Variable consideration
Cover Note

Objective

1 The purpose of this session is for EFRAG TEG to consider and provide feedback/direction on:

(a) Chapters 1, 2 and 3 and Overview of Current Guidance in the initial draft Discussion Paper on accounting for variable consideration. The executive summary and questions for constituents will be added later.

(b) Preview of an additional chapter to be included in the Discussion Paper to discuss the different approaches that exist in IFRS guidance.

(c) Whether and how the Discussion Paper should discuss an approach for accounting for liabilities for variable consideration by purchasers of goods and services that mirrors (analogises) the requirements for accounting for variable consideration within IFRS 15 *Revenue from Contracts with Customers* related to sellers of goods and services (i.e., IFRS 15 mirroring approach).

Questions for EFRAG TEG

2 The issues papers on an additional chapter to be possibly added in the Discussion Paper (see paragraph 1(b) above) and whether an IFRS 15 mirroring approach should be considered (see paragraph 1(c) above) include specific questions for EFRAG TEG. A few specific questions are also included in the draft Discussion Paper. In addition, EFRAG TEG members are asked for any comments on each of the chapters of the Discussion Paper, including:

(a) Whether appropriate examples of variable considerations have been presented or whether the examples reflect something else besides variable consideration (e.g., if they represent the partial acquisition of goods or services) (which would then be outside the scope of the Discussion Paper).

(b) Whether, as stated in Chapter 1, it is appropriate to limit the scope of the Discussion Paper to variable consideration arising within non-executory contracts and therefore not discussing issues with executory contracts.

(c) Whether a possible interpretation of IAS 32 *Financial Instruments: Presentation* that an equity component should be recognised for variable consideration that would depend on the purchaser’s future actions when a good or service received is sufficiently and appropriately reflected in Chapter 2 of the draft Discussion Paper. Is it appropriate that the draft Discussion Paper only mentions the approach as a possible interpretation of current guidance without considering the approach further?

(d) Whether additional approaches should be considered in Chapters 2 and 3, or whether any of the approaches mentioned should be removed.

(e) Whether there are additional advantages or disadvantages of the approaches considered in Chapters 2 and 3 that should be mentioned, or whether any of the advantages or disadvantages listed should be removed.

(f) Whether the Overview of Current Guidance (the diagrammatic representation and examples) is useful, sufficiently understandable and complementary to the analysis in Chapters 1, 2 and 3.

(g) Whether the actions of the EFRAG Secretariat to the comments received from TEG at previous meetings have been appropriately reflected (see the summary of the comments and the actions in paragraph 3 below).

Background

3 The issues to be considered in this session resulted from previous discussions of EFRAG TEG. The table below lists the comments made by EFRAG TEG at the July 2021, September 2021, October 2021 and November 2021 EFRAG TEG meetings and actions (i.e., how these comments are or will be addressed in the Discussion Paper).

EFRAG TEG Comments	Actions
At the July 2021 EFRAG TEG meeting, TEG members confirmed that there were different interpretations on how to account for variable consideration that was within the control of the purchaser. EFRAG TEG's conversation confirmed that there are two issues related to variable consideration: 1) Lack of (clear) guidance for some types of variable consideration; and 2) Different guidance for other types of variable consideration.	The draft Discussion Paper considers both issues.
When examples of variable consideration were considered at the July 2021 EFRAG TEG meeting, it was mentioned that, in some cases where the variability would depend on the purchaser's future actions, it could be argued that the purchaser has an equity component before those future actions take place. This equity component would be derecognised and a liability recognised when the entity would start using the asset. This issue was considered at the October 2021 EFRAG TEG meeting. It was agreed to include a brief description in the DP on an approach where an equity component would be recognised in relation to variable consideration. EFRAG TEG members expressed differing views on this approach and a number of concerns were expressed on the possible conclusion that the variable component is equity; some observed that the use of a	Chapter 2 of the draft Discussion Paper briefly mentions the equity component interpretation as a possible interpretation of the current guidance. Based on reservations expressed by EFRAG TEG members, Chapter 2 does not list this approach among the approaches that could be further considered when accounting for variable consideration that is yet to be paid. Instead, it focuses only on approaches for liability recognition.

