EFRAG FR TEG meeting
12 – 13 April 2022
Paper 05-02a
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DISCUSSION PAPER

ACCOUNTING FOR VARIABLE CONSIDERATION

[MONTH AND YEAR OF PUBLICATION]

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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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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]

CHAPTER 1: BACKGROUND AND SCOPE

> Note to EFRAG FR TEG members
>
> Chapter 1 has been amended following the comments made by EFRAG FR TEG members at its February 2022 meeting. Should EFRAG TEG decide to include Chapter 4 as drafted below, Chapter 1 would be updated to reflect this decision.

In many transactions, the consideration an obligor (in this paper referred to as a 'purchaser') will have to pay for an asset (a good or a service) is unknown (completely or partly) when the purchaser obtains the control of the acquired asset. In other words, the consideration the purchaser will have to pay for the acquired asset is variable.

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

- *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.

[Based on EFRAG FR TEG feedback on Chapter 4, the introduction will also state that any solution that could be chosen for accounting for variable consideration where divergence in the practice currently exists would be different from solutions that would follow from current requirements for some types of variable consideration. This is the case as current requirements on how to account for variable consideration differs. The Discussion Paper accordingly also considers whether there are justifiable reasons for these differences and if not, what the advantages and disadvantages would be of trying to align how variable consideration is accounted for.]

What are the accounting issues with variable consideration?

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

a) When the all the characteristics (including condition and quality) or value for the purchaser of a transferred asset, are 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 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 requirements on accounting for variable consideration are either interpreted differently, are considered inconsistent, or are not clear on 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 good or service received ('the liability recognition issue'). The main issue here is that current IFRS requirements (IAS 32 *Financial Instruments: Presentation*) are 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 in exchange for variable consideration: The issue is whether changes in the estimate[1] of variable consideration should (i) result in updating the cost of an acquired asset that is held by the purchaser or (ii) be recognised in profit or loss ('the measurement of the acquired asset 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 requirements on liabilities (e.g., IFRS 9 *Financial Instruments*) would, state that changes in the estimate of future outflows of a liability should be recognised in profit or loss, while other requirements would state that they should be included as an adjustment in 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[2] and are further explained in Chapters 2 ('the liability recognition issue) and 3 ('the measurement of acquired asset 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, requirements in different IFRS standards on how to account for variable consideration are different (as also illustrated in the issue described in paragraph 1.2b) above). The different requirements are summarised in the following Chapters below.

[1] Changes in accounting estimates are covered by IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* paragraphs 32 – 38. It follows that to the extent that at a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it shall be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change. In other cases it shall be recognised prospectively by including it in profit or loss.

[2] 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).

[Based on EFRAG FR TEG feedback on Chapter 4, this paragraph will state that because of the different requirements, it would not be possible to find a solution on the issues listed in paragraph 1.2 that would be similar to all of the existing requirements. There may not always be good reasons for some of the differences in current requirements. Accordingly, Chapter 4 looks at the different requirements and discusses whether an alignment of accounting requirements related to variable consideration should be considered].

Objective and scope of this Discussion Paper

1.5 The objective of this Discussion Paper is to explore various approaches to possible requirements on variable the areas mentioned in paragraph 1.2 where there is currently divergence in practice. The Discussion Paper considers the benefits and disadvantages of the approaches explored.

1.6 As noted, the Discussion Paper focuses on the purchaser's accounting, as the two issues mentioned in paragraph 1.2 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 account for the variable consideration in accordance with the requirements of IFRS 15 *Revenue from Contracts with Customers.* A discussion of IFRS 15 requirements would be different from discussing the liabilities for variable consideration requirements that apply to purchasers.

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 to the seller. This definition is based on the definition of contingent consideration included in IFRS 3 *Business Combinations*[3].

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:

a) The term 'contingent consideration' is used in IFRS 3. Although the definition of variable consideration used in this Discussion Paper is based on that definition, the analyses performed in this Discussion Paper are not necessarily restricted to (or do not necessarily cover) all the aspects of the definition of 'contingent consideration'.

[3] In IFRS 3, contingent consideration is defined as: "Usually, an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met."

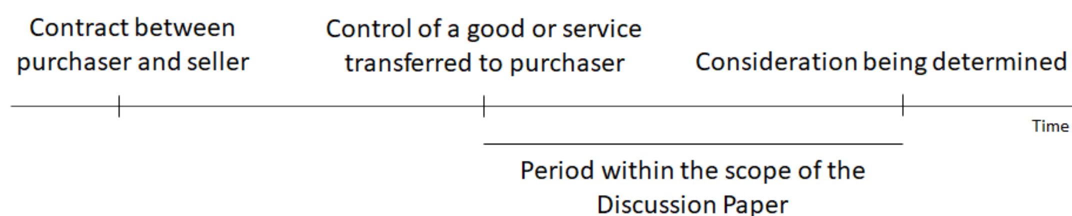
b) ‘Contingent consideration’ could be interpreted as meaning that the additional assets that may have to be transferred in exchange for a good or service received would be a fixed (for example, a given amount of money). The term ‘variable consideration’ not only includes those circumstances, but also 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[4]. 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[5] 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



1.13 As illustrated the Discussion Paper only considers situations under which the purchaser is controlling the asset transferred from the seller. The asset transferred from the seller does not need to be an asset that would be considered ready for its use. It could also include, for example, a drug under development.

1.14 If a contract is executory the combined right and obligation constitute a single asset or liability[6]. Unless the combined asset or liability would be a financial asset, the combined asset is normally not recognised except if it relates to an onerous contract. IAS 37 *Provisions, contingent liabilities and contingent assets* includes requirements on onerous contracts.

[4] How to account for the effects of changes in foreign exchange rates are covered by IAS 21 *The Effects of Changes in Foreign Exchange Rates*.

[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] See the Conceptual Framework paragraph 4.57.

Exclusion of fixed consideration

1.15 The price of a good or service may consist of both a fixed part and an additional variable part(s). When discussing the liability recognition issue in paragraph 1.2a) above, the conclusion could be affected by whether the fixed and variable part is considered together or separately. In this Discussion Paper, the variable consideration component is considered separately, and the Discussion Paper only considers the accounting issues for the variable consideration. The variable consideration is assessed separately to ensure that variable consideration is accounted for similarly no matter whether the total consideration includes a fixed component or not. Another reason for not assessing the fixed consideration component is because IFRS Standards usually include requirements on how to account for the fixed consideration.

Scope of the Discussion Paper

1.16 The discussion in Chapter 2 and 3 below is limited to variable consideration to be paid in cash or another financial asset. While the issue mentioned in paragraph 1.2a) ('the liability recognition issue') above only relates to situations under which a financial instrument is transferred, the issue mentioned in paragraph 1.2b) ('the measurement of the acquired asset issue') would also arise if consideration would not be paid in a financial instrument. However, to streamline the discussion in Chapter 3, the Paper focuses on transactions in which the consideration is to be paid in cash or another financial asset.

[Based on the EFRAG FR feedback Chapter 4 that assesses the complexities arising from non-cash consideration, it will be mentioned that Chapter 4 also considers non-cash consideration.]

Measurement of the acquired asset issue

1.17 The measurement of the acquired good or service issue (see paragraph 1.2b)) only arises when the acquired asset would initially and subsequently be measured based on cost by the purchaser. If the acquired asset is not measured at cost subsequently, but at, for example, fair value, the measurement of the acquired asset is updated, but this update reflects changes in the fair value of the acquired asset and not changes in the estimate of the consideration that has be paid for the asset. Similarly, if an acquired financial asset is initially measured at fair value and subsequently at amortised cost, the amortised cost is based on the fair value[7]. Accordingly, the discussion is not relevant to situations when the purchaser, for example, acquires a financial instrument (except for trade receivables) to which the requirements in IFRS 9 apply. Such an instrument would be measured at fair value at the initial recognition.

1.18 The discussion on 'the liability recognition issue' (see paragraph 1.2a) above) is, however, also relevant if the acquired asset would be accounted by using a different measurement basis than cost initially or subsequently.

Transactions that are carried out on market terms

1.19 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.

[7] Amortised cost of a financial asset is defined as: The amount at which the financial asset or financial liability is measured at initial recognition minus the principal repayments, plus or minus the cumulative amortisation using the effective interest method of any difference between that initial amount and the maturity amount and, for financial assets, adjusted for any loss allowance.

Consideration to be an asset

1.20 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

1.21 Variable consideration related to the acquisition of a business is outside the scope of this Discussion Paper. IFRS 3 *Business Combinations* includes requirements on how to account for contingent consideration. Accordingly, requirements exist on when to recognise a liability for variable consideration in a business combination and the issue listed in paragraph 1.2a) does therefore not exist when considering business combinations. IFRS 3 also includes requirements on not to reflect subsequent changes in the variable consideration in the carrying amounts of the assets acquired (which are generally also initially measured at fair value (see above)).

1.22 Although variable consideration in relation to business combinations is outside the scope of this Discussion Paper, some of the requirements included in IFRS 3 are considered when developing proposals and alternatives for how to account for variable consideration (outside business combinations). In that regard, it is, however, noted that there could be good arguments for having different requirements for variable consideration in a business combination compared to variable consideration for assets acquired on a stand-alone basis when it comes to whether changes in the estimate of variable consideration should be reflected in the carrying amount of the acquired assets (and liabilities). The reason is that if changes in the estimate of variable consideration were to be reflected in the carrying amount of the acquired assets in a business combination, the changes would have to be allocated to the various assets acquired and liabilities assumed, including goodwill. Such an allocation would result in additional issues having to be considered.

