combinations* is considered when developing proposals and alternatives for how to account for variable consideration (outside business combinations).

Substance of a transaction

1.21 Consideration is not necessarily variable just because the total amount to be transferred under an agreement is unknown. For example, if it is agreed that an entity can purchase an asset for CU 4 and additional assets for the same price, the consideration for each of the assets transferred is considered to be fixed in this Discussion Paper.

1.22 It will often require judgement to determine what is transferred in a transaction. In some cases, subsequent payments would thus not be variable consideration for the asset transferred, but would be payments for additional goods and services acquired.

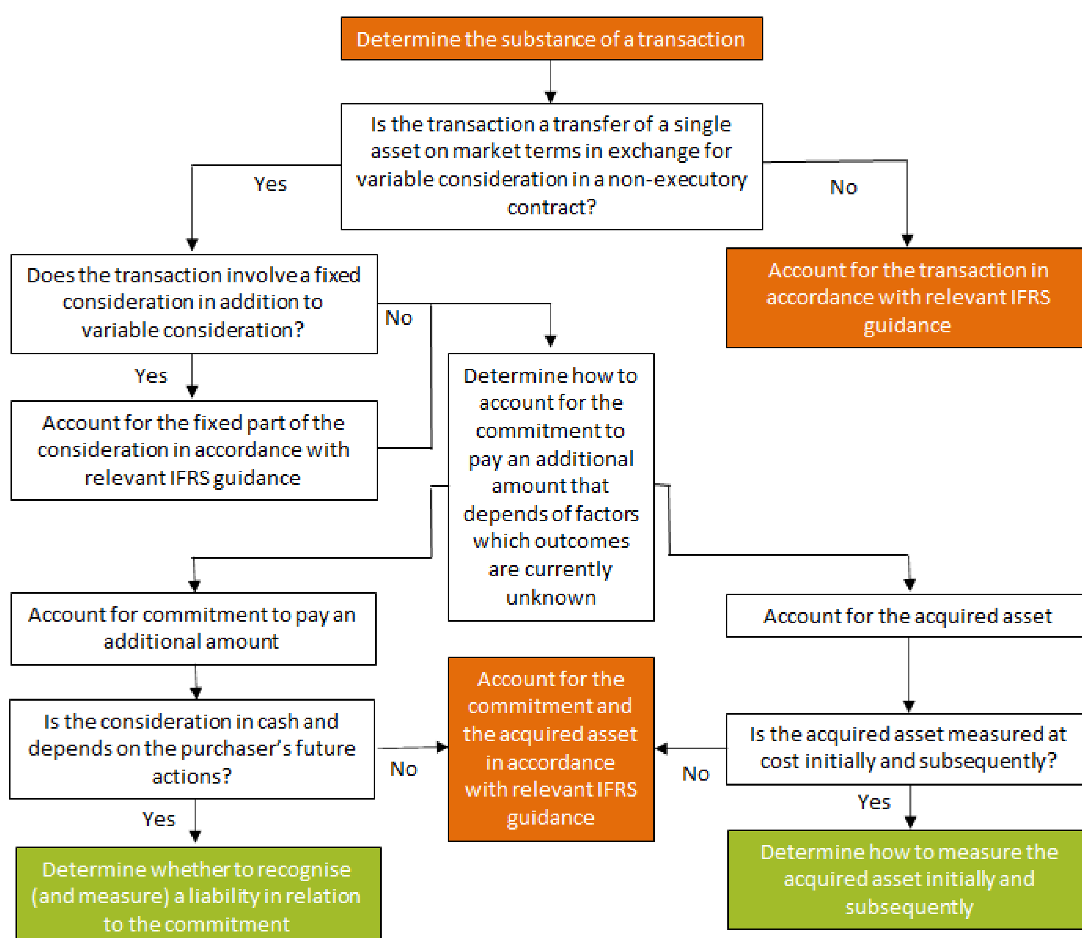
1.23 This Discussion Paper does not consider whether possible future additional payments would be payments for additional goods and services to be acquired instead of variable consideration for a good or service already acquired. Thus, it is out of the scope of the Discussion Paper whether, for example, additional payments could be considered to be related to the acquisition of additional rights related to a physical object. Some may thus consider that if an entity pays a fixed amount for a physical object and will have to transfer a given percentage of the profit generated by that physical object in the next five years, this could indicate that an entity has not acquired all the rights related to the physical object until after five years. Under that view, the payments related to the generated profit would not be variable consideration for the physical object received, but payments for the additional rights to be received related to the physical object – and hence not be variable consideration covered by this Discussion Paper.

Risk sharing/collaborative arrangements

1.24 As noted in the introduction to this chapter, variable consideration arrangements may be entered to share risks and benefits between the purchaser of a good or service and the seller. In that sense, this Discussion Paper is considering an element of risk sharing. The Discussion Paper, however, does not consider risk sharing/collaborative arrangements in a broader sense where the risk sharing is not only related to a transaction that transfers goods or services, but to an activity/activities (that is an agreement regulating how two parties cooperate in a business activity). There are also accounting issues related to such risk sharing/collaborative arrangements but these have been left out of this Discussion Paper to keep a targeted scope and the discussion focused on purchaser accounting for transactions with variable consideration in exchange for goods or services acquired.

1.25 The scope of the Discussion Paper can be illustrated by the shaded boxes in the diagram below. The issues listed in the orange boxes are outside the scope of this Discussion Paper while those in the green boxes are covered by the scope.

Diagram illustrating the scope of the Discussion Paper



CHAPTER 2: RECOGNITION OF A LIABILITY FOR VARIABLE CONSIDERATION

As explained in Chapter 1, there is currently divergence in practice on the application of IAS 32 Financial Instruments: Presentation regarding whether a purchaser should recognise a liability for variable consideration to be paid in cash (or by transferring another financial instrument), when the variability depends on the purchaser's future activities.

In order to develop guidance on whether to recognise a liability for variable consideration that would depend on the purchaser's future activities, the relevant guidance in the IASB's Conceptual Framework for Financial Reporting[4] is considered. However, this guidance is also interpreted inconsistently. Current guidance in other IFRS standards on whether/when to recognise a liability for variable consideration that depends on the purchaser's future activities is also examined, but this guidance points in different directions too. This Chapter accordingly examines the following different alternatives for when to recognise a liability for variable consideration that depends on the purchaser's future activities and examines some of the advantages and disadvantages of each of these alternatives:

- *A liability for variable consideration that depends on the purchaser's future activities is recognised when the purchaser receives the good or services to which the variable consideration relates.*
- *A liability for variable consideration that depends on the purchaser's future activities is recognised only when these future activities are performed.*

Introduction

2.1 There is currently diversity in practice on when to recognise a liability for variable consideration to be paid, by transferring a financial instrument, when the variability depends on the purchaser's future activities. This Chapter explains why this diversity exists and explores possible approaches on when the liability should be recognised.

2.2 First, an illustrative example is provided to illustrate the issue as an introduction to the Chapter. Then this Chapter discusses what the causes of the issue is regarding recognition of a liability for variable consideration.

2.3 Thereafter, this Chapter considers the relevant guidance on the definition of a liability as per the Conceptual Framework and how this can be interpreted in different ways. In addition, this Chapter provides an overview of the relevant current IFRS Standards regarding the recognition of the liability for variable consideration and, at a high-level, the reasons for differences across the guidance.

2.4 Finally, this Chapter describes possible approaches considered to account for the liability for variable consideration when the variability depends on the purchaser's future activities including their advantages and disadvantages.

Illustrative example

2.5 Below is a simple example provided to illustrate the issue and in order to discuss the accounting issues and possible approaches to be considered.

[4] The *Conceptual Framework for Financial Reporting* describes the objective of, and the concepts for, general purpose financial reporting.

2.6 Entity B (seller) has developed a recipe that will make chocolate spread preserve its consistency at higher temperatures. It has sold the intellectual rights of this recipe to Entity A (purchaser) (thus, the contract is non-executory[5]) for a fixed consideration. 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. Also, Entity A can keep the rights to the recipe.

2.7 In addition to the fixed consideration, if Entity A will sell over 10 000 jars of chocolate spread over five years, then the consideration to be paid to Entity B is CU 1 per jar of chocolate spread that is sold in excess of 10 000 jars and the payment will be in cash. For example, if Entity A will sell 50,000 jars over the next five years, it will have to pay Entity B CU 40 000[6].

2.8 Last year, Entity A had sold around 20 000 jars. It is assumed that it is more likely than not that Entity A will pay the consideration. The variability in this example is the number of jars of chocolate spread to be sold in excess of 10 000 jars in five years, and the variable consideration is the amount of cash Entity A has to transfer to Entity B for its future sales of chocolate spread jars in excess of 10 000 jars in the next five years.

Question to consider in this Chapter

2.9 The question to consider in this Chapter is whether/when should a liability for variable consideration, that depends on the purchaser's future activities, be recognised.

2.10 In the example, Entity B has transferred the intellectual rights of the recipe to Entity A who will have to transfer cash depending on its future sales. The variable consideration is based on Entity A's sales.

2.11 The question arises whether/when a liability should be recognised when Entity A has acquired the recipe[7].

What is the issue?

2.12 In the illustrative example, the variable payment Entity A will pay to Entity B is a financial asset, cash. Therefore, a liability to transfer an amount of cash would normally be covered by IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments*.