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theoretical example in the issue paper (for which the economic rationale was unclear) could provide a direction supporting the equity component, which would not be the case had a more realistic example been chosen. To avoid adding complexity to the DP, the mention of this possible interpretation should only be mentioned as a possible theoretical interpretation.	
At the July 2021 EFRAG TEG meeting, it was decided that the notion of 'cost' in IFRS should be considered. The notion of 'cost' was discussed at the September 2021 meeting. In that regard, the following comments were made, which will be taken into consideration when drafting the Discussion Paper (Refer to Agenda Paper 10-04 for the Structure of EFRAG's Discussion Paper): • EFRAG TEG generally agreed that there could be different interpretations on 'cost' as concluded in Agenda Paper 06-04 for the September 2021 meeting. • EFRAG TEG agreed that changes in variable consideration related to the period before an asset covered by IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets* would be ready for its intended use should be included in the cost of the asset. • It was noted that the notion of 'cost' in the IASB ED *Regulatory Assets and Regulatory Liabilities* should also be considered as it could reflect the IASB's latest thinking and suggested that cost could be updated. • The discussion on 'cost' should also include how 'cost' is defined in the Conceptual Framework.	In the draft Discussion Paper: • Whilst assessing current guidance for the subsequent measurement of acquired assets, Chapter 3 presents the different notions and interpretations of 'cost'. • As one of the possible additional approaches, Chapter 3 presents an approach under which changes in variable consideration that take place before the acquired asset is ready for its intended use is included in the cost of the asset. • To reflect the IASB's latest thinking, Chapter 3 mentions the measurement approach proposed in the IASB ED *Regulatory Assets and Regulatory Liabilities*. • Chapter 3 of the Discussion Paper includes a discussion of how 'historical cost' is explained in the Conceptual Framework.
At the July 2021 EFRAG TEG meeting, the view was expressed that the Discussion Paper should not consider an approach based on entities' expectations as such an approach would not be compatible with the Conceptual Framework which does not focus on expectations but on an entity's ability to avoid.	An approach based on what the entity expects to do is not considered in the Discussion Paper.
At the July 2021 EFRAG TEG meeting, it was decided that it should be further considered whether the Conceptual Framework could provide guidance on	In the draft Discussion Paper, the following has been included: • Chapter 2 considers the guidance in the Conceptual Framework on when a

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when to recognise a liability. In this regard, it should be considered what 'no practical ability to avoid' in the Conceptual Framework could mean in the case where an asset had been acquired, but an additional consideration had to be paid to use the asset. The view was presented that in such a case, the entity would not have a practical ability to avoid (unless the entity did not intend to use the asset – e.g. because it would just keep competitors from using it). It should also be considered what should be 'the past event': the transfer of the asset or the action of the purchaser that trigger the payment (or both). In this regard, the IASB's conclusions on the regulatory asset and liability project could be considered. In this project, it seemed that the IASB considered that if you had two possible 'past events' it was the first event that should be taken into account. The guidance on when to recognise a liability was considered at the September 2021 EFRAG TEG meeting. In that regard, the following comments were made to the agenda paper prepared by the EFRAG Secretariat, which will be taken into consideration when drafting the Discussion Paper: • The Conceptual Framework is not clear with regards to the role of economic compulsion when considering 'no practical ability to avoid'. • There are differing views on whether the 'past event' would always be when the purchaser would obtain control of a good or service. It could be argued that sometimes the purchaser would not have economic benefits from receiving an asset, but only when it started using an asset received (e.g., if the asset should deliver some specified performance targets). • The establishment of the contract should not be considered as the past event. IFRS 16 *Leases* states that the past event is when an asset is received – not when a contract is established. • The Discussion Paper should have a discussion on the Conceptual Framework without reaching a conclusion on the issues mentioned above. • If it would be included in the Discussion Paper, better arguments should be provided when stating that an entity would have no practical ability to avoid a	liability exists and that there are different interpretations of this guidance. • It is not considered in the discussions that the relevant 'past event' could be the signing of the contract. • The draft Discussion Paper does not include a discussion of constructive obligation. It is considered that such a discussion would fit best in Chapter 4. • The draft Discussion Paper does not include a discussion about an entity that would have no practical ability to avoid a reduction in sales or if it is not using an acquired asset. Accordingly, it has not been necessary to improve the wording on this. • The discussion on executory contracts has not been extended in the draft Discussion Paper. This is because EFRAG TEG has previously considered that the Discussion Paper should consider situations where a good or service has been received – but the payment for the good or service is uncertain. It is accordingly mentioned in Chapter 1 that executory contracts are outside the scope of the Discussion Paper.