Substance of a transaction

1.23 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 assets.

1.24 For example, a purchaser could receive a physical object in exchange for payments, that depend on the performance of the physical object that would be paid in the following five years in addition to an upfront payment. In this example, it could be considered whether the subsequent payments would be variable consideration for the asset received. A view could be that (i) the acquisition of the various rights related to a physical object should be considered as separate acquisitions and (ii) when the physical object is received, the purchaser only acquires some of the rights related to this object. The subsequent payments would therefore be payments for the additional rights. As these additional rights are not transferred when the physical object is transferred, but only after or as the additional payments have been made, the consideration for the asset acquired (i.e. the rights acquired) when the physical object is transferred is therefore not variable under this view.

1.25 Another view could be that the arrangement described above would not involve variable consideration but would be some sort of profit-sharing arrangement.

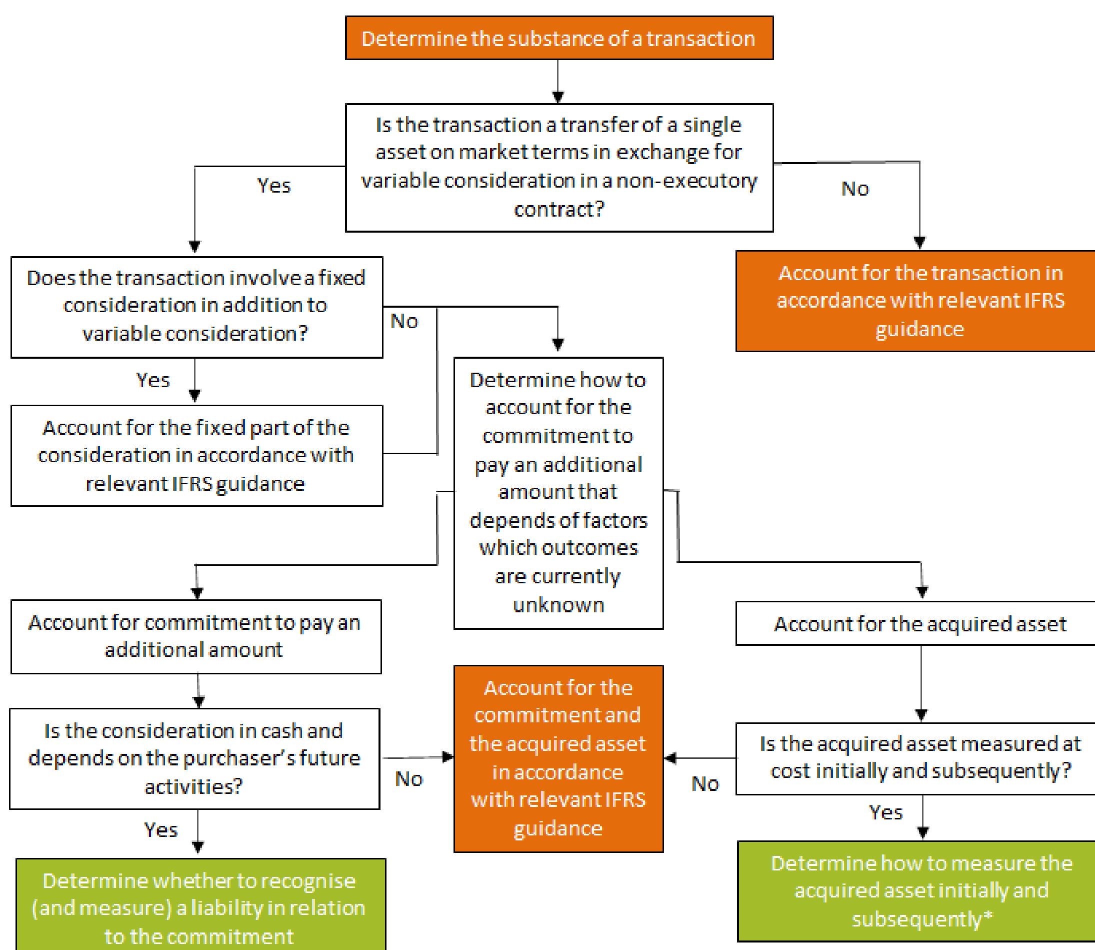
1.26 This Discussion Paper does not consider how to distinguish and determine the various assets that could be included in a transaction. It also does not focus on distinguishing whether a profit-sharing arrangement involves variable consideration or not. It is thus outside the scope of the Discussion Paper to consider the views presented in paragraphs 1.24 and 1.25 above.

Risk sharing/collaborative arrangements

1.27 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.

1.28 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 when 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 when to recognise a liability for variable consideration that would depend on the purchaser's future activities, the relevant requirements in the IASB's Conceptual Framework for Financial Reporting[8] is considered. However, these requirements are also interpreted inconsistently. Current requirements in other IFRS standards on when to recognise a liability for variable consideration that depends on the purchaser's future activities is also examined, but this 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.*
- *A liability for variable consideration that depends on the purchaser's future activities is recognised if the purchaser has no practical ability to avoid the payment.*

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 requirements 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 requirements.

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.

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

2.5 This Chapter does not look at measurement of a liability for variable consideration as there is currently no divergence in practice. This Chapter only focuses on areas where there is currently divergence in practice, i.e., when to recognise a liability for variable consideration.

Illustrative example

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

2.7 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[9]) 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.

2.8 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[10].

2.9 Last year, Entity A had sold around 20 000 jars. It is assumed that it is more likely than not that Entity A will make the payment. 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

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

2.11 In the example, Entity B has transferred the control of the use of 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.

2.12 The question arises when a liability should be recognised when Entity A has acquired the recipe[11].

What is the issue?

2.13 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.*

2.14 IAS 32 lists, in paragraph 11, what a financial liability is and this includes a contractual obligation to deliver cash or another financial asset to another entity.

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[9] 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.

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

[11] 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.

2.15 Also, 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 […]

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.

2.16 Based on the illustrative example, in applying IAS 32, 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.

2.17 For example:

a) Some consider 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. Therefore, they refer to paragraph 19 in IAS 32 where a financial **liability would be recognised**.

b) Also, 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 and when goods or services are received. 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[12], 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[13].

[12] 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.

[13] This was one of the reasons considered by some as indicated in an IFRS IC paper in September 2015.

c) On the other hand, 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** when goods or services are received regarding 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.

d) 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 when goods or services are received.; 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, a residual would exist, 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.

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

2.19 Should the IASB develop requirements to clarify the issue, it may consider the principles set out in the Conceptual Framework and/or the requirements in other IFRS Standards dealing with when to recognise a liability for variable consideration that depends on the purchaser's future activities. Such an approach is considered in the next section. It can be noted that the IASB is exploring to make clarifying amendments to IAS 32 to address common accounting challenges that arise in practice under the *Financial Instruments with Characteristics of Equity* project. This should be considered when monitoring developments regarding variable consideration.

How could the issue be addressed applying current requirements

When to recognise a liability for variable consideration based on the Conceptual Framework

2.20 The Conceptual Framework is considered in order to determine whether variable consideration that depends on the purchaser's future activities would meet the definition of a liability in the Conceptual Framework.

Definition and requirements regarding a liability in the Conceptual Framework

2.21 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)

2.22 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)

2.23 The criteria relating to 'the obligation is to transfer an economic resource' is considered to be met because it is in line with paragraph 4.37 of the Conceptual Framework. This paragraph states that in order to satisfy this criterion, the obligation must have the potential to require the entity to transfer an economic resource to another party (or parties). For that potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource - the transfer may, for example, be required only if a specified uncertain future event occurs. It is only necessary that the obligation already exists and that, in at least one circumstance, it would require the entity to transfer an economic resource. For transactions in scope of the project, the obligation already exists as there is a contract between the purchaser and the seller that specifies the variable consideration the purchaser of a good or service would have to transfer. Therefore, only the remaining two criteria are assessed below.

The entity has an obligation

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

2.25 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 actions 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 action*'.

2.26 Paragraph 4.34 of the Conceptual Framework goes on and explains that '*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*'.

2.27 Based on the Conceptual Framework, there are differing views on whether the entity has a practical ability to avoid taking the activities requiring the entity to transfer economic resource. For example:

a) 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) In contrast, others consider that the purchaser has no obligation for the following reasons.

    (i) 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.

(ii) The adverse economic consequences of not using an acquired asset would generally not be that severe compared to 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. 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.

2.28 Therefore, applying the criterion 'no practical ability to avoid' requires additional requirements or application guidance from the IASB Board.

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

2.29 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)

2.30 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).

2.31 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[14]. For example:

a) Some consider that the past event giving rise to the liabilities arises when the purchaser received the right to use the underlying assets rather than when the purchaser would conduct the activity. This is because the contract ceased to be executory from that point in time onwards. When the other party has performed, the purchaser owes something for obtaining control of the good or service. Accordingly, a **present obligation exists due to a past event**. Those supporting this view observe this is the analysis the IASB has retained when developing its proposals set out in the Exposure Draft Regulatory Assets and Regulatory Liabilities[15].

[14] 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 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.