2.13 Based on the illustrative example, applying IAS 32/IFRS 9, the question is whether the purchaser (Entity A) has the ability to avoid a transfer of cash and/or whether the uncertain future event (i.e. future sales of the jars) is beyond the control of the purchaser (Entity A). There are different interpretations on this as reflected below.

2.14 Paragraphs 19 and 25 of IAS 32 state:

> 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 in accordance […]

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[5] As per the Conceptual Framework, an executory contract is a contract where neither party has fulfilled any of its obligations, or both parties have partially fulfilled their obligations to an equal extent.

[6] (50 000 – 10 000) jars * CU 1 = CU 40 000.

[7] As it will be further explained above in Chapter 1, this Discussion Paper has taken the approach to consider a variable component of a consideration as a separate unit of account.

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 unless:

(a) the part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;

(b) the issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or

(c) the instrument has all of the features and meets the conditions in paragraphs 16A and 16B.

2.15 However, there are different interpretations on whether to recognise a liability for the future sales of the jars. For example:

a) Some consider that paragraph 25 of IAS 32 means that if variable consideration depends on the purchaser's future activities, **no liability should be recognised** related to the commitment to pay an additional amount depending on the future activities. It is argued that if variable consideration depends on the purchaser's future activities, the event of the occurrence or non-occurrence of uncertain future events is within the control of the purchaser.

b) Some consider that paragraph 25 of IAS 32 means that if variable consideration depends on the purchaser's future activities, **an equity component should be recognised**. Similar to the arguments presented in a) above, they argue that paragraph 25 of IAS 32 would mean that no financial liability could be recognised. However, it is argued that if no financial liability exists, there would exist a residual, i.e. an equity component which should be recognised. This equity component should be derecognised and a financial liability recognised if the future activities of the purchaser would result in a financial liability as per IAS 32.

c) Finally, some consider that paragraph 25 of IAS 32 means that a financial liability **should generally be recognised** when variable consideration depends on the purchaser's future activities. An argument presented in favour of this view is that paragraph 25 of IAS 32 states that the purchaser's future revenues, net income or debt to equity ratio, are beyond the control of both the purchaser and the seller of the instrument. Therefore, by analogy[8], in relation to variable consideration, the purchaser's future activity (or future performance) is also beyond the control of the purchaser and a financial liability ought to be recognised.

d) Some also note that the purchaser does not have a right to avoid paying the cash as it is a non-executory contract and the other party has performed.

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[8] Some supporting the view expressed have argued against this analogy as they 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 purchaser and the seller are financial liabilities. SIC-5 did not address the accounting for financial liabilities that are related to the acquisition of a non-financial asset.

Therefore they refer to paragraph 19 in IAS 32 where a financial liability would be recognised.

2.16 Due to the above different interpretations in applying IAS 32, there is divergence in practice on whether a liability should be recognised for variable consideration to be paid in cash when the variability depends on the purchaser's future activities.

2.17 Should clarifying guidance be introduced, a first step could be to assess whether this could be developed based on the current guidance in the IASB's *Conceptual Framework for Financial Reporting* (the 'Conceptual Framework') and/or the guidance in other IFRS Standards dealing with when to recognise a liability for variable consideration depends on the purchaser's future activities. Such an approach is considered in the next section.

How can the issue be addressed applying current guidance

Whether to recognise a liability for variable consideration based on the Conceptual Framework when the goods or services are received

2.18 The Conceptual Framework is considered in order to determine whether variable consideration when the goods or services are received and that depends on the purchaser's future activities would meet the definition of a liability in the Conceptual Framework.

Definition and guidance on a liability in the Conceptual Framework

2.19 As per the Conceptual Framework:

A liability is a present obligation of the entity to transfer an economic resource as a result of past events. (paragraph 4.26)

2.20 The Conceptual Framework further states that for a liability to exist three criteria must all be satisfied*:*

(a) The entity has an obligation;

(b) The obligation is to transfer an economic resource;

(c) The obligation is a present obligation that exists as a result of past events.

(paragraph 4.27)

2.21 The criteria relating to 'the obligation is to transfer an economic resource' is considered to be met as there is a conditional obligation, triggered by the conditions embedded in the variability. The purchaser of a good or service would have to transfer additional assets in exchange for the goods or services. Therefore, the remaining two criteria are assessed below.

The entity has an obligation

2.22 The Conceptual Framework states that an obligation is a duty or responsibility that an entity has no practical ability to avoid (paragraph 4.29).

2.23 Also, paragraph 4.32 of the Conceptual Framework states that in some situations, an entity's duty or responsibility to transfer an economic resource is conditional on a particular future activity that the entity itself may take. Such activities could include operating a particular business or operating in a particular market on a specified future date, or exercising particular options within a contract. In such situations, the entity has an obligation if it has no practical ability to avoid taking that activity[9].

2.24 Based on the Conceptual Framework, there are differing views on whether the entity has an obligation. For example:

a) If the asset has been delivered to the purchaser, this is a non-executory contract and the seller has performed its obligations. Some consider that the purchaser has no practical ability to avoid the variable payment because they consider the practical ability to be related to economic compulsion and as the purchaser has received the asset, he would be economically compelled to use it. Therefore, the purchaser **has an obligation**.

b) However, others consider that even if the purchaser obtains control of the asset, this does not necessarily mean that it has no practical ability not to use that asset. For example, the purchaser may acquire a brand name but not use it in order to prevent competitors from using it. Therefore the purchaser **does not have an obligation**.

Also, the adverse economic consequences of not using an acquired asset would generally not be so severe than the variable payment itself. For example: after an entity has acquired the chocolate spread recipe, it may decide that it will not use the recipe anyway as it is not (sufficiently) profitable and the economic consequences may not be seen to be more severe than the transfer of the cash. Therefore the purchaser **does not have an obligation**. However, some would consider this scenario to be unlikely as an economically rational entity ought to only purchase the recipe expecting it to be profitable.

The obligation is a present obligation that exists as a result of past events.

2.25 The Conceptual Framework states:

A present obligation exists as a result of past events only if:

(a) the entity has already obtained economic benefits or taken an action; and

(b) as a consequence, the entity will or may have to transfer an economic resource that it would not otherwise have had to transfer. (paragraph 4.43)

2.26 The question arises on what is the past event to be considered in order to recognise a liability for variable consideration that depend on the purchaser's future activities, for example, whether the past event should be the transfer of the asset or the activity of the purchaser that trigger the payment (or both).

2.27 Based on the Conceptual Framework, there are differing views, on whether the obligation is a present obligation that exists as a result of past events[10]. For example:

[9] The factors used to assess whether an entity has the practical ability to avoid transferring an economic resource may depend on the nature of the entity's duty or responsibility. For example, in some cases, an entity may have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences significantly more adverse than the variable payment itself. However, neither an intention to make a transfer, nor a high likelihood of a transfer, is sufficient reason for concluding that the entity has no practical ability to avoid a transfer (paragraph 4.34 of the Conceptual Framework).

[10] It can be considered that the establishment of the contract should not be considered as the past event as the seller has not yet performed under the contract. This is consistent with IFRS 16 Leases whereby the Basis for Conclusions states that although

a) Some consider that the past event giving rise to the liabilities arises when the purchaser received the right of use of the underlying assets rather than when the purchaser would conduct the activity. For example, as per the Exposure Draft on *Regulatory Assets and Regulatory Liabilities*, the past event is when the entity obtains the right of use of the asset. Therefore, if the past event related to the right of use of the asset, there would be a **present obligation due to a past event**. Also, the past event would be at the date of transfer of control of an asset, when the contract ceased to be executory because one party has performed. When the other party has performed, the purchaser owes something for obtaining control of the good or service. Therefore a **present obligation exists due to a past event**.

b) Others do not agree with the above and consider that if some specific performance target needs to be met in the future, for example, increased sales of chocolate spread jars, this target would not be known at the time of obtaining control of the good or service. Therefore, the future performance target would not be a past event and there would subsequently **not be a present obligation** for the variable consideration.

2.28 Other current guidance is looked at below on whether a liability for variable consideration is recognised when the goods or services are received.

Whether and when to recognise a liability for variable consideration when goods or services are received based on current guidance

2.29 As mentioned in paragraph 1.8 in Chapter 1, this Discussion Paper considers that a consideration is variable when the purchaser of a good or service may have to transfer additional assets in exchange for the goods or services. Current guidance related to consideration that would meet that definition is presented in the section 'Overview of current guidance' on page 41. The guidance related to whether and when to recognise a liability for variable consideration when goods or services are received and that would/could depend on the purchaser's future activities is summarised in the table below.

Overview of current guidance on whether/when a liability for variable consideration when goods or services are received and that depends on the purchaser's future actions is recognised

Standard/ interpretation	Variable consideration related to:	Is a liability recognised when good or service received?	When (at which point in time) is a liability recognised?
IAS 19 ***Employee Benefits***	Benefits from defined benefit pension scheme.	✔ *	When an employee covered by a Defined Benefit plan has rendered service to the entity.
IAS 19 ***Employee Benefits***	Long-term employee benefits (e.g. profit-sharing and bonus plans).	✔ *	When an employee renders service (exception for disability benefits).

a lessee may have a right and an obligation to exchange lease payments for a right-of-use asset from the date of inception, the lessee is unlikely to have an obligation to make lease payments before the asset is made available for its use.