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reduction in sales or not using an acquired asset. • The discussion should consider constructive obligations (for example, restructuring costs under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*). • The discussion on executory contracts should be extended.	
At the July 2021 EFRAG TEG meeting, it was mentioned that it should be considered whether the manner the purchaser of an asset for variable consideration should account for the transaction could be based on how the seller would account for it. Such an approach was presented in Agenda Paper 05-02 for the November 2021 EFRAG TEG meeting, however, TEG members wanted the analysis to be further developed before it would discuss the approach. It was thus agreed that the EFRAG Secretariat should prepare a paper on how variable consideration would be accounted for by a purchaser if the accounting by the purchaser should mirror how the seller would account for it under IFRS 15.	Paper 06-04 for this session presents an approach mirroring the requirements included in 'IFRS 15.
At the July 2021 EFRAG TEG meeting, it was mentioned that it should be considered whether IFRS 16 would be a good candidate for an approach for recognition of a liability for variable consideration as its requirements on variable consideration were not based on conceptual arguments.	The requirements and Basis for Conclusions related to IFRS 16 are reflected in Chapter 2 of the Discussion Paper.
At the July 2021 EFRAG TEG meeting, EFRAG TEG agreed that if the variability related to variable consideration is outside the control of the purchaser, a liability for variable consideration should be recognised.	In the draft Discussion Paper, the description of the issue on the lack of (clear) guidance on when to recognise a liability for variable consideration is limited to the situations where the variability is dependent on the purchaser's future actions.
At the July 2021 EFRAG TEG meeting, it was noted that it should be kept in mind that although no liability would be recognised, there could still be direct costs related to acquiring an asset, that should be capitalised.	This comment is not reflected in the draft Discussion Paper in order to keep the paper focused on variable consideration. When considering the draft Discussion Paper, EFRAG TEG is encouraged to note if it considers this comment to be reflected.
At the July 2021 EFRAG TEG meeting, EFRAG TEG members agreed that in a contract containing both a fixed-payment part and variable-payment part, recognition of a liability related to the variable part	The draft Discussion Paper reflects this assumption in Chapter 1 when explaining the unit of account.

