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## **Draft Discussion Paper: Variable consideration Cover Note**

### **Objective**

- 1 The objective of this session is for EFRAG FR TEG to recommend the draft Discussion Paper on variable consideration to the EFRAG FRB for approval. The EFRAG FRB approval is expected in July 2022.

### **Background**

- 2 At the May 2022 meeting, EFRAG FR TEG made suggestions that have been incorporated into the Discussion Paper. Specifically, the Discussion Paper should:
  - (a) Only present the two alternatives for requirements on when to recognise a liability for variable consideration that could be deducted from different interpretations of the Conceptual Framework (Chapter 2).
  - (b) Use the term 'Alternative' instead of 'Approach' for possible requirements.
  - (c) Specify whether the acquisition of a subsidiary for the presentation in separate financial statements was covered by the Discussion Paper.
  - (d) Only present three alternatives for requirements on whether/when to update the carrying amount of an acquired asset for the changes in estimates of the related liability for variable consideration. All the alternatives under which the carrying amount would be updated only under certain circumstances would be grouped and presented as one alternative (sometimes updating the carrying amount) and the various circumstances under which this could be done would be presented as criteria.
- 3 At its 1 June 2022 meeting, the EFRAG FRB received an educational session on the Discussion Paper. At the meeting, the EFRAG FRB expressed support for issuing the paper. It also provided the following comments that have been reflected in the Discussion Paper:
  - (a) It should be specified whether the acquisition of a subsidiary for the presentation in separate financial statements was covered by the Discussion Paper. Also, it should be clarified which aspects of IFRS 3 were excluded from the scope.
  - (b) It could be clarified what the notion 'depending on the purchaser's future action' means and whether Chapter 3 also only considers variable consideration that depends on the purchaser's future actions.
  - (c) A member questioned the framing of the liability recognition issue (i.e., when to recognise a liability) as mainly arising from the varied interpretation of the requirements of IAS 32 *Financial Instruments: Presentation* paragraph 25. The member opined that the inconsistency between the requirements IAS 16

*Property, Plant and Equipment, IAS 38 Intangible Assets* and those of IAS 32 was the root cause of diversity in practice.

- (d) The purpose of Chapter 4 focusing on holistic requirements should be clarified and Chapters 2 and 3 should be earmarked as part 1 and Chapter 4 as part 2 of the Discussion Paper.
- 4 The EFRAG staff subsequently had a call with the EFRAG FRB member who questioned whether the issue arising in relation to the recognition of a liability for variable consideration had been described appropriately. The EFRAG FRB member considered that the issue arose as IAS 32 would require a liability to be recognised for variable consideration that would depend on the purchaser's future actions while the definition of cost included in IAS 16 and IAS 38 would prohibit variable consideration be reflected in the cost. Accordingly, the question arose whether you could recognise a liability for something that could not be included in cost. The EFRAG FRB member argued that if the reason for the divergence in practice had arisen as a result of different interpretations of IAS 32, it would mean that the issue would also be relevant if a financial instrument was acquired for variable consideration. The EFRAG FRB member had not heard about any issues in that regard. The EFRAG FRB member was therefore concerned about stating in the Discussion Paper that different interpretations of IAS 32 paragraph 25 existed.
- 5 To further investigate the issue raised by the EFRAG FRB member, the EFRAG Secretariat has reached out to the IASB staff and specific senior figures in accounting firms. In addition, if the alternative view were true, it would be a departure from the premise of the Discussion Paper that the liability recognition issue only arises when the variable consideration depends on the purchaser's future action, and necessitate a revision of the first part of Chapter 2. Hence, the EFRAG Secretariat is cross-checking the views and understanding of the EFRAG FR TEG on which aspects of requirements have led to the noted diversity in practice.
- 6 While the outreach to specific senior figures in accounting firms will be done after this paper is uploaded (EFRAG FR TEG will receive an oral update on this), the EFRAG Secretariat has met with specific relevant members of the IASB staff to obtain their views on the matter. The IASB staff concurred with the view of EFRAG's Discussion Paper.
- 7 The IASB staff members also suggested specifying in the Discussion Paper that the liability arises as a result of a contract in the example in the Discussion Paper, which further points to IAS 32 being the relevant standard. This comment has been reflected in the Discussion Paper.
- 8 Based on the consultations done so far, the Discussion Paper has been updated to only acknowledge this alternative view without altering the premise of the research around the reason for diversity in practice (i.e., multiple interpretations of IAS 32 paragraph 25).
- 9 The Discussion Paper has also been updated to reflect drafting and other understandability-enhancing comments received.

**Questions for EFRAG FR TEG**

- 10 Do EFRAG FR TEG members consider that the issue(s) resulting in divergence in practice related to the recognition of a liability for variable consideration is/are reflected correctly in Chapter 2 of the Discussion Paper (i.e., do EFRAG FR TEG members consider that IAS 32, paragraph 25 is interpreted inconsistently)?
- 11 Based on the EFRAG FR TEG's discussions on the Discussion Paper, does EFRAG FR TEG agree that its comments have been reflected in:
- (a) Chapter 1 (Background and Scope)?

- (b) Chapter 2 (Recognition of a liability for variable consideration)?
  - (c) Chapter 3 (Measurement of an acquired asset)?
  - (d) Chapter 4 (Holistic assessment of variable consideration requirements)?
  - (e) Appendix 1 (Overview of current guidance)?
  - (f) Appendix 2 (IFRS recognition and measurement requirements considered in Chapter 4)?
  - (g) Appendix 3 (Summary of past IFRS Interpretations Committee issues)
- 12 Does EFRAG FR TEG agree that the Executive Summary included in the Discussion Paper reflects the content of the Discussion Paper?
- 13 Does EFRAG FR TEG recommend the Discussion Paper to the EFRAG FRB Board for approval?

### **Agenda Papers**

- 14 In addition to this cover note, the agenda paper for this session is Agenda paper 03-02 – Draft Discussion Paper.