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Our ref: RJ-EFRAG 621 D
Direct dial: +31 (0)88 4960391
Date: Hoofddorp, November 2023
Re: EFRAG Discussion Paper Accounting for variable consideration

Dear members of the EFRAG Technical Expert Group,

The Dutch Accounting Standards Board (DASB) appreciates the opportunity to provide a response to the EFRAG Discussion Paper Accounting for variable consideration (hereafter DP). Our general comments on the discussion paper are included in this letter and our responses to the specific questions are included in the appendix to this letter.
To address the accounting for variable consideration, our view is that the primary focus should be on the determination of the result by an entity. Taking the balance sheet as a starting point could result in less relevant and reliable information.
In situations that a variable consideration is linked to future performance or use of an asset and the variable consideration payable reflects an outflow of resources embodying economic benefits that relate to that period, recognizing the variable consideration in that period will result in relevant information in the income statement. In addition, such an approach will also have significant costs benefits because the initial estimate and subsequent periodic estimates of a liability for such variable consideration will not be necessary.
We also stress that in many situations not recognizing a liability relating to variable consideration will not have any impact on equity at initial recognition of the related asset. Reason is that the opposite entry of a recognized liability at initial recognition would have been accounted for as part of the cost of that asset. That will also be the case for subsequent remeasurements of such a liability. Therefore, we believe that the accounting for variable consideration relating to the acquisition of assets shall not solely be addressed by focussing on the recognition of a liability and its subsequent measurement . We suggest to develop an approach similar to the approach regarding non-index based variable lease payments for lessees in IFRS 16.
In addition, we believe that the accounting for variable consideration shall be addressed using a standard-by-standard approach. Keeping the scope of a project on variable consideration narrow will help to come up with a solution which will result in relevant and reliable information. The primary focus of the project should be on variable consideration relating to the acquisition of intangible assets (IAS 38) and property, plant and equipment (IAS 16).

If you have any questions please do not hesitate to contact me.

Yours sincerely,

drs. G.M. van Santen RA
Chairman Dutch Accounting Standards Board

QUESTION 1 - WHEN TO RECOGNISE A LIABILITY FOR VARIABLE CONSIDERATION

Chapter 2 explores two alternatives for requirements on when to recognise a financial liability for variable consideration that depends on the purchaser's future actions under IAS 32/IFRS 9:

a) Alternative 1: Recognising a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration. (The Discussion Paper includes suggested criteria on when a purchaser entity would not have the practical ability to avoid taking the action(s) that would trigger the variable consideration (see Question 2 below)).

b) Alternative 2: Recognising a liability when the purchaser performs the actions that trigger the variable consideration.

The Chapter also includes assessments of qualitative characteristics of useful information for each of the two alternatives.

Do you agree with these assessments?

Response

No, we are of the view that an IFRS 9 approach may not (always) be the appropriate starting point for the accounting for a transaction with a variable consideration. Such an approach puts too much focus on the liability recognition at a certain moment in time and less on the determination of the result for a period. An example of such an approach is the accounting for contingent consideration regarding a business combination (initial and subsequent measurement using an IFRS 9 approach). However, such an approach could result in relevant and reliable information when variable consideration which relates to the acquisition of investment property measured at fair value in accordance with IAS 40.

When do you think a purchaser should recognise a financial liability covered by IFRS 9 for variable consideration that would depend on the purchaser's future actions? Please explain your answer.

Response

We are not in favor of an approach which focusses primarily on the timing of the initial recognition of a liability and its subsequent measurement ('an IFRS 9 approach'). We believe that an approach similar to IFRS 16 regarding variable lease payments could be applied.

If an IFRS 9 approach were to be applied to variable consideration that would depend on the purchaser's future action, we believe that a purchaser shall recognise a financial liability consisting of the fixed and variable consideration at its fair value as soon as the purchaser obtains control over the asset. Applying such an approach we believe that the liability consisting of the fixed and variable consideration shall be one unit of account within the scope of IFRS 9.