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should be considered independently of that related to the fixed part.	
At the July 2021 EFRAG TEG meeting, it was noted that as it could be discussed whether a liability to pay with bitcoins would fall under IAS 37, an example including Bitcoins should not be included in the Discussion Paper.	The draft Discussion Paper does not include an example with payment with Bitcoins.
At the September 2021 EFRAG TEG meeting, in relation to the question on whether differences in existing guidance should be assessed, EFRAG TEG agreed to discuss in the Discussion Paper why the guidance on variable consideration in current IFRS Standards is different and “map” the different guidance without trying to identify an approach that should be applied in all cases. Agenda Paper 05-03 for the November 2021 meeting presented an overview of current guidance in relation to the recognition of a liability for variable consideration and on whether subsequent changes in the estimate of a liability for variable consideration should be reflected in the cost of the acquired asset, respectively. At the November 2021 EFRAG TEG meeting, it was agreed that the EFRAG Secretariat should restructure the paper on the ‘mapping’ of current requirements so that the various steps – both in relation to the liability to pay variable consideration and the measurement of the acquired asset would be considered together. It was suggested that in the Discussion Paper, some of the different scenarios could be included in an appendix	A diagram of the current guidance has been included in the draft Discussion Paper in a section named ‘Overview of current guidance’ which is included in the Discussion Paper. Before the diagrams, examples of variable consideration are provided.
At the November 2021 meeting, the view was presented in relation to the paper on the mapping of existing standards, that volume discounts were not variable consideration and that consideration that would have to be paid under IAS 19 *Employee Benefits* would not depend on the employer’s future actions (differing views were expressed on this). It was also noted that IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* was a relevant standard to consider in relation to variable consideration and it could be assessed whether amending paragraph 25 of IAS 32 could be a pragmatic solution to the issue related to when to recognise a liability for variable	The draft Discussion Paper still considers rebates to be variable consideration. The EFRAG Secretariat considers that this follows from the IFRIC agenda decision ‘IAS 2 Inventories: Discounts and rebates’ from 2004 and the Basis for Conclusions accompanying IFRS 15 also mention refunds to be variable consideration. The EFRAG Secretariat also notes the differing views among EFRAG TEG members on whether consideration paid under IAS 19 would be variable consideration and has therefore kept considering that part of this consideration could be variable. In Chapter 2 of the draft Discussion Paper, it appears that the issue considered in the Chapter arises because of paragraph 25. As mentioned in Chapter 1, executory

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consideration that had been considered by the IFRS Interpretations Committee. It was also considered important to keep in mind in the discussion whether a contract would be executory. Generally, a liability would not be recognised in an executory contract.	contracts are outside the scope of the Discussion Paper. The draft Discussion Paper mentions in Chapter 1 that, unless a financial instrument, an asset or a liability related to an executory contract is normally not recognised unless the contract is onerous. Guidance on onerous contracts is included in IAS 37 *Provisions, contingent liabilities and contingent assets*.
At the September 2021 EFRAG TEG meeting, it was noted that in the discussions it was important to take into account what would drive the variability and the nature of the liability. For example, whether it would relate to the value of the asset or not.	In Chapter 3 of the draft Discussion Paper, approaches are considered where it is taken into account whether the variable consideration is linked to the quality of the asset received or the future benefits it will generate.
At the September 2021 EFRAG TEG meeting, it was noted that another issue that should be discussed would be whether, in some cases, the seller retains an interest in an asset transferred. This could either be limited or unlimited in time. If it was limited in time, it could be considered whether this was similar to an acquisition made in steps. If it would be unlimited, it was a question of whether you had acquired the entire asset or not. It could then also be questioned whether this was related to the characteristics of the asset, and it could be considered as an argument for updating cost even when a liability would not be recognised initially. At its November 2021 meeting, it was agreed to have a discussion of risk-sharing arrangements and step acquisitions at the beginning of the Discussion Paper. However, the Discussion Paper should not present a solution to these issues. Differing views were expressed on what should be the length of this discussion. In addition, differing views were expressed on whether the assessment of control should focus on the 'entire' good or the various embodied rights.	Chapter 1 of the draft Discussion Paper states that determining the substance of a transaction is outside the scope of the Discussion Paper. It provides an example of this. It also provides an example of a situation where all rights related to a physical object may not have been transferred.
At the September 2021 EFRAG TEG meeting, an approach to account for variable consideration (which is not directly reflected in any current IFRS Standards) was suggested. Under the approach, a liability for variable consideration would be recognised and changes would be reflected in the cost, to the extent the variability would relate to the quality or value of the asset. In other cases, a liability should not initially be recognised and subsequent changes should be included in profit or loss.	In relation to the recognition of a liability for variable consideration to be paid in cash where the consideration depends on the future actions of the purchaser, Chapter 2 of the draft Discussion Paper considers only two approaches: 1) A liability for variable consideration is recognised when the goods and services are received 2) A liability for variable consideration is only recognised when the future actions (or lack