Standard/ interpretation	Variable consideration related to:	Is a liability recognised when good or service received?	When (at which point in time) is a liability recognised?
IAS 19 ***Employee Benefits***	Short-term employee benefits (profit sharing and bonus plans).	✗/✓ *	When an employee renders service, the obligation can be estimated reliably and the entity has no realistic alternative but to make the payments.
IAS 37 ***Provisions, Contingent Liabilities and Contingent Assets***	Contingent liabilities and provisions.	✗ *	Contingent liabilities are not recognised. Provisions are recognised when all the below conditions are met: - An entity has a present obligation (legal or constructive) as a result of a past event IAS 37 specifies that it is only those obligations arising from past events existing independently of an entity's future actions (i.e. the future conduct of its business) that are recognised as provisions - It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation. - A reliable estimate can be made of the amount of the obligation.
IFRS 2 ***Share-based Payment***	Cash-settled share-based payments.	✓ *	When good or service is received
IFRS 3 ***Business Combinations***	Contingent consideration in a business combination.	✓ *	When the acquirer obtains control of the acquiree.
IFRS 16 ***Leases***	Variable payments in a lease contract that are not in substance fixed, dependent on an index or rate, related to a residual value guarantee or related to the cost of dismantling and removing the item.	✗	When an event or condition that triggers payment occurs.

* does not distinguish between variable consideration depending on the purchaser's future activities and variable consideration depending on factors outside the control of the purchaser

2.30 As can be seen in the table above, depending on the standard, a liability is either recognised or not recognised when a good/service is received. There is, accordingly, no consistent way in current guidance to recognise a liability for variable consideration. .

2.31 The reasons for the particular IFRS Standards for their recognition requirements are provided in in the table below to the extent a reason is provided in the Basis for Conclusions.

Current guidance	Reasons in the Basis for Conclusions
Guidance under which a liability is recognised when a good or service is received	
IAS 19 (Long-term employee benefits)	An obligation exists even if a benefit is not vested (paragraph BC 55).
IFRS 2	To be consistent with the requirements in IAS 19 (paragraph BC 245).
IFRS 3	An acquirer's agreement to make contingent payment is the obligation event in a business combination transaction (paragraph BC 346).
Guidance under which a liability is not recognised when a good or service is received	
IAS 37	No reasons found in the Basis for Conclusions for the requirements in IAS 37. However, when the IFRS Interpretations Committee interpreted IAS 37 in relation to when an liability for a levy should be recognised, it noted that the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, as identified by the legislation (paragraph BC 18 of IFRIC 21).
IAS 19 (short-term benefits)	For simplification purposes. 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 BC 17).
IFRS 16	Exclusion of variable lease payments linked to future performance for the following reasons: - For some IASB members, this decision was made solely for cost-benefit reasons. - 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. (paragraph BC 169)

2.32 As there is currently different guidance on when to recognise a liability for variable consideration and as the Basis for Conclusions show that the differences are due to different, sometimes practical, reasons (through time) on when a liability arises, there is not a preferred approach to be followed by analogy in the current IFRS literature for variable consideration that depends on the purchaser's future activities. This being the case, the following section explores different alternatives on when to recognise a liability related to variable consideration that depends on the purchaser's future activities.

Possible approaches considered to recognise a liability for variable consideration

2.33 Taking into consideration the above current guidance, the following possible approaches may be considered in order to recognise a liability for variable consideration that depends on the purchaser's future activities.

2.34 An approach whereby an equity component would be recognised if the variable consideration depends on the purchaser's future activities (refer to paragraph 2.15 b)) was not considered because this treatment has not been applied in practice.

Possible approaches that are reflected in current guidance

Approach 1 – Recognise a liability for variable consideration when a good or service is received

2.35 This approach is about recognising a liability when a good or service is received and where the variability depends on the purchaser's future activities.

2.36 Based on the illustrative example above on the chocolate spread recipe (paragraphs 2.6 to 2.8), a liability for the future sales would be recognised when the purchaser receives the recipe.

2.37 Advantages of this approach include:

a) It is prudent to recognise liabilities earlier rather than later, especially in conditions of uncertainty.

b) This earlier recognition could provide users with useful information to predict future outcomes based on their analyses.

c) This approach is reflected in current guidance and is therefore comparable to the treatment under several IFRS Standards, e.g., IFRS 2, as per the table following paragraph 2.29.

d) A liability for variable consideration that depends on the purchaser's future activities would be accounted for similarly to a liability for variable consideration that depends on factors other than the purchaser's future activities. According to the current requirements in IAS 32 and IFRS 9, when the variability is beyond the control of both the purchaser and the seller, a financial liability would be recognised for variable consideration when a good or service is received. If this manner of accounting for variable consideration is assumed to result in the most useful information for predicting future cash flows when the variability is beyond the control of the purchaser, it is difficult to find good arguments for why it would not also result in the most useful information when the variability can be controlled by the purchaser.

e) The alternative to recognising the liability in question when a good or service is received, would be to recognise the liability when the purchaser takes the future activities on which the variability depends (see Approach 2 below). Recognising a liability when the future activities are taken could result in a counterintuitive accounting outcome. This is because:

(i) The activities undertaken by the purchaser could be expected to be those that would overall be most beneficial for the purchaser.

(ii) As discussed in Chapter 3, there could be different approaches to account for a liability that would be recognised when the future activities of the purchaser are undertaken. One approach would be to recognise an expense when recognising the related liability. If a liability for variable consideration is recognised when a good or service is received, the Discussion Paper considers that this liability would always be part of the cost of an asset – hence no expense would be recognised.

Recognising a liability for variable consideration when the purchaser would take a beneficial action could thus result in an expense being recognised (for example, if the variability would depend on whether the purchaser would enter a profitable market, a liability would be recognised when the purchaser would enter that market although it will be very profitable in the long run for the purchaser to operate in that market). Recognising an expense when beneficial actions would be taken could give the impression that the actions would not be beneficial for the purchaser - unless all the benefits from the actions would also be recognised simultaneously. Recognising a liability for variable consideration when a good or service is received could mitigate this issue.

f) The approach may be easier, that is less costly, to apply compared to assessing linkage to the quality of the asset (Approach 4) for example, because of judgement regarding whether variable consideration is linked to the initial quality of the acquired asset.

g) The approach could be combined with a recognition threshold so that a liability would not be recognised when the measurement uncertainty would be too high. This could ensure that the information would be a faithful representation.

2.38 Disadvantages of this approach include:

a) The approach would include additional estimates of future variable payments that may be highly subjective and uncertain. This subjectivity could affect the usefulness of the information. However, it may not be more difficult to make these estimates than those for variable payments that do not relate to the future activities of the purchaser.

b) The approach would be more costly to apply compared to an approach under which a liability would only be recognised when the purchasers future activities that would trigger the future variable payment have occurred (i.e. Approach 2). This is because estimates would have to be made and updated until the future activities occur if the liability is recognised when a good or service is received. This could then result in significant costs for entities.

Approach 2 – Recognise a liability for variable consideration when the future activities (or lack of) of the purchaser that would trigger the variable payment have occurred

2.39 Another approach is recognising a liability only when the activities (or lack of) of the purchaser that trigger the variable payments have occurred. It could be argued that up until this point (i.e. until an event has occurred), the purchaser would not have a liability.

2.40 In the example with the chocolate spread, this would mean that Entity A would only start recognising a liability (of CU 1) related to the variable consideration when it has sold 10 001 jars of chocolate spread.

2.41 Advantages of this approach include:

a) This approach is consistent with some IFRS guidance, e.g. IFRS 16 (which is the most recent standard addressing variable consideration) and IAS 37 (also as interpreted under IFRIC 21 *Levies* whereby the obligating event that gives rise to a liability to pay a levy is the activity that triggers the payment of the levy, e.g., the generation of revenue in the current period.

b) This approach could be seen to recognise a liability when there is certainty to an extent compared to Approach 1, for example (that is, the approach would result in more reliable information than Approach 1).

c) The approach would be the least costly approach of the possible approaches suggested in the Discussion Paper, as it would be the approach under which a financial statement preparer would have to make the least estimates (as the liability would only be recognised when the uncertainty around it would have been resolved).

2.42 Disadvantages of this approach include:

a) This approach would be the least prudent approach as a liability would be recognised later than under the other approaches considered in this Discussion Paper.

b) It is difficult to find any arguments for why it would be useful to account for variable consideration that depends on the purchaser's future activities differently from variable consideration that does not depend on the purchaser's future activities (see paragraph 2.37d) above).

c) As earlier noted, the approach could result in a counterintuitive recognition of a liability when an activity that would benefit the purchaser takes place (see paragraph **Error! Reference source not found.**.

d) The approach would result in a different accounting treatment than variable consideration in the scope of IAS 19, IFRS 2 and IFRS 3. This, for example, means that if an asset is acquired as part of a business combination, a liability for variable consideration is recognised when the asset is transferred, whereas this would not be the case if the asset is acquired outside a business combination.

Question to EFRAG TEG

2.43 The approaches suggested above specifically relate to variable consideration that would depend on the purchaser's future activities (i.e. this is the scope considered in Chapter 2). The below approaches (Approach 3 and 4) have a broader scope which could apply to all types of variable considerations. Therefore, these Approaches 3 and 4 could be considered in Chapter 4 of the Discussion Paper which focusses on different current requirements for variable consideration[11].