Do you think that other alternatives for requirements for liabilities for variable consideration than those listed should be considered? If so, please specify these other alternatives.

Response

We identify an approach similar to the accounting for variable lease payments excluding variable lease payments that do not depend on an index or rate (non-index based) under IFRS 16 as an available alternative.

During the development of IFRS 16, there were differing views whether variable payments linked to future performance or use of an underlying asset in a lease contract meet the definition of a liability (IFRS 16.BC168). We expect that these differing views also exist regarding variable consideration outside lease contracts. Our view is that the principles of IFRS 16 provides a more pragmatic solution that could result in relevant and reliable information. In situations that a variable consideration is linked to future performance or use

of an asset and the variable consideration payable reflects an outflow of resources embodying economic benefits that relate to that period, recognizing the variable consideration in that period will result in relevant information in the income statement. Such an approach has also significant costs benefits because the initial estimate and subsequent periodic estimates of a liability for such variable consideration will not be necessary.
We also stress that in many situations not having to recognize a liability relating to variable consideration will not impact equity at initial recognition of the related asset. Reason is that the opposite entry of a recognized liability at initial recognition would have been accounted for as part of the cost of that asset. That will also be the case for subsequent remeasurements of such a liability. Therefore, we believe that the accounting for variable consideration relating to the acquisition of assets shall not be addressed generally using an IFRS 9 approach.
Are you aware of any issues relating to the measurement of a recognised financial liability for variable consideration? If so, please elaborate on these issues.
Response
Sellers of investment property might provide guarantees to buyers or might demand variable consideration if certain occupancy is achieved. These kind of guarantees/arrangements related to such tenancy level in respect of an item of investment property may affect the initial purchase price of the investment property (and its fair value) within the scope of IAS 40. Another issue regarding the (remeasurement) of a recognized financial liability relates to the presentation of such remeasurement in the income statement. If a liability is remeasured through the income statement, these are mostly considered 'financing cost', whereas in most cases these remeasurements relate to actions and activities in relation to the company's operations and mostly should be captured in cost of sales or equivalent as part of operating profit. As well as the ambiguity on the 'if and when' to recognize the liability, there is a variety in how the offset of changes in liability should be captured in the income statement, if that is the company's option.

QUESTION 2 - HOW TO ASSESS THAT AN ENTITY HAS NO PRACTICAL ABILITY TO AVOID TAKING AN ACTION

Chapter 2 suggests five alternative criteria for assessing when a purchaser would have no practical ability to avoid taking an action which would trigger a variable consideration (when the purchaser is not legally or constructively obliged to perform the future actions). The five suggested criteria are:

a. When avoiding taking an action would mean that the purchaser would have to cease its activities.
b. When avoiding taking an action would have a significant unfavourable economic impact on the entity.
c. When avoiding taking an action would have a significant unfavourable economic impact in the context of the acquired asset.
d. When avoiding taking an action would result in using an acquired asset in a manner that would not reflect the economic purpose of acquiring the asset.
e. When avoiding taking an action would have marginal economically unfavourable consequences for the entity.

Do you agree that the above criteria are valid for assessing whether a purchaser would not have the practical ability to avoid performing a future action that would trigger variable consideration?

Response

We are not convinced that such an approach should be included in IFRS for variable consideration related to the acquisition of assets such as intangible assets and property, plant and equipment. We do not believe that, by itself, economic compulsion could or should result in having to recognise a liability. Therefore, we propose a much narrower interpretation of no practical ability to avoid taking an action. No practical ability could be the case when variable consideration shall be considered in-substance fixed consideration (for example, a payment which shall be made when the asset is available for use). Such payments are unavoidable and, thus, are economically indistinguishable from fixed consideration. In addition, we believe that the provisions regarding 'not having the practical ability' in relation to variable consideration should be in line with the future implementation of that concept in IAS 32/IFRS 9 and IAS 37. We also view that, as an additional argument, costs-benefits considerations should be taken into account.