[15] The Exposure Draft defines a regulatory liability as 'an enforceable present obligation, created by a regulatory agreement, to deduct an amount in determining a regulated rate to be charged to customers in future periods because the revenue already recognised includes an amount that will provide part of the total allowed compensation for goods or services to be supplied in the future'. An entity may recognise a liability at the end of a given reporting period to reflect its total allowed compensation for goods or services supplied during that period even if adjustments to regulated rates occur when the entity subsequently supplies goods or services on a subsequent reporting period. In this case, the obligating event is not when the entity supplies goods or services (and charges customers for that supply) on a subsequent period.

b) In contrast, others consider that if some specific performance target that the past event is when the entity conducts the activities on which the variable payments depend. For example, those stakeholders think that some specific performance targets (or conditions) need to be met in the future, such as, increased sales of chocolate spread jars. Those targets 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.

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

When to recognise a liability for variable consideration based on current requirements

2.33 As mentioned in paragraph 1.8 in Chapter 1, this Discussion Paper considers that a consideration is variable when the purchaser of specified goods or services may have to transfer additional assets in exchange for those goods or services. Current requirements related to consideration that would meet that definition is presented in the section 'Overview of current requirements' on page 64. The requirements related to when to recognise a liability for variable consideration and that would/could depend on the purchaser's future activities is summarised in the table below.

Overview of current requirements on when a liability for variable consideration that depends on the purchaser's future actions is recognised

Standard[16]	Variable consideration in the form of:	When is a liability recognised?	Is a liability recognised when good or service received?
IAS 19 ***Employee Benefits*** Paragraph 71	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*** Paragraphs 155 and 157	Long-term employee benefits (e.g. profit-sharing and bonus plans).	When an employee renders service (exception for disability benefits).	✔ *
IAS 19 ***Employee Benefits*** Paragraphs 11 and 19	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.	✘ [17] / ✔ *

[16] IFRS 9 has not been included in the table below as the question in the Discussion Paper relates to when a liability is recognised for variable consideration that depends on the purchaser's future activities applying IAS 32. This table reflects other current requirements.

[17] It is not sufficient that goods or services are received but also the obligation should be estimated reliably and the entity has no realistic alternative but to make the payments.

Standard[16]	Variable consideration in the form of:	When is a liability recognised?	Is a liability recognised when good or service received?
IFRS 2 ***Share-based Payment*** Paragraph 7	Cash-settled share-based payments.	When good or service is received	✔ *
IFRS 3 ***Business Combinations*** Paragraphs 39 and 7	Contingent consideration in a business combination.	When the acquirer obtains control of the acquiree.	✔ *
IFRS 16 ***Leases*** Paragraph 27 a-b, B42, BC164-167, BC170	Variable lease payments that depend on an index or rate or are deemed to be in-substance fixed payments. Also included are residual value guarantees that are de facto variable lease payments.	Recognise at the commencement date of the lease agreement	✔
IFRS 16 ***Leases*** Paragraphs 25, 27 and 38, BC 168-169	Variable lease payments in a lease contract that are neither in-substance fixed payments, nor are dependent on an index or rate. Lessee payments that are neither, related to a residual value guarantee nor 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

2.34 In addition, there are other current requirements, for example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* on contingent liabilities[18] that could be analogously applied for the recognition of liabilities for variable consideration. Under IAS 37.27, contingent liabilities are not recognised. Also, recognition of provisions are in scope of IAS 37 and this could be used by analogy (IAS 37.14).

A provision shall be recognised if:

(a) an entity has a present obligation (legal or constructive) as a result of a past event;

(b) it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

(c) a reliable estimate can be made of the amount of the obligation.

2.35 IAS 37 states that for an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event (paragraph 17). Also, 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 (paragraph 19 of IAS 37).

2.36 Also, as per the Exposure Draft ED/2021/1 *Regulatory Assets and Regulatory Liabilities*, the variable consideration relates to 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). As per the ED, an entity should recognise all regulatory assets and all regulatory liabilities existing at the end of the reporting period (paragraph 25).

2.37 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. Most of the current requirements reflect that a liability is recognised when the goods or services are received. However, this is not consistent with the most recent IFRS requirements, IFRS 16.

2.38 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

2.39 Considering current requirements and the guidance in the Conceptual Framework, the following three approaches could be considered for when to recognise a liability for variable consideration in cash that would depend on the purchaser's future activities:

a) Approach 1 under which a liability would always be recognised when control of the acquired asset would be transferred to the purchaser;

[18] Paragraph 10 of IAS 37: A contingent liability is:

(a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or

(b) a present obligation that arises from past events but is not recognised because:

(i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

(ii) the amount of the obligation cannot be measured with sufficient reliability.

b) Approach 2 under which a liability would always be recognised only after the future activities (or lack of) of the purchaser that would trigger the variable payment have occurred.

c) Approach 3 under which a liability would be recognised when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment.

2.40 These three approaches are further described below and their advantages and disadvantages are summarised in a table at the end of this chapter. An approach whereby an equity component would be recognised if the variable consideration depends on the purchaser's future activities (refer to paragraph 2.17d)) was not considered because this treatment has not been applied in practice.

Approach 1

2.41 Under Approach 1, a liability would always be recognised when control of the acquired asset would be transferred to the purchaser.

2.42 In the case of the of the chocolate spread recipe (paragraphs 2.7 to 2.9), a liability for the future sales would be recognised when the purchaser receives the recipe.

Approach 2

2.43 Under Approach 2, a liability would always be recognised only after the future activities (or lack of) of the purchaser that would trigger the variable payment have occurred.

2.44 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.

Approach 3

2.45 Under Approach 3, a liability would be recognised when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment. The outcomes of Approaches 1 and 3 could be the same if, at the time the control of the acquired asset is transferred, the purchaser does not have a practical ability to avoid performing the future activity that triggers the variable payment. On the other hand, the outcomes of Approaches 2 and 3 could be the same if the purchaser has a practical ability to avoid performing the future activity that triggers the variable payment before the activity is performed.

2.46 This approach is based on the definition of a liability in the Conceptual Framework (see paragraph 2.24 above). Under this approach, it is assessed that the relevant past event (see paragraph 2.30 above) would be when the control of the acquired good or service is transferred (see paragraph 2.31a) above). Under Approach 3, the critical aspect is therefore whether the purchaser has a practical ability to avoid taking the actions that would trigger the variable consideration (see paragraphs 2.26 - 2.28 above).

Possible criteria for assessing when the purchaser would not have a practical ability to avoid paying the variable consideration

2.47 As noted above, there are differing views on when an entity has no practical ability to avoid an activity that would trigger a variable payment (see paragraphs 2.26 - 2.28 above). For example, there are differing views on whether an entity has a practical ability to avoid using an asset it has purchased.

2.48 It is therefore assessed that if Approach 3 should be applied, it would be necessary to develop further guidance/criteria for when an entity would not have a practical ability to avoid a payment. At one extreme, it could be said that an entity does not have a practical ability to avoid paying a variable consideration if it would mean that it **would have to cease its activities** to avoid the payments. At the other extreme, it could be said that an entity does not have a practical ability to avoid paying a variable consideration if it would be **marginally economically unfavourable** for the entity not to perform the activities that would trigger the variable payments. That is, the entity would experience minimal economic compulsion to pay the variable consideration. Between these extremes, there could be the following alternatives:

a) **Significant unfavourable economic impact for the entity**. As mentioned in paragraph 2.26 above, the Conceptual Framework states that an entity would have no practical ability to avoid a transfer if any action that it could take to avoid the transfer would have economic consequences that would be significantly more adverse than the variable payment itself. To assess whether something would be 'significant' it could be argued that the effect on the entity as a whole should be considered. That is, if the entity would have to change its business model or cease profitable sales, the adverse effect could be significant.

b) **Significant unfavourable economic impact related to the acquired asset**. Alternatively, 'significant' could be seen in relation to the asset acquired. For example, if the asset acquired could generate cash flows worth CU 10 without incurring variable consideration but CU 15 by incurring a variable consideration of CU 2, the economic consequences could be significantly more adverse than the variable payment itself. Accordingly, although the additional cash flows of CU 3 would be completely insignificant when considering the total cash flows of the purchaser, the fact that they would be significant when comparing to the cash flows woth CU 10 results in the purchaser not having the practical ability to avoid paying the variable consideration.

c) **Impact linked to initial economic purpose for acquiring the asset**. If an asset is acquired for the purpose of being used in a particular manner which would trigger variable payments, it could be said that the purchaser has no practical ability to avoid performing the activities that would trigger these variable payments as not using the asset in the manner intended would have an adverse economic impact. The reasoning is quite similar to the arguments presented under b) above, but does also take into account the intended economically beneficial purpose or utility when an asset is acquired. That is, it is only considered to be practically unavoidable for an entity to pay variable consideration if that variable consideration would have to be paid following the realisation of the initial intention of acquiring an asset.

   For example, a football club may want to acquire a particular football player. In its budget for the acquisition, the football club management make the assumption that the player will play at least 20 matches in the first year. If it is agreed that the purchaser football club has to pay an additional variable amount to the seller club if the football player plays in at least 20 matches in the first year of signing the player, the football club should recognise a liability for the variable consideration when the football player is transferred.

On the other hand, under situations where the trigger for variable payment occurs if the purchaser entity subsequently uses the acquired asset in a different manner than was intended at the acquisition of the asset, these payments would not deemed to be practically unavoidable and a liability should not be recognised. For example, if an entity, acquires a building for the purpose of using it as its headquarters for the foreseeable future, it should not recognise a liability that would be related to variable payments that would have to be paid were it to sell the building. If such an entity acquires a property intended to be its headquarters under an agreement that if it sells the property to a third party within next five years it would have to pay 5% of its profit to the initial seller, then the entity should not recognise a liability for the variable consideration even if it would be economically beneficial for the purchaser to resell the property.