Does EFRAG TEG agree to exclude Approaches 3 and 4 from Chapter 2 and to include them in Chapter 4? Please explain.

Approach 3 – Recognise a liability to the extent the variable consideration is linked to the initial quality of the acquired asset

2.44 A possible approach to consider is recognising a liability when a good or service is received when the variable consideration is linked to the initial quality of the acquired asset and such quality will be confirmed/known only in a subsequent moment. The quality of the acquired asset is the capability of doing what the asset is supposed to do. In other cases, a liability is not recognised.

2.45 Examples of variable consideration that are linked to the initial quality of the acquired asset are if the purchaser would have to pay an additional amount if an acquired drug would be approved by the health authorities or if the purchaser of a machine has to pay an additional amount if the machine is capable of producing more than a given amount of units per minute.

[11] If EFRAG TEG agrees to include Chapter 4

2.46 Advantages of this approach include:

a) The approach is more prudent than Approach 2 because a liability would be recognised at an earlier stage under this Approach (but less prudent than Approach 1).

b) If combined with an approach that would either reflect all changes in liabilities in the cost of the acquired asset or only changes in liabilities that are originally included in the measurement of the acquired asset, the approach could result in the cost of the asset reflecting the price of the quality of the asset that has been acquired (see Chapter 3). This would also mean that the cost of the asset (including the variable parts) would be better matched with the resulting income. This would be result in useful in useful information for predicting future cash flows and assessing management's stewardship. To the extent that the variable consideration is not linked to the initial quality of the acquired asset, it could be argued that this consideration will relate to activities to be made in future periods and accordingly should be reflected in profit or loss in future periods.

2.47 Disadvantages of this approach include:

a) May be difficult to assess whether variable consideration is linked to the initial quality of the acquired asset or at what point there is a linkage.

b) This approach is not reflected in current guidance, therefore, this may affect comparability of transactions. Also, it may be difficult for users to readily understand this new approach.

c) Would include estimates of variable payments that may be highly subjective and uncertain as they relate to the future.

d) This subjectivity could then affect the usefulness of the information.

e) May be difficult and complex to apply, because of having to make estimates of future payments. This could then result in significant costs for entities.

Approach 4 - An approach mirroring IFRS 15 Revenue from Contracts with Customers

2.48 [To be discussed by EFRAG TEG as a separate issues paper.]

CHAPTER 3: MEASUREMENT OF AN ASSET AT COST

There is currently divergence in practice on whether the cost of an asset acquired for variable consideration should be updated to reflect changes in the estimate of the variable consideration. The divergence in practice seems mainly to relate to the cases where the transaction would not be covered by IAS 19, IAS 37, IFRS 2, IFRS 3 or IFRS 16.

The divergence in practice has arisen as guidance is considered to be unclear and conflicting, lacking and/or because different interpretations of existing guidance are possible.

This Chapter considers these issues and possible approaches that could be considered, should clearer guidance be introduced. When providing clearer guidance on the issue, it is first considered what 'cost' means as this Chapter only considers the measurement of assets that are measured at cost initially and subsequently. However, it is assessed that the definition of 'cost' in IFRS literature could be interpreted differently as to whether or not subsequent changes in the estimate of the variable consideration shall be reflected in the measurement of an asset at cost. The Conceptual Framework is also not assessed to provide much guidance on the issue.

Six possible approaches are then presented on whether/when the changes in the estimate of variable consideration should be reflected in the cost of the acquired asset together with their advantages and disadvantages:

- *Not to update the original cost estimate for changes in the estimate of variable consideration.*
- *Update the cost of the estimate originally included in the cost of the asset.*
- *Always update the cost estimate for changes in the estimate of variable consideration.*
- *Update the cost of the estimate until the asset is ready for its intended use.*
- *Update the cost estimate to the extent that the variable consideration is related to future economic benefits to be derived from the asset.*
- *Update the cost estimate to the extent the variable consideration is linked to the initial quality of the asset.*

Introduction

3.1 This Chapter considers how changes in estimates related to variable consideration are reflected in the initial and subsequent measurement at cost of an asset. The Chapter first considers the nature of the subsequent measurement of an asset initially at cost to reflect changes in the estimate of variable consideration to be paid.

3.2 Then this Chapter considers how the issue could be addressed applying current guidance, e.g., by looking at the definition of cost, the Conceptual Framework and current IFRS Standards.

3.3 Subsequently, this Chapter describes possible approaches considered to account for changes in estimates of variable consideration including their advantages and disadvantages.

3.4 This Chapter only considers approaches under which cost of an acquired asset is measured by reference to the measurement of either the corresponding liability or resources already transferred. The cost of an asset could be determined independently of the recognition and measurement of the corresponding liability. However, that would result in a day-1 gain or loss that is not useful information to users of financial statements. Such gains and losses would only reflect differing measurement approaches towards the related asset and liability, and not reflect any economic events. Furthermore, the scope of the Discussion Paper is to address areas where there is divergence in practice. Hence, this Chapter only considers acquired assets that are initially and subsequently measured at cost.

What is the issue?

3.5 When a purchaser has acquired an asset that should be initially and subsequently measured at cost, a question arises whether this cost should be updated to reflect changes in the estimate of the liability for variable consideration to be paid.

3.6 Divergence in practice exists on this issue as there is no explicit guidance on the matter and/or the guidance that does exist is inconsistent or interpreted differently for some transactions (particularly those not covered by IAS 19, IAS 37, IFRS 2, IFRS 3 or IFRS 16).

3.7 A reason for the divergence in practice is that the definition of 'cost' in IAS 16, IAS 38 and IAS 40 *Investment Property* can be interpreted differently.

3.8 'Cost' is defined in paragraph 6 of IAS 16, paragraph 8 of IAS 38 and paragraph 5 of IAS 40 as:

> The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction, or, when applicable, the amount attributed to that asset when initially recognised in accordance with the specific requirements of other IFRSs, e.g., IFRS 2 *Share-based Payment*.

3.9 This definition of 'cost' could be interpreted differently, for example:

a) The definition of cost includes the amount of cash or cash equivalents that would eventually be paid (i.e., the definition refers to the transfer of cash or cash equivalent or fair value of other consideration either at acquisition or construction or when applicable). Therefore, this definition encompasses all amounts expected to be paid in cash or cash equivalents even when these are contingent on when the asset is received (i.e., variable consideration). As a result, it could be argued that the **cost of the asset should be updated** to reflect changes in variable consideration;

b) The definition of 'cost' refers to 'to acquire an asset at the time of its acquisition or construction' and 'when initially recognised'. It could thus be argued that the definition includes a point in time that does not envisage that 'cost' could be updated as a result of changes in the amount paid (or given) to acquire an asset. As a result, it could be argued that the **cost of the asset should not be updated** to reflect changes in variable consideration.

3.10 The issues with the current guidance are illustrated in the 'Overview of current guidance' section of the Discussion Paper and further explained below.

Illustrative example from Chapter 2

3.11 Referring to the illustrative chocolate spread example in Chapter 2 (paragraphs 2.5 to 2.8), the asset recognised relates to the intellectual rights of the recipe that preserves the consistency of the chocolate spread at higher temperatures and is measured at cost.

3.12 As noted in paragraph 3.4, this Chapter builds on the assumption that the asset acquired and the related liability are not measured independently, therefore the asset would have the same amount as the liability at initial recognition. Therefore, the question arises whether this intellectual rights of the recipe, accounted for as an asset, measured at cost should be updated subsequently to reflect changes in the estimate of variable consideration to be paid, i.e. changes in estimate of future sales of the chocolate spread jars. In other words, should this change in estimate of the variable consideration be recognised in profit or loss or be capitalised as part of the asset.

3.13 For example:

a) If Entity A (purchaser) recognises a liability when it receives the recipe and measures this based on its expected sales, should the measurement of the asset be updated if Entity A would revise its estimate of the jars it expects to sell within the next five years from 50 000 (which was the initial estimate) to 70 000 jars, i.e., an increase of 20 000 jars?

b) If Entity A (purchaser) does not recognise a liability when it receives the recipe, but only as it sells more than 10 000 jars, should the measurement of the asset only be updated after the entity sells 10 001 jars of spread and for subsequent sales?

3.14 As shown in the 'Overview of current guidance', and summarised below, there is different guidance on whether the cost of the acquired asset should be updated to reflect changes in the related liability. The table below indicates whether the cost should be updated (✔) or not (✘). As it appears from the table, there is no general guidance, apart from the treatment of rebates and trade discounts for standards such as IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible assets*) on whether the cost should be updated. However, in some cases there is guidance. The table also illustrates the inconsistency across current guidance. For example, if the liability for variable consideration, would be covered by IFRS 9, the guidance states that the changes in the measurement of the liability should be included in profit or loss, while the guidance for the measurement of the asset in some cases, e.g., IAS 16, would state that the changes should be reflected in the measurement of the asset.

Current guidance on whether the cost of an asset should be updated to reflect changes in the related liability

Guidance	Type of variable consideration	Cost of asset updated?	Treatment of variable consideration
IAS 2 / IAS 16 / IAS 38	Entitlement to rebates and trade discounts.	✔	Deducted from cost.
IAS 19	Benefits from defined benefit pension scheme	✘	Recognised in profit or loss (except for variable consideration related to long-term service or bonus plan).