Specifically regarding variable consideration related to the acquisition of assets such as intangible assets and property, plant and equipment, we suggest to use an approach similar to the approach in IFRS 16 regarding the accounting for variable lease payments by lessees.

Are there other criteria that should be considered? If so, please elaborate on these other criteria.

Response

No.

Which of the above criterion/criteria would you prefer and why?

Response

We prefer none of the above criteria.

QUESTION 3 - INTERPRETATIONS OF THE DEFINITION OF COST

Chapter 3 notes that the definition of 'cost' included in IAS 16, IAS 38 and IAS 40 ("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") is interpreted differently.

How do you interpret current requirements in relation to whether/when the measurement at cost of an asset covered by IAS 16 or IAS 38 should be updated to reflect changes in estimates of variable consideration?

Response

Our interpretation is that the cost of an asset within the scope of IAS 16 or IAS 38 should be updated using a similar approach as the one included in IFRIC 1 Changes in Existing Decommissioning Restoration and Similar Liabilities, which requires the cost of a related asset to be adjusted to reflect changes in decommissioning, restoration and similar liability. Therefore, we believe that these standards in combination with IFRIC 1 provide a clear solution for this issue.

How do you think 'cost' should be defined to provide the most useful information and do you think it is useful to consider that measurement at cost should be similar across all IFRS Standards?

Response
Our view is that cost of an asset within the scope of IAS 16 or IAS 38 should be updated for variable consideration if that results in relevant information. Updating the cost of an asset results in relevant information if such an update reflects an outflow of resources embodying economic benefits that relate to future periods. We suggest an approach in which variable consideration linked to future performance or use of an asset is recognized in the income statement unless (part of) the variable consideration reflects an outflow of resources embodying economic benefits that relate to future periods. Such an approach could be similar to the approach in IFRS 16 regarding the accounting for variable lease payments by lessees. However, we believe that (part of) the variable consideration which reflects an outflow of resources embodying economic benefits that relate to future periods shall be recognized as part of the costs of the related asset. This will be necessary to allocate the costs of the asset to the periods in which the asset will be used.

QUESTION 4 - POSSIBLE REQUIREMENTS FOR WHEN MEASUREMENT AT COST SHOULD BE UPDATED TO REFLECT CHANGES IN ESTIMATES OF VARIABLE CONSIDERATION

Chapter 3 explores the following three possible alternatives for requirements for when the cost of an asset should be updated in situations where the asset is acquired in exchange for variable consideration in cash or another financial instrument:
a) Alternative 1: Not updating the cost estimate.
b) Alternative 2: Updating the cost to reflect all subsequent changes in estimates of variable consideration.
c) Alternative 3: Sometimes updating the cost of an asset.
The Discussion Paper lists the following criteria which could be used to determine when the cost of the asset should be updated. One or several of the criteria could be used:

- Update if estimates of variable consideration are included in the measurement of the asset’s cost at initial recognition.
- Update if the change in estimates of variable consideration takes place before the asset is ready for its intended use.
- Update the cost to the extent that variable payments are associated with future economic benefits to be derived from the asset.
- Update the cost to the extent that variable consideration is linked to the initial quality of the asset.

Do you think that other possible requirements than those explored in the Discussion Paper should be considered? If so, what are these other requirements?
Response
Yes. An alternative approach could be that the cost of a related asset will never be updated using an approach similar to the approach in IFRS 16 regarding the accounting for variable lease payments by lessees (which are not in-substance fixed). We also refer to our response under question 3.
Chapter 3 presents the qualitative characteristics of useful information for the three possible alternative requirements (including the four different criteria under Alternative 3) for when measurement at cost should be updated to reflect changes in estimates of variable consideration.
Do you agree with the assessed characteristics of useful information for the alternatives?