Advantages and disadvantages of the approaches

2.49 Advantages and disadvantages of the above three Approaches are listed in the table below.

	Approach 1 Recognise a liability for variable consideration when control of the acquired asset would be transferred to the purchaser	Approach 2 Recognise a liability for variable consideration when the future activities of the purchaser that would trigger the variable payment have occured	Approach 3 Recognise a liabitliy when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment
Relevance	As stated in paragraph 3.8, the initial recognition of the cost of an asset is based on the measurement of the related liability. Therefore an asset is only recognised (measured at an amount different from nil) if a related liability is recognised. Recognising a liability for variable consideration when control of a good or service is acquired accordingly reflects the corresponding asset and thereby the wealth of the purchaser.	Less useful performance figures could result from the fact that variable consideration is not reflected initially in the measurement/recognition of the acquired asset (see the argument on Approach 1).	Approach 3 would more frequently result in the recognition of a liability compared with Approach 2 but less frequent than Approach 1. Relative to Approach 2, Approach 3 would thus result in more relevant reported information about the wealth and performance of the purchaser. However, in cases where recognition occurs after the acquisition of the asset, the reported information would be less relevant than that from Approach 1.

	Approach 1 Recognise a liability for variable consideration when control of the acquired asset would be transferred to the purchaser	Approach 2 Recognise a liability for variable consideration when the future activities of the purchaser that would trigger the variable payment have occured	Approach 3 Recognise a liabitliy when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment
	Recognising the acquired asset would also mean that profit or loss would be affected by the depreciation/amortisation expenses of the acquired asset from the moment the control has been transferred (if the asset is ready for its intended use). This would mean that the profit or loss statement would not be overstated at the earlier stages compared to the alternative because there would be an expense relating to depreciation/amortisation being recognised in profit or loss during these earlier stages.		
	An earlier recognition (i.e., compared to the alternative) could provide users with transparency on obligations and useful information to predict future outcomes on their analyses, e.g., the cost (or expected cost) of an asset on a timely basis.	Least useful information for predicting future cash flows.	Higher predictive value (i.e. predicting future cash outflows) than Approach 2 and arguably Approach 1 as the recognised amount reflects the practical ability to avoid making variable payments.

	Approach 1 Recognise a liability for variable consideration when control of the acquired asset would be transferred to the purchaser	Approach 2 Recognise a liability for variable consideration when the future activities of the purchaser that would trigger the variable payment have occured	Approach 3 Recognise a liabitliy when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment
	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 requirement results 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 be the case when the variability is within the control of the purchaser.		
	Recognising a liability for variable consideration when a good or service is received could mitigate the issue issue on counterintuitive accounting listed to the right.	Recognising a liability when the future activities have taken place could result in a counterintuitive accounting outcome because: - The activities undertaken by the purchaser could be expected to be those that would overall be most economically beneficial for the purchaser.	Could sometimes result in an accounting outcome that could be considered counterintuitive as it could result in the same outcome as Approach 2.

	Approach 1 Recognise a liability for variable consideration when control of the acquired asset would be transferred to the purchaser	Approach 2 Recognise a liability for variable consideration when the future activities of the purchaser that would trigger the variable payment have occured	Approach 3 Recognise a liabitliy when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment
		- 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. In this case, recognising an expense could give the impression that the purchaser's actions would not be beneficial for the purchaser even though the purchaser would benefit from the market over a long period.	
Faithful representat ion	The measurement uncertainty could be high. It would thus include additional estimates of future variable payments that may, in some circumstances, 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 it is for variable payments that do not relate to the future activities of the purchaser. Also, a threshold could be introduced so that a liability would not be recognised when the measurement uncertainty would be so high that providing a figure would be assessed not to result in useful information.	The measurement uncertainty would be low.	Measurement uncertainty could be high when a liability is recognised before the activities that would trigger the variable consideration take place.

	Approach 1 Recognise a liability for variable consideration when control of the acquired asset would be transferred to the purchaser	Approach 2 Recognise a liability for variable consideration when the future activities of the purchaser that would trigger the variable payment have occured	Approach 3 Recognise a liabitliy when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment
	It could be argued that it would not be a faithful representation to recognise a liability for something that would depend on the purchaser's future activity (and the purchaser accordingly can avoid).	Would not result in the purchaser recognising a liability for something the purchaser can avoid. However, it could result in no liability being recognised when the purchaser has no practical ability to avoid the variable payment.	Would result in a faithful representation as the purchaser recognises a liability when it has no practical ability to avoid the payment and does not recognise a liability when the purchaser has the practical ability to avoid the payment.
Comparability	Consistent with the treatment under several IFRS Standards, e.g., IFRS 2, as per the table following paragraph 2.33. But inconsistent with other requirements (see cell to the right).	Would result in a different accounting treatment than variable consideration in the scope of IAS 19, IFRS 2 and IFRS 3. However, it would be consistent with some other IFRS requirements, e.g., partly consistent with 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.	Would result in a different accounting treatment compared with existing requirements.
	Generally consistent with how the seller would recognise a contract asset for the variable consideration under IFRS 15.	Generally not consistent with how the seller would recognise a contract asset for variable consideration under IFRS 15. However, it would be consistent with how a seller would account for revenue for a sales-based or usage based royalty promised in exchange for a licence of intellectual property.	Would sometimes be consistent with how the seller would recognise a contract asset for variable consideration under IFRS 15.

	Approach 1 Recognise a liability for variable consideration when control of the acquired asset would be transferred to the purchaser	Approach 2 Recognise a liability for variable consideration when the future activities of the purchaser that would trigger the variable payment have occured	Approach 3 Recognise a liabitliy when the purchaser does not have a practical ability to avoid performing the future activity which would trigger the variable payment
Prudence[19]	It is prudent to recognise liabilities earlier rather than later, especially in conditions of uncertainty.	This approach is less prudent as a liability is recognised at a later point in time.	Less prudent than Approach 1 but more prudent than Approach 2.
Costs	Would be more costly for preparers to apply as estimates would have to be made when a good or service is received and updated until the future activities occur.	Less costly for preparers as estimates would not have to be made and updated.	Would be more costly than Approaches 1 and 2 for preparers as the entity would have to assess whether there is has a practical ability to avoid the future activities that would trigger the variable payments. Also, if it would have no practical ability to avoid those future activities it would have to estimate the liability and update this estimate.

[19] Prudence is a technical criterion that is assessed when providing endorsement advice on IFRS Standards to the European Commission.

CHAPTER 3: MEASUREMENT OF AN ACQUIRED ASSET

There is currently divergence in practice on whether the cost of an asset acquired in exchange for variable consideration should be updated to reflect changes in the estimate of the variable consideration.

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

This Chapter considers these issues and possible approaches that could be considered, should clearer requirements be introduced. When providing clearer requirements 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 An issue regarding whether the cost of an asset acquired in exchange for variable consideration should be updated to reflect changes in the estimate of the variable consideration has arisen in past discussions of the IFRS Interpretations Committee. There is currently divergence in practice on this and interviews conducted by the EFRAG Secretariat with major audit firms confirmed this. The interviews with audit firms indicated that practice is inconsistent and is as follows:

a) Not reflecting changes in variable and contingent consideration in the subsequent measurement of the asset;

b) Reflecting some, but not all, changes in variable and contingent consideration in the subsequent measurement of the asset; and

c) Reflecting all changes in variable and contingent consideration in the subsequent measurement of the asset.

3.2 The IFRS Interpretations Committee has discussed variable payments for the purchases of PPE and intangible assets in 2013 and again in 2015 but decided not to add the issue to its agenda. The IFRS Interpretations Committee noted that the issue was too broad and should be addressed by the IASB is a separate project covering variable payments.

3.3 When considering whether changes in estimates related to variable consideration should be reflected in the measurement at cost of the acquired asset, this 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.

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

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

Initial recognition of the asset

3.6 A number of options can be considered in relation to how to reflect variable consideration in the cost of the good or service received at initial recognition.

	Cost of the asset	**Liability for variable consideration**	**PL/OCI**	**Explanation**
Option 1- measurement of asset based on liability	✓	✓	✗	The variable consideration recognised as a liability is also recognised as part of cost of the asset
Option 2 – measurement of asset independent of liability (not based on liability)	✗	✓	✓ Expense	The estimated amount of variable consideration is not recognised as part of the cost of the asset but recognised in the liability
Option 3 – measurement of asset independent of liability (not based on liability)	✓	✗	✓ Gain	The estimated amount of additional variable consideration is recognised as part of the cost of the asset but not in the liability
Option 4– measurement of asset independent of liability (not based on liability)	✓	✓	✓ (expense or gain)	Variable consideration is recognised in both the liability and as part of the cost of the asset. However, these are separately estimated.

3.7 Based on the table above, the tendency might be to recognise the variable payment as a liability and as part of the cost of the asset (Option 1). This is consistent with some of the existing IFRS requirements and avoids a day one gain/loss, compared to Options 2, 3 and 4, that may not be 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 real economic events.

3.8 Of the options listed above, this Discussion Paper only considers measuring the cost of an asset based on the measurement of the related liability. This is because it is considered not to be useful to recognise a gain or a loss.