Guidance	Type of variable consideration	Cost of asset updated?	Treatment of variable consideration
IAS 16 / IFRS 16 / IFRIC 1	Costs of dismantling and removing the item and restoring the site on which it is located (or restoring the underlying asset to the condition required by the terms and conditions of the lease).	✔	Initial estimate and changes in the initial estimate are reflected in the cost of the asset.
IFRS 2	Cash-settled share-based payments.	✘	Recognised in profit or loss.
IFRS 9	Any variability that will affect cash flows of financial liabilities measured at amortised cost or fair value through profit or loss[12].	✘	Changes in the estimated outflow related to variable consideration are recognised in profit or loss.
IFRS 3	Any variability of acquirer purchase price that will affect whether additional assets should be transferred for the acquisition of a business.	✘	Initial estimate is included in cost. Subsequent changes are generally recognised in profit or loss.
IFRS 16	Variability of lease payments that depends on an index or rate or is in substance fixed.	✔	Initial estimate and changes in the initial estimate are reflected in the cost of the asset.
IFRS 16	Variability of lease payments that depend on anything else other than index or rate or residual value guarantee (when not in substance fixed)	✘	Recognised in profit or loss.
Regulatory assets and regulatory liabilities (IASB Exposure Draft)	Changes in expected cash flows arising from uncertainty in amount and timing of the enforceable rights (obligations) to increase (decrease) future rates charged to customers arising from a regulatory agreement (i.e. regulatory assets and regulatory liabilities)	✔	Reflected in the cost of the asset

3.15 In the table above, the proposed measurement guidance in the January 2021 IASB Exposure Draft on Accounting for Regulatory assets and Regulatory liabilities is also included, albeit being mainly applicable to providers of goods and services (i.e., seller entities), to illustrate the IASB's latest thinking whereby the variability in estimates of future cash flows is reflected in the measurement of the regulatory assets and regulatory liabilities (i.e., a cash flow based measurement that was described as modified historical cost).

[12] This is relating to the liability measurement whereby changes in the estimate would be recognised in profit or loss. Therefore, this means that there would be no update to the cost of asset.

How can the issue be addressed?

3.16 If guidance were to be developed on changes in the estimate of the liability for variable consideration to be paid, the guidance in the Conceptual Framework and the reasons for the current guidance could be examined.

3.17 The Conceptual Framework refers to the historical cost of an asset when it is acquired or created as the value of the costs incurred in acquiring or creating the asset (paragraph 6.5).

3.18 The Conceptual Framework (paragraph 6.7) also states that the historical cost of an asset is updated over time to reflect certain changes:

> The historical cost of an asset is updated over time to depict, if applicable:
>
> a) the consumption of part or all of the economic resource that constitutes the asset (depreciation or amortisation);
>
> b) payments received that extinguish part or all of the asset;
>
> c) the effect of events that cause part or all of the historical cost of the asset to be no longer recoverable (impairment); and
>
> d) accrual of interest to reflect any financing component of the asset.

3.19 It could be argued that cost is only updated for the four criteria in paragraph 3.18 above and these four criteria are not applicable for changes in estimates of variable consideration. Therefore, it could be argued that there is no sufficient guidance in the Conceptual Framework in order to assess whether the cost of the asset should be updated for changes in estimates of variable consideration.

3.20 However, this argument could be seen to be an interpretation rather than clear guidance. Accordingly, the guidance in the Conceptual Framework does not provide a clear direction on whether the cost of an asset should be updated to reflect changes in variable consideration.

Reasons for current guidance

3.21 The reasons for the current IFRS guidance and the IASB Exposure Draft proposed guidance for regulatory assets and regulatory liabilities is summarised in the table below, when such reasons appear from the Basis for Conclusions accompanying the Standards/Interpretations. As it appears from the table, the IASB may, when providing a reason for its choices in the Basis for Conclusions, favour updating the cost of an asset if the variable consideration has originally been reflected in the cost.

Current guidance	Reasons in the Basis for Conclusions
Reasons provided for updating cost of an asset	
IAS 2/ IAS 16 / IAS 38 relating to rebates and trade discounts	No reasons included in the Basis for Conclusions.
IAS 16 / IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities	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 BC 15 of IAS 16).

Current guidance	Reasons in the Basis for Conclusions
	In the related interpretation (IFRIC 1) IFRIC 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 BC 11).
Regulatory Assets and Regulatory Liabilities IASB Exposure Draft	The IASB Board selected modified historical cost as the measurement basis because in the IASB Board'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).
Reasons provided for not updating cost of an asset	
IFRS 3	The IASB Board 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 BC 357).
IFRS 9	No reasons included in the Basis for Conclusions.
IFRS 16	In relation to variable consideration included in the lease liability (in-substance fixed payments and variable lease payments that depend on an index or rate), the IASB Board decided that a lessee should recognise the remeasurement as an adjustment to the right-of-use assets for the following reasons: (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. (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. (c) the requirement to update the cost of the right-of-use asset is similar to the requirements in IFRIC 1. (paragraph BC 192).

Possible approaches on whether to update cost of the asset to reflect changes in the estimate of the variable consideration liability

3.24 Based on the different current guidance, the reasons for the guidance (when provided in the Basis for Conclusions) and the different interpretations of 'cost' in current guidance and the Conceptual Framework, different possible approaches could be considered for whether to update cost to reflect changes in estimate of variable consideration.

Possible approaches based on current guidance

Approach 1 - Not updating original cost estimate

3.25 As noted in paragraph 3.19 above, the definition of cost in IFRS Standards could be interpreted as meaning that measurement at cost of an acquired asset implies no update in measurement occurs subsequently.

3.26 Guidance in current Standards could be used to support such an interpretation. Paragraph 16 of IAS 16, for example, refers to 'initial estimate' of the costs of dismantling and removing, when it lists what the cost of an item of property, plant and equipment comprises.

3.27 In addition, paragraph 30 of IAS 16 and paragraph 74 of IAS 38 state that after the initial recognition, an asset accounted for under a cost model should be measured at its cost less any accumulated amortisation/depreciation and any accumulated impairment losses. Neither IAS 16 nor IAS 38 mention that the measurement of an asset accounted for by the Standards should be adjusted by changes in the estimate related to variable consideration.

3.28 The guidance in IFRS 16 could also be used to support the view that 'cost' of assets should not be subsequently updated for changes in the variable consideration.

3.29 Paragraph 24 of IFRS 16 describes what should be included in the cost of a right-of-use asset. Also, paragraph 30 of IFRS 16 specifies that when the cost model is applied for the subsequent measurement of a right-of-use asset, it should be measured

> at cost […] adjusted for any remeasurement of the lease liability […]

3.30 From paragraph 30 of IFRS 16, it could be argued that adjustments of any remeasurement of the lease liability are not part of the definition of cost – but are an adjustment that should be made to cost when measuring a right-of-use asset subsequently to the initial recognition. Accordingly, when it is not explicitly stated that cost should be 'adjusted for any remeasurement of the liability, then cost should not be updated.

3.31 Finally, the guidance in IFRS 3 could also be used to support the view that original estimates should not be updated, although IFRS 3 allows entities to revise the original estimate during the measurement period. This is because, changes should only be made to the extent they reflect facts and circumstances that existed as of the acquisition date (paragraph 45 and 58 of IFRS 3).

3.32 Based on current guidance, a possible measurement approach for assets that are acquired in exchange for variable consideration and are measured at cost could be not to reflect changes in the estimate of variable consideration in the cost of an asset. instead such changes would be recognised in profit or loss.

3.33 Recognition of changes in estimates that would be recognised in profit or loss would include both:

a) changes of the estimates of variable consideration that were included in the initial measurement of the liability; and

b) changes of the estimates of variable consideration that were **not** included in the initial measurement of the liability.

3.34 Applying this approach to the chocolate spread recipe example in paragraph 3.13:

a) If a liability for the variable consideration is recognised when the purchaser receives the recipe, and this is originally measured based on the assumption that the purchaser expects to sell 50 000 jars, the increase in the liability (i.e. relating to 20 000 jars) would be recognised in profit or loss.

b) If a liability for the variable consideration is not recognised when the purchaser receives the recipe, and the purchaser then sells more than 10 000 jars, the liability that would then be recognised would similarly be included in profit or loss.

3.35 Advantages of this approach include:

Impact on prudence

a) To the extent that a liability for variable consideration is not recognised for variable consideration (for example, if settled in cash, depends on the purchaser's future activities), the approach is prudent, as assets would be measured at a lower amount than under an approach where the changes in the estimates would be reflected in the cost of an asset.

b) However, under an approach where a liability for variable consideration is recognised when an asset is acquired (for example, if settled in cash and the variability does not depend on the purchaser's activities), and included in the initial cost of the asset, the approach would not be more prudent but equally prudent compared to subsequently including cost in the asset. If the estimate of variable consideration is reduced, the approach would result in a higher carrying amount of the acquired asset compared to an approach where changes in the estimate of the variable consideration are reflected in the cost of an asset (i.e. reduction of an asset). and vice versa if the estimate of variable consideration is increased.

Comparability

c) Consistent with the accounting of transactions covered in other IFRS Standards, i.e.. IAS 19, IFRS 2, IFRS 3, IFRS 16 to the extent the variability does not depend on an index or rate)[13].

Relevance

d) To the extent that the variability is caused by circumstances or an event that takes place in the given accounting period that is unrelated to the future cash flows expected to be derived from the acquired asset, the most useful information for predicting future cash flows and assessing stewardship might be to recognise the income or expense from the change in the variable consideration in the period the change takes place. The alternative of including the change in the cost price of the asset might not result in a meaningful matching of (amortisation/depreciation) cost with the related income.