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Two variations of this approach were also mentioned: • Not to recognise any liability when control of the asset would be transferred as a 'past event' could be argued only to occur when the quality of the asset would subsequently be determined. Until then, it was uncertain whether the seller had transferred what was promised. • Recognise a liability in both cases, but only reflect subsequent changes in the cost to the extent the changes related to the value of the asset (and not, for example, the use of the asset).	of) of the purchaser that would trigger the variable payment have occurred. Questions for EFRAG TEG are included above on whether additional approaches should be considered in Chapter 2. The reason of the EFRAG Secretariat not to include additional proposals is that such proposals would result in variable consideration that would depend on the purchaser's future actions would be accounted for using an approach significantly different from the approaches by which other types of variable consideration are accounted. The EFRAG Secretariat accordingly considers that the other approaches than those mentioned above would be better considered in the possible additional Chapter 4 (As noted in Paper 06-04 for this session, the EFRAG Secretariat could, however, see an approach partly based on IFRS 15 guidance to be considered in Chapter 2). Chapter 3 of the Discussion Paper includes approaches where the reflection of changes in the estimation of variable consideration depends on: 1) The quality of the asset or 2) the value/future economic benefits to be derived from the asset.
At the October 2021 EFRAG TEG meeting, it was suggested that the Discussion Paper should be amended to include additional examples with clarity on their economic substance. For instance, the transfer of a football player for which the variable consideration would depend on the number of matches the player would play. Another example could be a real-estate sale where the variable consideration would depend on the profit the buyer could book, if the buyer would sell the property within two years, or if the variable consideration would depend on the rent, the purchaser could charge. It was also suggested to consider the variability clause in Tier 1 financial instruments issued by banks (while acknowledging that funding transactions are not in the scope of the DP).	Chapter 1 of the draft Discussion Paper includes the suggested examples of variable consideration related to football player transfer and real-estate sales.
At the November 2021 EFRAG TEG meeting, it was assessed that most of the differences in how variable consideration is currently accounted for do not result from assessments that the differences would be beneficial but reflected that the Standards were made at different times.	This analysis of reasons for differences across existing Standards would be reflected in a possible additional Chapter (Chapter 4) if a decision is made to include such an additional chapter in the Discussion Paper.

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At the November 2021 EFRAG TEG meeting, it was agreed that the Discussion Paper, should include an executive summary stating what the IASB could do to remediate current gaps in guidance and whether current differences in guidance on variable consideration are justified.	An executive summary will be included in the Discussion Paper at a later stage.
At the November 2021 EFRAG TEG meeting, the structure of the Discussion Paper was considered. EFRAG TEG did not express any concerns with the proposal to discuss: • In Chapter 2: When to when to recognise a liability for variable consideration when the variability depends on the purchasers' future actions. • In Chapter 3: How changes in estimates related to variable consideration should be reflected in the measurement at cost of an asset. EFRAG TEG should at a later stage discuss whether an additional chapter considering the different guidance on recognition and measurement of a liability for variable consideration, and how this can affect the measurement of an acquired asset. Also, EFRAG TEG should at a later stage consider whether a chapter on value changes of consideration should be included.	A paper has been prepared for this session on whether an additional chapter considering the different guidance on recognition and measurement of a liability for variable consideration, and how this can affect the measurement of an acquired asset.

Agenda Papers

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

(a) Agenda paper 06-02 – Draft Discussion Paper (Chapters 1, 2, 3 and Overview of current guidance);

(b) Agenda Paper 06-03 – Issues Paper on whether to extend the Discussion Paper's objective and include an additional chapter; and

(c) Agenda Paper 06-04 – Issues Paper on an IFRS 15 mirroring approach for accounting for variable consideration.