3.9 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?

3.10 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.

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

3.12 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.

3.13 '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*.

3.14 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.

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

Illustrative example from Chapter 2

3.16 Referring to the illustrative chocolate spread example in Chapter 2 (paragraphs 2.6 to 2.9), 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.

3.17 As noted in paragraph 3.8, 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.

3.18 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?

3.19 As shown in the 'Overview of current requirements', and summarised below, the requirements on whether the cost of the acquired asset should be updated to reflect changes in the liability for variable consideration differ across IFRS Standards. The table below indicates whether the cost should be updated (✔) or not (✘). Except for 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*), there is no general guidance on whether the cost should be updated. The table also illustrates the inconsistency across current requirements. For example, if the liability for variable consideration, would be covered by IFRS 9, the requirements states that the changes in the measurement of the liability should be included in profit or loss, while the requirements 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 requirements on whether the cost of an asset should be updated to reflect changes in the related liability

Requirements	Variable consideration in the form of:	Cost of asset updated?	Treatment of variable consideration
Requirements on how to measure cost			
IAS 2 / IAS 16 / IAS 38 Paragraph 11 of IAS 2 Paragraph 16 of IAS 16 Paragraph 27 of IAS 38	Entitlement to rebates and trade discounts.	✔	Deducted from cost.
IAS 16 / IFRS 16 Paragraph 16 of IAS 16 Paragraph 24 of IFRS 16	Costs of dismantling and removing the item and restoring the site on which it is located.	✔	Initial estimate and changes in the initial estimate are reflected in the cost of the asset.

Requirements	Variable consideration in the form of:	Cost of asset updated?	Treatment of variable consideration
IFRS 16 Paragraphs 24, 27, 29, 30	Variable lease payments that depend on an index or rate or are in- substance fixed payments. Residual value guarantees that are de facto similar to variable lease payments that are dependent on an index or rate.	✔	Initial estimate and changes in the initial estimate are reflected in the cost of the asset.
IFRS 16 Paragraphs 27, 38	Variable lease payments in a lease contract that are neither in-substance fixed payments, nor dependent on an index or rate.	✗	Recognised in profit or loss.
Requirements on how to treat changes in the liability			
IAS 19 Paragraphs 57 and 120	Benefits from defined benefit pension scheme	✗	Recognised in comprehensive income (except for variable consideration related to long-term service or bonus plan[20]).
IFRS 2 Paragraph 30	Cash-settled share-based payments.	✗	Recognised in profit or loss.
IFRS 3 Paragraphs 38 and 40	Any variability of acquirer purchase price that will affect whether additional assets should be transferred for the acquisition of a business. Also, the acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.	✗	Initial estimate is included in cost. Subsequent changes are generally recognised in profit or loss.
IFRS 9 Paragraph B 5.4.6	Any variability that will affect cash flows of financial liabilities measured at amortised cost or fair value through profit or loss[21].	✗	Changes in the estimated outflow related to variable consideration are recognised in profit or loss.

[20] Paragraph 156 of IAS 19.

[21] 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. An example of variable consideration here is variable consideration to be paid in cash to the seller if the purchaser sells a certain amount of items over an agreed threshold.

3.20 The proposed measurement in the January 2021 IASB Exposure Draft on Accounting for Regulatory assets and Regulatory liabilities can also be taken into account, 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 technique that was described as modified historical cost). Changes in expected cash flows relating to regulatory assets and regulatory liabilities[22] are reflected in the cost of the asset (paragraph 55 of the ED).

How can the issue relating to the subsequent measurement of the acquired asset be addressed?

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

3.22 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).

3.23 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.

3.24 In addition, paragraph 6.9 of the Conceptual Framework states that the amortised cost of a financial asset or financial liability, which is a variation of historical cost measurement, is updated over time to depict subsequent changes such as the accrual of interest, the impairment of a financial asset and receipts or payments.

3.25 It could be argued that cost is only updated for the four criteria in paragraph 3.23 above and these four criteria are not applicable for changes in estimates of variable consideration. Therefore, it could be argued that cost of the acquired asset should not be updated for changes in estimates of variable consideration.

3.26 However, the list in paragraph 3.23 could also be argued not to present clear guidance. In addition, it can be noted that changes in expected cash flows that are reflected in the cost of the asset, as stated above, under the IASB's Exposure Draft *Regulatory Assets and Regulatory Liabilities*, is not consistent with the Conceptual Framework.

[22] 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.

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

3.27 Based on the different current requirements, the reasons for the requirements (when provided in the Basis for Conclusions) and the different interpretations of 'cost' in current requirements 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 requirements

Approach 1 - Not updating original cost estimate

3.28 The definition of 'cost', for example in IAS 16 or IAS 38, refers to 'to acquire an asset at the time of its acquisition or construction' and 'when initially recognised'. It could thus be argued this definition does not envisage that 'cost' could be updated as a result of changes in the amount paid (or given) to acquire an asset.

3.29 Requirements in current Standards could be used to support that cost is not updated subsequently. 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.

3.30 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. Furthermore, IAS 16 states that the recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management (paragraph 20).

3.31 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.

3.32 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.

3.33 Applying this approach to the chocolate spread recipe example in paragraph 3.18:

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 instead of being capitalised as part of the asset which is the intellectual rights of the recipe.

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 instead of being capitalised as part of the asset which is the intellectual rights of the recipe.

3.34 Advantages of this approach include:

Relevance

a) If variable consideration depends on factors arising from a particular period and is expensed at that period, recognition in profit or loss would provide more useful information because this would reflect the impact of period-specific factors influencing variable consideration.

Comparability

b) 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)[23].

Impact on prudence

c) The approach is prudent, as assets would be measured at a lower amount than under an approach where the increase in the liability due to changes in estimates would be reflected in the cost of an asset.

Cost-benefit

d) 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. However, we cannot ascertain as this stage if this would be a material cost or not.

3.35 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).

b) Counterintuitive information may arise due to recognising an income when there is a decline in expected future cash outflows and an expense when there is an increase in expected future cash outflows.

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, e.g., 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.

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[23] 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.

Approach 2 - Updating estimates included in the measurement of the asset's cost at initial recognition

3.36 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.

3.37 By analogy, IFRIC 1 is an example of requirements 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.

3.38 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.

3.39 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 0 above, the approach would provide relevant information for estimating future cash flows and assessing stewardship if the variable consideration is linked to the future cash flows the acquired asset is expected to generate.

Comparability and understandability

b) 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.

Faithful representation

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

3.40 Disadvantages of this approach include:

Comparability and understandability

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

Prudence

b) The approach is not prudent, as assets would be measured at a higher amount than under an approach where the increase in the liability due to changes in estimates would be reflected in profit or loss.

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

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

3.42 This is reflected in one of the interpretations of the definition of cost in paragraph 3.14 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.

3.43 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.

3.44 IFRS 15 *Revenue from Contracts with Customers* deals 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.

3.45 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.

3.46 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.

3.47 Applying the chocolate spread recipe example[24]:

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, the increase in the liability that would occur if the purchaser subsequently would expect to sell 70 000 jars would be reflected in 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 reflected in the cost of the asset.

3.48 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 0 above, the approach would provide relevant information for estimating future cash flows and assessing stewardship if the variable consideration is linked to the future cash flows the acquired asset is expected to generate.

Comparability and understandability

[24] 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.

b) 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.

Reliability

c) 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.

3.49 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.

Comparability and understandability

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

Prudence

c) 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.

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

3.50 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.

3.51 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.

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

3.53 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.

3.54 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.

3.55 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 requirements 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 requirements

3.56 In addition to the approaches mentioned above that are based on current requirements, 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

3.57 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.

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

3.59 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 0 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.

3.60 Disadvantages of this approach include:

Comparability and understandability

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

Prudence

b) 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

c) 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?

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

3.61 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.

3.62 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.

3.63 Advantages of this approach include:

Relevance

a) Following the arguments presented in paragraph 0 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.

3.64 Disadvantages of this approach include:

Comparability and understandability

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

Prudence

b) 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.

Cost

c) 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.

Faithful representation

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

CHAPTER 4: HOLISTIC ASSESSMENT OF VARIABLE CONSIDERATION REQUIREMENTS

Chapters 2 and 3 focus on the areas of accounting for variable consideration that are known to have diversity in practice. This Chapter assesses the IFRS requirements for variable consideration in a holistic manner with a view to: a) identify any incremental complexities in other aspects of variable consideration requirements that are not addressed in Chapters 2 and 3; and b) inform the thinking on whether there is a need to align variable consideration requirements across different IFRS Standards.

Thus, this Chapter also assesses the recognition and measurement requirements related to liabilities for variable consideration to be paid in non-cash consideration (i.e., by the transfer of non-financial assets or providing services in the future).

It also assesses the consistency (or lack thereof) of IFRS recognition and measurement requirements related to variable consideration, including consistency of those requirements that are covered in Chapters 2 and 3 and those requirements that are only assessed in this chapter. The Chapter assesses the implications of any differences in the recognition and measurement requirements and comes to a view on whether these differences are justified from both a cost-benefit and usefulness of information perspective.

Finally, this Chapter discusses the advantages and disadvantages of aligning requirements of variable consideration across IFRS Standards to ensure these are based on the same set of principles.

This chapter concludes that there may be incremental complexity in accounting for non-cash variable consideration, when compared to accounting for cash consideration, primarily due to measurement challenges.