Cost-benefit

e) Recognising changes in estimates in profit or loss may be slightly less costly than updating cost of an asset. This is because an entity would need to continuously link obligations with the asset.

3.36 Disadvantages of this approach include:

a) To the extent that the variability is related to the future cash flows expected to be derived from the acquired asset, it might be more useful for predicting future cash flows and assessing stewardship to include the changes in the estimate in the cost of the asset so as to match costs of the asset with the future income (through amortisation and depreciation of the carrying value of the asset).

[13] The possible approaches in Chapter 3 only covers the accounting of how to update changes in estimates in the cost of assets where there is divergence in practice. It does not cover assets under IAS 19 (to the extent not related to long-term service or bonus plan), IFRS 2, IFRS 3, IFRS 16 to the extent the variability does not depend on an index or rate.

b) To the extent that the variability of the consideration is positively correlated to the acquired asset's expected future cash flows, counterintuitive information may arise due to recognising an expense when there is an increase in expected future cash flows, and income when there is a decline in expected future cash flows.

c) The approach could create significant volatility in profit or loss as a result of recognising gains and losses that are not related to the period.

d) It would result in variable consideration related to rebates or obligations to dismantle and remove and item or restore a site not being accounted for in a comparable manner to many other types of variable consideration.

Approach 2 - Updating estimates originally included in the cost of an asset

3.37 The definition of cost in IFRS Standards could also be interpreted as implying that the original estimate of an asset should be updated to reflect changes in an estimate that was originally included in the measurement of the cost of the asset.

3.38 IFRIC 1 is an example of guidance that could be used to argue that estimates of cost of a good or service acquired in exchange for variable consideration should be updated to the extent the variable payments are initially included in the measurement of the asset. Accordingly, only to the extent that variable consideration is included in the initial measurement of an asset, should changes be included in the cost of the asset.

3.39 The Basis for Conclusions of IFRIC 1 (paragraph BC10), notes that the IFRIC considered that recognising changes in the estimated outflow of resources embodying economic benefits in current period profit or loss would be inconsistent with the initial capitalisation of decommissioning costs under IAS 16.

3.40 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 3.35d) above, the approach would provide more relevant information for estimating future cash flows and assessing stewardship if:

(i) the liability for variable consideration is recognised when the asset is received (and thus included in the original cost of the asset) and the variable consideration is positively linked to the acquired asset's expected future cash flows[14];

(ii) the liability for variable consideration is not recognised when the asset is received and the variable consideration is not positively related to the acquired asset's expected future cash flows.

Prudence

[14] To the extent that variable consideration is related to the cash flows generated from an asset, there is a higher chance that a change in the liability will relate to future cash flows the asset is expected to generate the earlier the liability is recognised. That is, if a liability for variable consideration is recognised when a good or service is received, there is a higher chance that a given change in the estimate will relate to future cash flows to be generated by the asset compared with the situation where the liability is only recognised when the event or circumstance that triggers the variable consideration has occurred.

b) To the extent that a liability for variable consideration is not recognised for variable consideration when the related good or service is received, the approach is prudent, as assets would be measured at a lower amount than under an approach where the changes in the estimates would be reflected in the cost of an asset.

c) However, under an approach where a liability for variable consideration is recognised when an asset is received, and included in the initial cost of the asset, the approach would not be more prudent but equally compared to subsequently including cost in the asset. If the estimate of variable consideration is increased, the approach would result in a higher carrying amount of the acquired asset compared to an approach where changes in the estimate of variable consideration are recognised in profit or loss and vice versa if the estimate of variable consideration is decreased.

Faithful representation

d) Whether or not an estimate of variable consideration is originally included in the cost of an asset could be determined relatively objectively.

Comparability and understandability

e) Approach 2 would result in similar guidance as the guidance on variable consideration related to rebates or obligations to dismantle and remove an item or restore a site. Also, Approach 2 would generally be similar to how IFRS 16 accounts for changes in estimates of variable consideration.

3.41 Disadvantages of this approach include:

Relevance

a) Approach 2 would not result in the most useful information for estimating future cash flows and assessing stewardship if:

(i) the liability for variable consideration is recognised when the asset is received (and thus included in the original cost of the asset) and the variable consideration is not positively linked to the future cash flows, the acquired asset is expected to generate;

(ii) the liability for variable consideration is not recognised when the asset is received and the variable consideration is positively related to the future cash flows, the acquired asset is expected to generate. In these cases, Approach 2 could result in counter-intuitive information as an expense would be recognised when there would be an increase in expected future cash flows.

Comparability and understandability

b) Approach 2 would result in different requirements on when to update the cost of an asset for changes in variable consideration compared to the guidance in IAS 19, IFRS 2 and IFRS 3.

Approach 3 - Updating the cost of the asset to reflect all changes in an estimate

3.42 The definition of cost in IFRS Standards could also be interpreted as the original estimate of an asset should be updated to reflect all changes in an estimate related to variable consideration.

3.43 This is reflected in one of the interpretations of the definition of cost in paragraph 3.9 whereby the cost of the asset would include the entire amount of cash or cash equivalents paid – even when these are contingent when the asset is received and thus only paid subsequently.

3.44 The fact that both IAS 16 (paragraph 16), IAS 38 (paragraph 27) and IAS 2 (paragraph 11) should take trade discounts and rebates into account when determining the cost of an asset, could be used to support the argument that cost should reflect the amount finally paid.

3.45 IFRS 15 *Revenue from Contracts with Customers* is dealing with variable consideration from the party receiving variable consideration. According to this standard (paragraph 59), an entity shall at the end of each reporting period update the estimated transaction price, in which variable consideration is included, to represent the circumstances present at the end of the reporting period. Changes in variable consideration is reported in 'revenue' similar to the revenue from the sale of the good or service to which it relates.

3.46 It could thus be argued that if IFRS 15 requires adjustments in the transaction price for goods and services from the perspective of the seller, it would be appropriate for the purchaser also to adjust the cost of those goods and services.

3.47 An approach could therefore be suggested under which both of the following changes in estimates of variable consideration would be reflected in the cost of the acquired asset:

a) changes of the estimates of variable consideration that were included in the initial measurement of the liability; and

b) changes of the estimates of variable consideration that were **not** included in the initial measurement of the liability.

3.48 Applying the chocolate spread recipe example[15]:

a) If a liability for the variable consideration is recognised when the purchaser receive the recipe, and this is originally measured based on the assumption that the purchaser expects to sell 50 000, the increase in the liability that would occur if the purchaser subsequently would expect to sell 70 000 jars would be added to the cost of the asset.

b) If a liability for the variable consideration is not recognised when the purchaser receives the recipe, and the purchaser then sells more than 10 000 jars, the liability that would then be recognised would similarly be included in the cost of the asset.

3.49 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 3.35d) above, the approach would provide relevant information for estimating future cash flows and assessing stewardship if the variable consideration is positively linked to the future cash flows the acquired asset is expected to generate.

[15] The difference with this example compared to Approach 2 is that, for Approach 3, any changes of the estimates of variable consideration that were not included in the initial measurement of the liability would also update the cost of the asset.

Reliability

b) As all changes in variable consideration would be reflected in the cost of the asset, no need for subjective judgement would be needed to determine whether a change in estimate should be included or not.

Comparability and understandability

c) Approach 3 would result in variable consideration related to rebates or obligations to dismantle and remove and item or restore a site being accounted for in a comparable manner to those assets for which any new guidance would be introduced.

3.50 Disadvantages of this approach include:

Relevance

a) Approach 3 would not result in the most useful information for estimating future cash flows and assessing stewardship if the changes in the estimate of variable consideration are not positively linked to the future cash flows, the acquired asset is expected to generate.

Prudence

b) To the extent that a liability for variable consideration is not recognised for variable consideration when an asset is received, the approach would be less prudent than Approach 1.

Comparability and understandability

c) Approach 3 would result in different requirements on when to update the cost of an asset for changes in variable consideration compared to the guidance in IAS 19, IFRS 2, IFRS 3 and IFRS 16.

Cost

d) Approach 3 would be more costly to apply than Approach 1 as a link between liabilities and the acquired assets would need to be established and the cost of the asset would need to be updated.

Approach 4 - Updating estimates until the asset is ready for its intended use

3.51 The definition of cost in IFRS Standards could also be interpreted as the original estimate of an asset should be updated to reflect changes in estimates related to variable consideration until the asset is ready for its intended use.

3.52 Paragraph 16 of IAS 16 requires that cost of an item of property, plant and equipment comprises any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

3.53 A similar requirement is included in IAS 38 (paragraph 27).

3.54 The time when the asset is ready for its intended use could thus be seen as the point in time from which the 'cost' is fixed and only changed by accumulated amortisation/depreciation and any accumulated impairment losses.

3.55 This approach would mean that, for example, variable payment that would have to be paid if a drug is approved for which the entity has acquired the right, should be included in the measurement of the right when the drug is approved (as the rights to the drug are only ready for their intended use when the drug can be sold). On the other hand, variable consideration related to the subsequent sale of the drug should not be included in the cost as these costs are not related to the period before the asset is ready for its intended use. Instead, these costs are indications of the development in the fair value of the asset, which should not be reflected in the cost measure.