Response
Yes.
If not, which elements should be considered and which assessments do you disagree with?
Response
N/A
When do you think ‘cost’ should be updated to reflect changes in estimates of variable consideration?
Response
We are in favor of alternative 3. The cost of an asset should be updated if the variable consideration to be payable is associated with the future economic benefits to be derived from the related asset.
If you think that ‘cost’ should sometimes be updated, under what circumstances should it be updated?
Response
Updating the cost to the extent that variable payments are associated with future economic benefits to be derived from the asset. All other variable payments shall be recognised directly in the income statement. Such an approach could be similar to the approach in IFRS 16 regarding the accounting for variable lease payments by lessees (which are not in-substance fixed). Variable consideration which is in substance fixed shall be recognized as soon as the related asset is recognized.

QUESTION 5 - GENERAL REQUIREMENTS ON ACCOUNTING FOR VARIABLE CONSIDERATION

Chapter 4 complements Chapters 2 and 3 of the Discussion Paper by assessing the broader requirements for accounting for variable consideration. Chapter 4 examines the advantages and disadvantages of respectively developing a unified set of principles for IFRS requirements to account for variable consideration and undertaking Standard-by-Standard amendments that could apply to the two issues covered in Chapters 2 and 3 (i.e., liability recognition when payment depends on purchaser’s future actions and measurement of the acquired asset).
Do you agree with the advantages and disadvantages identified?
Response
Yes.
Based on your assessment and the outlined advantages and disadvantages of respectively developing a unified set of principles for IFRS requirements to account for variable consideration and undertaking a Standard-by-Standard amendment, which of the standard-setting responses do you support?
Response
We support a standard-by-standard approach in which the accounting for variable consideration will be addressed. We do not believe in one unified approach for all variable consideration. However, a unified approach shall be applied for the acquisition of assets within the scope of IAS 16 and IAS 38. We also believe that variable consideration regarding investment property (IAS 40) and inventory (IAS 2) shall be addressed specifically in these standards.
An approach for variable consideration regarding the acquisition and subsequent accounting of associates and joint ventures applying the equity method (IAS 28) and/or in respect of the application of the cost or equity method in IAS 27.10 (a) and (c) respectively, could differ from the approach for the acquisition of assets within the scope of IAS 16 and IAS 38.

Variable considerations in those circumstances are more akin to the requirements of IFRS 3 in relation to the acquisition of a business, even though measured at cost or equity method.
Do you think that requirements to deal with the issues mentioned in Chapters 2 and 3 should be based on a unified set of principles for how to account for variable consideration?
Response
We refer to our answer above.

QUESTION 6 - APPLYING AN IFRS 15 MIRRORING APPROACH

Chapter 4 notes that requirements on variable consideration included in IFRS 15, could be 'mirrored' to provide guidance on how to account for a liability for variable consideration (with the exception of the constraint to only include in the transaction price the amount of variable consideration that is highly probable not to result in a significant reversal in the amount of cumulative revenue recognised).
Do you think such an approach would result in useful information? Please explain why or why not?
Response
No. We do not believe that mirroring the accounting of purchasers with the accounting of sellers under IFRS 15 (and IAS 16 and IAS 38) shall be a primary objective when developing guidance applicable to the accounting for variable consideration form the buyer's perspective. The recognition and measurement of revenue from the seller's perspective have other objectives than the recognition and measurement of variable consideration from the buyer's perspective. The core principle of IFRS 15 is to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods and services (IFRS 15.2). That objective is different for the accounting for variable consideration from a buyer's perspective. The focus on the accounting by the buyer should be on the accounting of costs in the income statement as part of the determination of income.
The objective of the accounting for variable consideration is to provide information about (existing and future) liabilities of the entity. Information about priorities and payment requirements of existing and future claims shall help users to predict how future cash flows will be distributed among those with a claim against the entity. This information shall help users to assess the reporting entity's liquidity and solvency position. We refer to Conceptual Framework OB13-14. However, we do not believe that this should mean that claims regarding variable consideration related to the acquisition of asset such as intangible assets and property, plant and equipment shall be recognized in the balance sheet. We are of the view that to meet the objective above, in specific situations information provided in the notes to the financial statements could be sufficient. We refer to our suggestion to investigate whether an approach similar to the approach in IFRS 16 for variable lease payments could be a solution.