The analysis shows there are several Standards related to accounting for variable consideration. The differences in recognition and measurement requirements for liabilities for variable consideration and acquired assets in different IFRSs are justified either by conceptual reasons, cost-benefit considerations, or the objective of achieving consistency across some Standards. There are also factors unique and perhaps only justifiable to particular transactions. Furthermore, these Standards were developed at different points in time, under different prevailing circumstances and this can explain some of the differences.

The DP, through Chapters 2 and 3, has provided approaches/principles that can inform the requirements for the accounting topics known to have diversity in practice and where there are difficulties with the interpretation of existing requirements- and these solutions can aid targeted amendments to IFRS requirements.

In addition, based on the analysis in this Chapter, including the outline of advantages and disadvantages of a unified set of principles, stakeholder views will be sought on whether any revisions to the multiple applicable Standards are best addressed on an individual Standards basis, within a few Standards where the gaps matter most, or whether the development of a unified set of principles is the best way forward.

Introduction

4.1 This Chapter assesses a) the recognition and measurement requirements for liabilities for non-cash variable consideration; b) the consistency (or lack thereof) of recognition and measurement requirements for the liability for variable consideration across different IFRS Standards; c) the consistency (or lack thereof) of requirements for the inclusion of variable consideration in the measurement of the acquired assets acquired across different IFRS Standards; d) the resulting implications for standard setting after considering the advantages and disadvantages of aligning the recognition and measurement requirements.

Recognition and measurement of liabilities for non-cash variable consideration

4.2 Chapter 2 only considered the recognition and measurement requirements for liabilities for variable consideration to be paid in cash or another financial instrument and where the variability of consideration depends on the purchaser's future actions.

4.3 However, payment through non-cash variable consideration (i.e., transfer of non-financial assets or delivery of services) can also occur for some of the transactions that are within the scope of Chapter 2. Hence, this Chapter assesses the requirements for non-cash consideration in paragraphs 4.5 to 4.14 (i.e., except for own equity settled share-based payment[25]).

4.4 As is the case for liabilities for cash (financial instruments) variable consideration, the requirements for non-cash variable consideration could have differing recognition thresholds and differing measurement approaches across different IFRS Standards. Paragraphs 4.16 to 4.73 below assess the consistency (or lack thereof) of a) IFRS requirements for the recognition and measurement of liabilities and b) IFRS requirements for inclusion of variable consideration in the measurement of acquired assets. This analysis of requirements encompasses both cash and non-cash variable consideration.

Specific IFRS requirements for liabilities for non-cash consideration

4.5 It is implicit that, except for transactions that would be within the scope of IAS 32/ IFRS 9 and IFRS 2, the IFRS requirements for liabilities for variable consideration under IAS 19, IFRS 3 and IFRS 16 are applicable for payments both in the form of a transfer of cash (financial instruments) and non-cash consideration.

4.6 The obligations for the transfer of non-cash consideration that do not fall within the scope of IAS 19, IFRS 3 and IFRS 16- can be within the scope of IAS 37 (including IFRIC 1) (i.e., for obligations to restore or dismantle assets at a future date).

[25] As noted in Chapter 1, equity-settled share-based payment are outside the scope of the DP. IFRS 2.7 states that equity-settled share-based payment would result in the recognition of equity.

4.7 Furthermore, the March 2017 IFRS Interpretations Committee discussions in relation to accounting for a liability representing the obligation of an entity to deliver gold in exchange for an asset or right to receive gold (i.e., for commodity loans) concluded that an accounting policy choice[26] (i.e., IAS 8) could be applied. The fact pattern of the commodity loans question related to a fixed commitment but if it related to variable consideration, it could be argued that IAS 37 could be applicable as there is uncertainty associated with the variable consideration and it relates to a non-financial obligation.

4.8 The various IFRS Standards for the recognition and measurement of assets (IAS 2, IAS 16, IAS 38, IAS 40, IAS 27, IAS 41, IFRS 6, and IFRS 16) always or sometimes require the initial measurement of acquired assets at cost. Furthermore, IFRS 9 initial measurement is at fair value and subsequent measurement is at either amortised cost or fair value. Only IFRS 16 provides general requirements for the inclusion of variable consideration (and by implication non-cash variable consideration) in the definition of cost/initial measurement of acquired assets.

4.9 It is worth noting that IAS 16 and IAS 38 standards respectively address the inclusion of non-cash consideration in the initial measurement of PPE (i.e., IAS 16.24) and intangible assets (i.e., IAS 38.45) in the event of exchange[27] of PPE and intangible assets for non-monetary asset(s). However, these particular requirements for non-monetary exchanges do not address whether to include variable non-cash consideration in the initial and subsequent measurement of acquired assets.

Incremental complexity associated with accounting for non-cash consideration

4.10 The question when to recognise a liability for variable consideration (i.e. whether it is when the goods or services are received or when the trigger for variable consideration occurs) that is addressed in Chapter 2 does not depend on the type of consideration. Thus, the three approaches, criteria proposed in Chapter 2 would also be applicable for liabilities for non-cash variable consideration.

4.11 Similarly, the accounting challenge of whether to update the carrying value of the acquired asset for changes in liabilities for variable consideration and the proposed six approaches addressed in Chapter 3 apply to both cash and non-cash variable consideration.

4.12 However, as enumerated in the 2019 IVSC *IVS 220 Non-Financial Liabilities* Exposure Draft[28], the measurement/valuation of non-financial liabilities including those related to non-cash variable consideration is more challenging than it is for financial liabilities and would be a cause for incremental complexity relative to the financial-liability-related transactions[29] analysed in Chapter 2.

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[26] https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/2017/ias-1-ias-2-ias-8-ias-39-ifrs-9-commodity-loans-march-2017.pdf

[27] These two Standards respectively state that for these non-monetary exchanges, the cost of items of PPE or intangible assets are measured at fair value unless a) the commercial transaction lacks commercial substance or b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the acquired item is not measured at fair value, its cost is measured at the carrying value of the asset given up.

[28] https://www.ivsc.org/wp-content/uploads/2021/10/Non-FinancialExposureDraft-FINAL-.pdf

[29] Chapter 2 only considers liabilities for variable consideration to be paid in cash (financial instruments).

4.13 The challenges of determining the value of non-financial liabilities include those related to non-cash variable consideration that arise from the highly illiquid market for non-financial liabilities (i.e., due to the unique nature, limited transaction volume, and fulfilment requirements of non-financial liabilities). There are other factors[30] that distinguish non-financial liabilities from financial liabilities.

4.14 These measurement challenges would extend to the subsequent measurement of acquired assets to the extent that this measurement includes variable consideration (i.e., if the changes in the liabilities for non-variable consideration are included in the subsequent measurement of the acquired assets).

[30] Non-financial liabilities typically do not have a corresponding and offsetting asset recognised by the counterparty, whereas financial liabilities typically do.

Note for EFRAG FR TEG members

The below description of recognition and measurement requirements for liabilities for variable consideration will be further streamlined and aligned with the Overview of current requirements. And some of the content may be placed in the Appendix and consideration will be given to a reader-friendly format of presentation of these requirements.

Assessing consistency of recognition and measurement requirements for liabilities for variable consideration

4.15 Building on the analysis in Chapter 2 and the Overview of Current Requirements section, the below paragraphs further detail the recognition and measurement requirements for liabilities for variable consideration and provide an assessment of overall consistency (or lack thereof) of these requirements.

Recognition and measurement requirements for variable consideration liabilities

IAS 19

4.16 As mentioned in Chapter 2, liabilities for variable consideration can arise for an entity when employees, in exchange for their services, are entitled to: additional short-term (with variability depending on profit-sharing or bonus plans); or long-term payments (with variability depending on profit-sharing or bonus plans, or on long-term disability benefits); or defined benefit pensions (with variability depending on factors related to entitlement at retirement/demographic factors). Correspondingly, the recognition and measurement requirements of IAS 19 are applicable as described below.

Short-term employee benefits

4.17 IAS 19.11 requirements related to short-term employee benefits state that when an employee has rendered service to an entity during an accounting period, an entity recognises the undiscounted amount of short-term employee benefits to be paid in exchange for services that service either as

a) as a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognise that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; or

b) as an expense, unless another IFRS requires or permits the inclusion of the benefits in the cost of an asset; the cost should include the expected cost of paid absence to the extent that the employee's service has increase the entitlement to future paid absence.

4.18 IAS 19.19 notes that an entity shall recognise the expected cost of profit-sharing and bonus payments under IAS 19.11 when, and only when:

a) the entity has a present legal or constructive obligation to make such payments as a result of past events; and

b) a reliable estimate of the obligation can be made.

4.19 The initial and subsequent measurement of liabilities for short-term employee benefits is the undiscounted expected amount to be paid (IAS 19.16)

Long-term employee benefits

4.20 IAS 19.157 addresses long-term disability benefits. It notes that if the benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognised when an event occurs that causes a long-term disability.

4.21 The initial and subsequent measurement of liabilities for long-term employee benefits is the present value of a reliable estimate of the ultimate cost.

Defined benefit plans

4.22 For defined benefit plans, amounts that depend on future actions of the employer and are conditional on future services being delivered by the employee would be recognised when an employee covered by a defined benefit plan has rendered a service.

4.23 The initial and subsequent measurement of defined benefit plan liabilities is the present value of a reliable estimate of the ultimate cost.