3.56 Advantages and disadvantages of this approach would generally be similar to Approach 3 for the period until the asset is ready for its intended use and similar to Approach 1 for the period thereafter. In relation to comparability and understandability, however, it might be considered that the approach would be different from the guidance included in IAS 19, IFRS 2, IFRS 3, IFRS 16 and IAS 2, IAS 16 and IAS 38 regarding rebates.

Possible approaches not reflected in current guidance

3.57 In addition to the approaches mentioned above that are based on current guidance, this Chapter discusses two additional possible approaches:

a) An approach under which the original cost of an acquired asset is updated for changes in variable consideration to the extent an estimate of the variable consideration was originally included in the cost and if not originally included, then to the extent variable consideration payments are associated with future economic benefits to be derived from the asset.

b) An approach under which the original cost of an acquired asset is updated to the extent the variability is linked to the initial quality of the asset.

Approach 5 – Update the original cost estimate to the extent that those payments are associated with future economic benefits to be derived from the asset

3.58 As noted in paragraph 1.3, the issues considered in Chapter 2 and 3 of this Discussion Paper, are issues previously considered by the IFRS Interpretations Committee. The IFRS Interpretations Committee eventually came to the conclusion that the issue was too broad for it to address. However, during its discussions, it developed a possible approach for when changes in variable consideration should be reflected in the cost of an asset. Under this approach the following changes in the estimate of variable consideration would be reflected in the cost of the acquired asset:

a) changes of the estimates of variable consideration that were included in the initial measurement of the liability; and

b) changes of the estimates of variable consideration that were **not** included in the initial measurement of the liability to the extent that those variable consideration payments are associated with future economic benefits to be derived from the asset.

3.59 Applying the chocolate spread recipe, for example, if the recipe is improved to preserve the chocolate spread at even higher temperatures compared to before, any changes in estimate for variable consideration to be paid relating to this improvement in the recipe would be updated in the cost of the asset.

3.60 Another example of future economic benefits to be derived from the asset is variable payments relating to increased production capacity of an asset.

3.61 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 3.35d) above, the approach would generally provide relevant information for estimating future cash flows and assessing stewardship except to the extent that variable consideration is originally included in the cost of the asset, but the variability is not positively associated with future cash flows, the acquired asset is expected to generate.

b) Compared with Approach 1, Approach 5 would reduce volatility in profit or loss resulting from recognising gains and losses that are not related to the period.

Comparability and understandability

c) Approach 5 would result in variable consideration related to rebates or obligations to dismantle and remove and item or restore a site being accounted for in a comparable manner to those assets for which any new guidance would be introduced.

3.62 Disadvantages of this approach include:

Prudence

a) To the extent changes in variable consideration would be included in the measurement of the acquired asset because they would be associated with future economic benefits to be derived from the asset (and hence not because the liability for variable consideration was originally included in the cost of the asset), Approach 5 would be less prudent than Approach 1.

Reliability

b) The assessment of whether variable consideration is associated with future economic benefits to be derived from the asset would often be subjective. For example, if variable consideration would be related to the revenue of an entity and a particular acquired asset would contribute significantly to the revenue, would the variable consideration be associated with future economic benefits to be derived from the asset? Would the conclusion be different, if the effect on revenue would be much less significant?

Comparability and understandability

c) Approach 5 would result in different requirements on when to update the cost of an asset for changes in variable consideration compared to the guidance in IAS 19, IFRS 2, IFRS 3 and IFRS 16.

Cost

d) Approach 5 may be more complex to apply for preparers compared to, for example Approach 1, as it would require judgement related to whether some changes in estimates of variable consideration should be reflected in the cost of the acquired asset, some parts of changes in estimates would be capitalised while other parts would be recognised in profit or loss. Also, when changes in a liability for variable consideration should be reflected in the cost, a link between the liability and the asset needs to be maintained and the cost of the asset needs to be updated.

Approach 6 – Update of cost of the asset to the extent the variability is linked to the initial quality of the asset

3.63 Finally, a possible approach to consider is updating the cost of an asset to the extent the variable consideration is linked to the initial quality of the acquired asset. In other cases, for example, when the variability would be related to the use of the asset, the resulting changes in estimates would be recognised in profit or loss.

3.64 Variable consideration that would be linked to the initial quality of the acquired asset could, for example, be if the purchaser would have to pay an additional amount if an acquired drug would be approved by the health authorities or if the purchaser of a machine would have to pay an additional amount if the machine is capable of producing more than a given amount of units per minute

3.65 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 3.35d) above, Approach 6 would generally provide relevant information for estimating future cash flows and assessing stewardship. This is because the quality of the asset would be associated with the future cash flows to be generated from the asset.

b) Compared with Approach 1, Approach 6 would reduce volatility in profit or loss resulting from recognising gains and losses that are not related to the period.

Comparability and understandability

c) It could be argued that Approach 6 would account for variable consideration similarly to how variable consideration related to dismantling and removing and item or restoring a site is accounted for.

3.66 Disadvantages of this approach include:

Prudence

a) To the extent changes in variable consideration would be included in the measurement of the acquired asset because they would be linked to the initial quality of the asset, Approach 6 would be less prudent than Approach 1.

Faithful representation

b) The assessment of whether variable consideration is related to the initial quality of an asset would often be subjective.

Comparability and understandability

c) Approach 6 would result in different requirements on when to update the cost of an asset for changes in variable consideration compared to the guidance in IAS 19, IFRS 2, IFRS 3, IFRS 16 and for rebates in IAS 2, IAS 16 and IAS 38.

Cost

d) Approach 6 may be more complex to apply for preparers compared to, for example Approach 1, as it would require judgement related to whether some changes in estimates of variable consideration should be reflected in the cost of the acquired asset, some parts of changes in estimates would be capitalised while other parts would be recognised in profit or loss. Also, when changes in a liability for variable consideration should be reflected in the cost, a link between the liability and the asset needs to be maintained and the cost of the asset needs to be updated.

OVERVIEW OF CURRENT GUIDANCE

This section provides an illustrative overview of current guidance (and lack of current guidance) applying to examples of common types of variable consideration. This overview thus illustrates where there is lack of (clear) guidance/guidance is interpreted differently and therefore to what types of transactions the discussions in Chapters 2 and 3 apply. It also shows, how current guidance differs in how it accounts for variable consideration.

Examples covered by the illustration

OV.1 The diagrams below show the guidance related to the most common types of variable consideration. The diagram shows:

a) When a liability for variable consideration should be recognised (■);

b) How a recognised liability for variable consideration should be measured (initially and subsequently) (■);

c) Whether changes in the liability for variable consideration should be included in the cost of the acquired asset (■).

OV.2 These examples illustrate in what types of transactions the variable consideration covered by the guidance in the diagram could arise:

a) A good or a service acquired in exchange for cash-settled share-based payment. For example, an entity acquires a specialised piece of PPE and promises a payment in cash that will correspond to the value of five of the entity's ordinary shares in five years. (See IFRS 2 Diagram).

b) A business acquired in exchange for variable consideration to be paid in cash. For example, if an acquire will have to pay additional CU 10 millions for a business if the turnover of the business in the first year following the acquisition exceeds CU 20 millions. (See Main Diagram).

c) A service is acquired from an employee in exchange for paying a salary, a pension plan, and both short and long-term bonuses. For example, if an entity asks an employee to construct a machine. The employee is covered by the entity's defined benefit pension plan and is entitled to both short-term and long-term bonuses depending on her/his team's and the entity's performance. (See IAS 19 Diagram).

d) A right to use a tangible asset for 10 years is acquired. Each year an amount is paid which is adjusted by the Consumer price index (CPI). (See IFRS 16 Diagram).

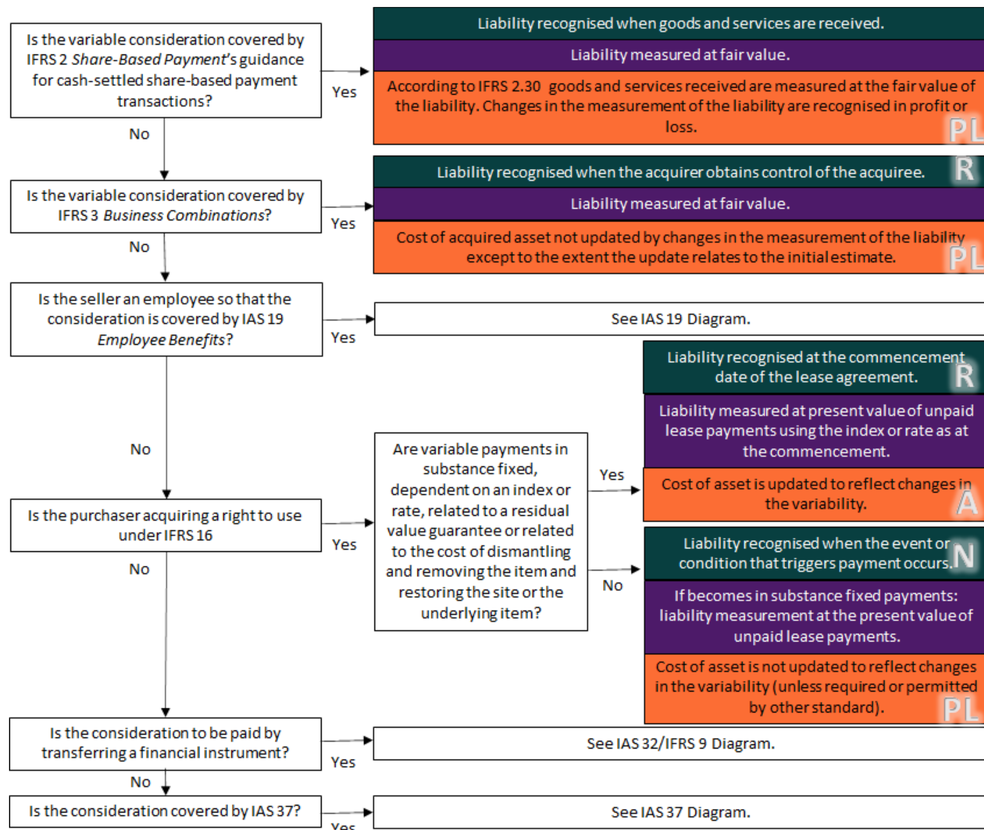
e) A good or service acquired in exchange for a variable consideration in cash or another financial instrument. For example, if an entity is acquiring a building in exchange for consideration that would depend on the estimated market value of that particular building in two years. Another example, would be if the purchaser is acquiring a machine and the consideration would depend on the price at which the purchaser sells the special products produced by the machine. A third example would be if a purchaser acquires some cars and will receive a rebate of CU 1 000 for each car purchased if more than ten cars are purchased before the end of the calendar year. (See IAS 32/IFRS 9 Diagram)[16].