IAS 37

4.24 As noted earlier, liabilities for variable consideration to be paid that do not fall within the scope of other Standards (IAS 19, IAS 32/IFRS 9, IFRS 2, IFRS 3, and IFRS 16) may be within the scope of IAS 37. For instance, as noted in paragraph above, if an entity acquires goods or services in exchange for payment in non-cash consideration at a future date, it may fall within the scope of IAS 37.

4.25 As noted in Chapter 2, under IAS 37, an item that would meet the definition of a liability should only be recognised as a provision when:

a) It is probable that an outflow of resources embodying economic benefits will be required to settle the obligation; and

b) A reliable estimate can be made of the amount of the obligation.

4.26 IAS 37 specifies that when it is not clear whether there is a present obligation, a past event should only be deemed to give rise to a present obligation if it is more likely than not that a present obligation exists at the end of the reporting period.

4.27 IAS 37 requires provisions to be measured at the best estimate of the expenditure required to settle the present obligation at the end of the reporting period. The Standard mentions that when the provision being measured involves a large population of items, the obligation is estimated at the expected value. However, when a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability.

4.28 IAS 37 thus states that when the provision being measured involves a large population of items, the obligation is measured at expected value (that is by weighting all possible outcomes by their associated probabilities). When a single obligation is being measured, the individual most likely outcome may be the best estimate. However, when other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

IAS 32 and IFRS 9

4.29 The question of whether/ when variable consideration to be paid in cash or financial instruments is to be recognised as a financial liability is addressed in Chapter 2 with a detailed analysis of the IAS 32.19 and IAS 32.25 requirements for liability recognition.

4.30 When a liability for variable consideration meets the definition of a financial liability under IAS 32 it is recognised and initially measured at fair value and subsequently measured either at amortised cost or fair value under IFRS 9.

IFRS 2

4.31 As noted in Chapter 2, liabilities for variable consideration can occur when an entity acquires goods or services in exchange for future cash-settled share-based payment. IFRS 2.7 notes the entity shall recognise a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

4.32 When the goods or services received or acquired in a share-based payment do not qualify for recognition as assets they shall be recognised as expenses (IFRS 2.8).

4.33 Liabilities for cash-settled share-based payments are measured at the fair value (with the corresponding goods and services measured by reference to the liability). The fair value of a cash-settled award is determined on a basis consistent with that used for equity-settled awards (IFRS 2.30-33). This means that market-based performance conditions and non-vesting conditions are reflected in the 'fair value', but non-market performance conditions and service conditions are not – these are reflected in the estimate of the number of awards expected to vest. Thus, the 'grant-date fair value' is not in accordance with IFRS 13.

IFRS 3

4.34 As noted in Chapter 2, liabilities for variable consideration for acquirers in a business combination arises when there is an obligation for the acquirer entity to transfer additional assets or equity interests if specified future events occur or conditions are met.

4.35 IFRS 3.39 requires an acquirer to recognise the acquisition-date the fair value of contingent consideration as part of the consideration transferred in exchange for the acquired business. There is no mention of a recognition threshold in the requirements implying that all contingent consideration to be recognised even if it is not deemed to be probable of payment at the date of the acquisition.

4.36 IFRS 3.40 states that the obligation to pay contingent consideration shall be classified as either a financial liability or equity based on IAS 32.11. If the contingent consideration meets the definition of a financial liability, it can be accounted for under IFRS 9 and initially and subsequently measured at fair value.

4.37 IFRS 3.58 states that some changes in the fair value of the contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at acquisition date. Such changes are measurement period adjustments in accordance with IFRS 3.45-59. The acquirer can update provisional amounts recognised at acquisition date for measurement period adjustments.

4.38 IFRS 3.58 states that the acquirer shall account for changes in fair value of contingent consideration that are not measurement period adjustments as either a) equity with no remeasurements or b) other contingent consideration that is either within the scope of IFRS 9, measured at fair value at each reporting date and changes in fair value are recognised in profit or loss; or not within the scope of IFRS 9, measured at fair value at each reporting date, and changes in fair value are recognised in profit or loss.

IFRS 16

4.39 As noted in Chapter 2, IFRS 16.27a-c require variable lease payments that are deemed to be in-substance fixed payments, variable lease payments that depend on an index or rate (for example changes in a benchmark interest rate or a consumer price index), and residual value guarantees; to be included in the measurement of the lease liability at commencement date.

4.40 All other variable lease payments (including those that depend on future performance or the use of the asset) are recognised as expenses in profit or loss when an event or condition that triggers payment occurs (IFRS 16.38-b).

4.41 The initial and subsequent measurement of the lease liability (whose determination includes residual value guarantees and variable lease payments that are either in-substance fixed lease payments or depend on an index or rate) is the present value of expected future payments.

4.42 The remeasurement of the lease liability includes the variable lease payments included in the initial measurement of the lease liability (implicit in IFRS 16.38-b).

Possible analogous application of other Standards

IFRS 15 mirroring approach

4.43 IFRS 15 requirements for the treatment of variable consideration[31] whilst determining transaction price for the purposes of recognising revenue by seller entities can possibly be applied analogously for the accounting for liabilities for variable consideration by purchaser entities (i.e. the IFRS 15 mirroring approach).

4.44 IFRS 15 imposes a constraint to the recognition of variable consideration amount in revenue. Specifically, it requires an entity to recognise revenue only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur when the uncertainty associated with the right of return is subsequently resolved.

4.45 IFRS 15.BC203 highlights that the IASB concluded that information to users of financial statements would not be useful if the estimate of variable consideration (and consequently the amount of revenue recognised) is too uncertain and, therefore, may not faithfully depict the consideration to which the entity will be entitled in exchange for the goods or services transferred to the customer.

[31] Under IFRS 15 requirements, the amount of revenue recognised can vary because of discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties or other similar items. The promised consideration can also vary if an entity's entitlement to the consideration is contingent on the occurrence or non-occurrence of a future event. For example, an amount of consideration would be variable if either a product was sold with a right of return or a fixed amount is promised as a performance bonus on achievement of a specified milestone.

4.46 However, the IFRS IC has examined[32] and concluded that the mirroring approach would not be appropriate for the recognition of liabilities for variable consideration. However, a modification of the IFRS 15 mirroring approach that excludes the constraint could be considered.

Recognition and measurement principles of the Regulatory Assets and Regulatory Liabilities Exposure Draft

4.47 As is the case with applying the IFRS 15 mirroring approach for purchaser entities, the principles considered by the IASB for the recognition and measurement of regulatory assets (enforceable rights to increase future rates charged to customers) and regulatory liabilities (enforceable obligations to reduced future rates charged to customers) might be analogously applicable for the recognition and measurement of liabilities for variable consideration and for the cost of the acquired asset.

4.48 The Exposure Draft *Regulatory Assets and Regulatory Liabilities* proposes that if it is uncertain whether a regulatory asset or regulatory liability exists, an entity should recognise that regulatory asset or regulatory liability if it is more likely than not that it exists.

4.49 The ED (Paragraphs 25 and 26) also proposes that entities should measure regulatory assets and regulatory liabilities at historical cost, modified for subsequent measurement by using updated estimates of the amount and timing of future cash flows. Entities would use a cash-flow-based measurement technique that:

a) includes an estimate of all future cash flows resulting from a regulatory asset or regulatory liability that are within the boundary of the regulatory agreement and only those cash flows; and

b) discounts those estimated future cash flows to their present value.

4.50 The IASB considered that a modified historical cost measurement would provide useful information about an entity's regulatory assets and regulatory liabilities, and about regulatory income and regulatory expense recognised as a result.

Overall assessment: recognition and measurement of liabilities for variable consideration

Overview of differences in recognition and measurement of liabilities for variable consideration

4.51 The below diagram summarises the differing recognition requirements across Standards showing variation in existing IFRS Standards on the recognition of variable consideration.

[32] The issue was thus considered by IFRIC at its May 2012 meeting (Agenda Paper 3A). After IFRS 15 was issued, IFRIC considered the IFRS 15 approach again. In a staff paper (Agenda Paper 02A) for the November 2015 IFRIC meeting it was noted

4.52 *Differing recognition requirements*: As depicted in the above diagram, recognition can depend on when goods or services received, or when there is no realistic alternative or when the event triggering the payment of variable consideration has occurred.

4.53 *Differing recognition thresholds*: Under IAS 37, a present obligation for which a reliable estimate of the amount can be made is only recognised if it is probable (i.e. more likely than not) that an outflow of resources embodying economic benefits will be required to settle the obligation. IFRS 9 and IFRS 16 do not include such a threshold.

4.54 If the principles of IFRS 15 principles were analogously applied (i.e. an IFRS 15 mirroring approach), there would be a constraint to the recognition of liabilities. Furthermore, the recognition threshold of IFRS 5 differs from that of regulatory liabilities.

4.55 *Different measurement requirements*: The differences in existing measurement models can be summarised as follows:

a) Some liabilities are measured at fair value in accordance with IFRS 13 (these include liabilities for contingent consideration under IFRS 3);

b) Some liabilities are measured at an “adjusted fair value” which is different to what is required under IFRS 13 (these include cash settled share-based payment liabilities);

c) Some liabilities are measured at a “current value” or modified historical cost based on the present value of cash-flows (such as lease liabilities and regulatory liabilities).

d) Some liabilities are estimated at expected value and others at most likely (as is the case for some IAS 37 provisions).