f) A good or service acquired in exchange for a variable number of non-financial assets for which IAS 37 would apply in relation to the liability or in exchange for the purchaser takes on a liability covered by IAS 37. For example, if the purchaser acquires an asset in exchange for assuming the seller's liability related to restoring the site at which the asset has been placed. (See IAS 37 Diagram).

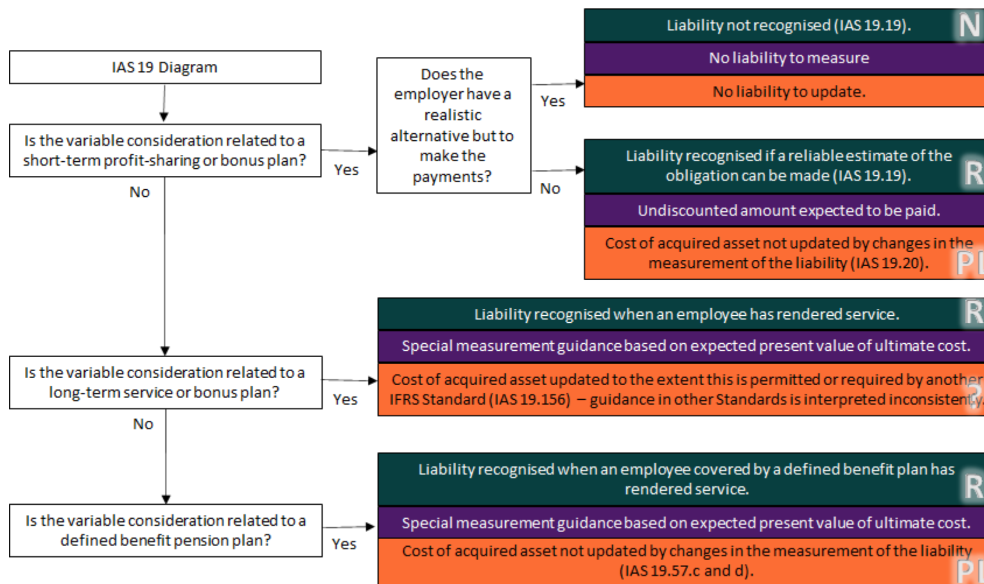
[16] In some cases a variable component in a contract would be an embedded derivative – and thus not variable consideration covered by this Discussion Paper.

Illustration of current guidance

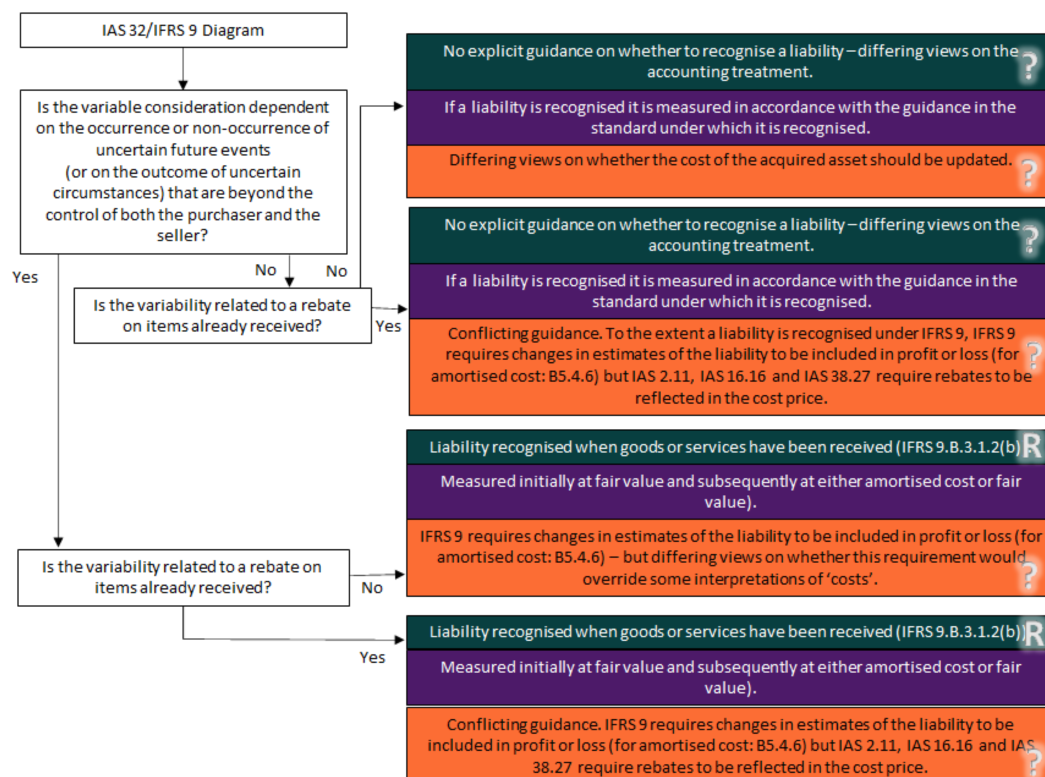
Main Diagram



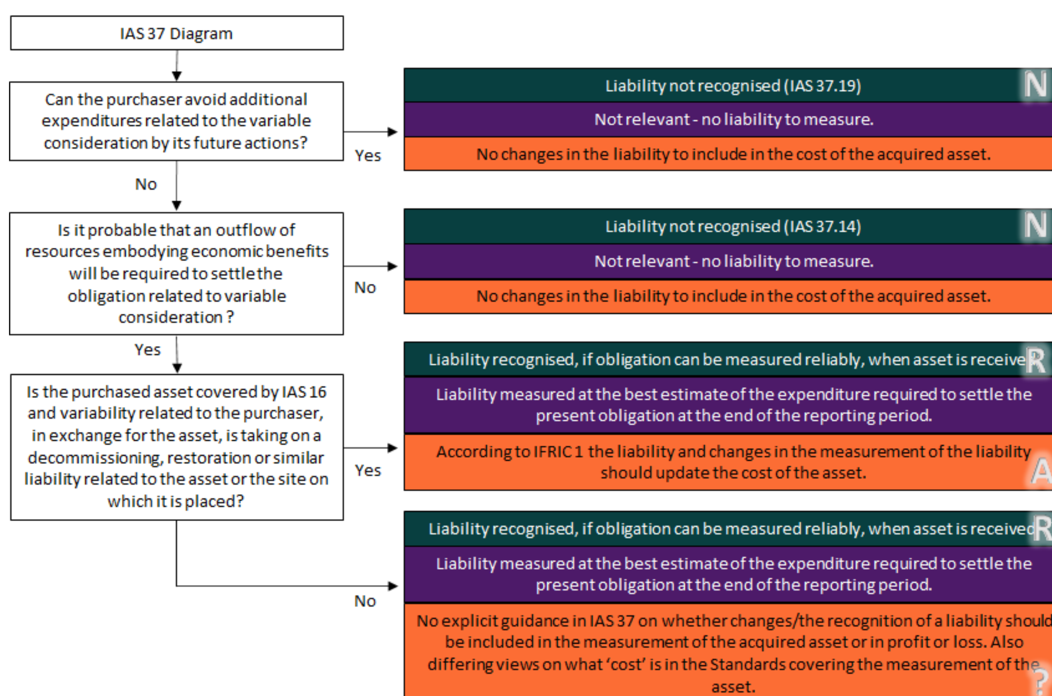
IAS 19 Diagram



IAS 32/IFRS 9 Diagram



IAS 37 Diagram



In the diagram ‘?’ means that there is no clear guidance on the subject. ‘A’ means that changes in the estimate of the liability is reflected in the cost of an asset. ‘PL’ means that changes in the estimate of the liability are recognised in profit or loss (hence not reflected in the cost of the acquired asset). ‘R’ means that a liability for variable consideration is generally recognised when the acquired goods or services have been received. ‘N’ means that a liability for variable consideration is generally not recognised with the goods or services are received.

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