Reasons underpinning the differences in recognition and measurement of liabilities

4.56 The reasons for the particular IFRS Standards for their recognition requirements are provided in in the Table 4.1 below to the extent a reason is provided in the Basis for Conclusions.

Table 4.1: Reasons for differences in requirements for liabilities for variable considerations

Current guidance	Reasons in the Basis for Conclusions
Requirements 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).
IFRS 16	Residual value guarantees and variable lease payments that are either in-substance fixed payments or depend on an index or rate are included in the lease liability in the initial measurement at the commencement of the lease for the following reasons: IFRS 16. BC164 notes that variable lease payments that are in-substance fixed lease payments are payments that, despite their variability, are unavoidable and, thus, are economically indistinguishable from fixed lease payments. IFRS 16. BC165 notes the IASB decided to include variable lease payments that depend on an index or a rate in the measurement of lease liabilities because they are unavoidable and do not depend on any future activity of the lessee. Any uncertainty relates to the measurement of that liability and not to its existence. IFRS 16.BC170 notes that residual value guarantees are similar to variable lease payments that depend on an index or rate.
Requirements 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[33]).
IAS 19 (short-term benefits)	For simplification purposes.

[33] Paragraph BC 18 of IFRIC 2 states:

"The Interpretations Committee noted that a levy is triggered as a result of undertaking an activity in a specified period, as identified by the legislation. As a result, the Interpretations Committee concluded that there is no constructive obligation to pay a levy that relates to the future conduct of the business, even if:

(a) it is economically unrealistic for the entity to avoid the levy if it has the intention of continuing in business;

(b) there is a legal requirement to incur the levy if the entity does continue in business;

(c) it would be necessary for an entity to take unrealistic action to avoid paying the levy, such as to sell, or stop operating, property, plant and equipment;

(d) the entity made a statement of intent (and has the ability) to operate in the future period(s); or

(e) the entity has a legal, regulatory or contractual requirement to operate in the future period(s)."

Current guidance	Reasons in the Basis for Conclusions
	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)

Note for EFRAG FR TEG members

The below description of recognition and measurement requirements for the inclusion of variable consideration in the measurement of the acquired asset will be further streamlined and aligned with the Overview of current requirements. And some of the content may be placed in the Appendix and consideration will be given to a reader-friendly format of presentation of these requirements.

Assessment of consistency in requirements for inclusion of variable consideration in the measurement of acquired assets

4.57 Similar to the liabilities for variable consideration, there is a need to assess the consistency (or lack thereof) of IFRS requirements for the inclusion of variable consideration in the measurement of acquired assets.

4.58 The main issues addressed by the IFRS IC in the past were related to the measurement of acquired PPE, intangible assets, and service concession arrangements- as it is for these that challenges in practice have typically arisen. However, other categories of assets that can be acquired in exchange for variable consideration including inventories, right-of-use assets, investments and financial assets, investment properties, and biological assets. The IFRS Standards for the recognition and measurement of these different asset classes (IAS 2, IAS 16, IAS 38, IAS 40, IAS 27, IAS 41, IFRS 6, and IFRS 16) require the initial measurement of acquired assets at cost. IFRS 9 requires initial measurement of acquired assets at fair value and subsequent measurement at either amortised cost or fair value.

4.59 Below is a summary of the requirements (or lack thereof) related to inclusion of variable consideration in the measurement of the acquired asset. It covers the requirements of the different assets Standards as well as IFRS 3 requirements that may affect the initial recognised fair value of the acquiree.

Requirements for variable consideration in the measurement of acquired assets

IAS 16

4.60 IAS 16 neither address whether variable consideration is included in cost of acquired assets within its scope nor whether changes in any related liabilities for variable non-cash consideration are included in the updated cost of the respective acquired assets within scope. However, the cost of PPE is updated whilst applying IFRIC 1 requirements.

4.61 The inclusion of variable consideration in the cost of the acquired PPE assets only arises in relation to the purchaser entity’s entitlement to rebates and trade discounts, which are deducted from the cost.

IAS 2 and IAS 38

4.62 These Standards neither address whether variable consideration is included in cost of acquired assets within their scope nor whether changes in any related liabilities for variable non-cash consideration are included in the updated cost of the respective acquired assets within scope.

4.63 The inclusion of variable consideration in the cost of the acquired inventories or intangible assets only arises in relation to the purchaser entity’s entitlement to rebates and trade discounts, which are deducted from the cost.

IFRS 3

4.64 As stated in the analysis of requirements for liabilities for variable consideration, only measurement period adjustments including changes in the fair value of contingent consideration that reflect new information may be used to update the initial acquisition value of the acquiree (IFRS 3.58).

IFRS 9

4.65 As noted earlier, a financial liability exists when the liability for variable consideration is to be paid in cash (or financial instrument). When a liability for variable consideration is measured in accordance with IFRS 9 at either fair value or amortised cost, subsequent changes in the estimate of variable consideration are included in profit or loss and the measurement of the acquired asset is not updated irrespective of its classification category.

4.66 IFRS 9 does not address the treatment of variable consideration in situations where financial assets may be acquired in exchange for variable consideration (e.g., in securitisation transactions).

IFRS 16

4.67 IFRS 16.24-a states that the cost of right-of-use asset includes the amount of the initial measurement of the lease liability at the commencement date. As noted in paragraph describing the recognition requirements of lease liability its initial measurement includes variable lease payments that are either in-substance fixed payments or depend on an index or rate. Also included are residual value guarantees which can be deemed to be de facto variable lease payments.

4.68 IFRS 16.24-d states that cost of right-of-use asset also includes an estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required by the term dismantle or restore the underlying asset to the terms and conditions of the lease, unless those costs are incurred to produce inventories.

4.69 There could be a view that the costs of dismantling, removal and restoration are generally not variable consideration components as defined in this DP but it could be argued that this is a variable consideration component if it is an obligation of the lessee to the lessor that arose as part of the lease contract.

4.70 IFRS 16.30-b states that the lessee shall measure the right-of-use asset at cost adjusted for any remeasurement of the lease liability. As noted in the analysis of liabilities requirements, the remeasurement of the lease liability includes the variable lease payments included in the initial measurement of the lease liability.

IAS 27, IAS 40, IAS 41, IFRS 6

4.71 These Standards neither address whether variable consideration is included in cost of acquired assets within their scope nor whether changes in any related liabilities for variable non-cash consideration are included in the updated cost of the respective acquired assets within scope.

Overall assessment: requirements for inclusion of variable consideration in the measurement of acquired assets

4.72 There is inconsistency between IFRS 16 requirements- where changes in the liability update the cost of the right-of-use asset, and the requirements in IFRS 9 to recognise changes in the financial liability measured at cost in profit or loss.

Reasons underpinning differences in requirements for the inclusion of variable consideration in the measurement of acquired assets

4.73 The reasons for the current IFRS requirements and the IASB Exposure Draft proposed guidance for regulatory assets and regulatory liabilities are summarised in the table below, when such reasons appear from the Basis for Conclusions accompanying the Standards/Interpretations.

Table 4.2: Reasons for differences in requirements for the inclusion of variable consideration in the measurement of acquired assets

Current requirements	Reasons in the Basis for Conclusions
Reasons provided for updating cost of an asset with variable consideration	
IAS 16 / IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities (There is a view that these are generally not variable consideration components as defined in this DP but it could be if it is an obligation to the seller of the PPE that arose at acquisition)	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). 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).
IFRS 16	In relation to variable consideration included in the lease liability (variable lease payments that are either in- substance fixed payments or those that depend on an index or rate; residual value guarantees), 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).
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 acquired assets with variable consideration	
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.

Current requirements	Reasons in the Basis for Conclusions
No reason provided on inclusion of variable consideration components in cost of acquired assets	
IAS 2/ IAS 16 / IAS 38 Variable consideration only relates to rebates and trade discounts under IAS 2/ IAS 16 /IAS 38	No reasons included in the Basis for Conclusions.

Implications for standard setting

4.77 As shown in the analysis in Chapters 2 and 3, the above detailed analysis of variable consideration requirements, and the reasons for differences in Tables 4.1 and 4.2; the differences in recognition and measurement requirements for liabilities for variable consideration and acquired assets are justified by conceptual reasons, cost-benefit considerations (IFRS 16- exclusion of variable lease payments that depend on future performance or usage of asset from the lease liability measurement), the objective of consistency across some Standards (e.g., IFRS 2 and IAS 19 requirements). There are also factors unique and perhaps only justifiable to particular transactions (e.g., the need for measurement period adjustments under IFRS 3). Furthermore, these Standards were developed at different points in time, under different prevailing circumstances and this can explain some of the differences.

4.78 Chapters 2 and 3 have proposed possible approaches to address the aspects known to have diversity in practice- some of the approaches are underpinned by existing requirements and others differ from these requirements. The solutions in the two chapters can contribute to the targeted amendments of IFRS requirements where most difficulties arise. Beyond that, it may be helpful to develop general principles for the accounting for variable consideration that can aid the alignment of requirements across Standards or possibly inform future standards for emerging transactions that may have variable consideration components.

4.79 It is worth noting that the IASB Third Agenda Consultation request for information (RFI) included variable and contingent consideration as one of the 30 potential topics that could be on in its future project agenda. Paragraph B 81 of the RFI highlighted the challenges discussed by IFRS Interpretations Committee on the recognition of liabilities for variable consideration and inclusion of variable consideration in measurement of the acquired assets (i.e. what is addressed in Chapters 2 and 3 of this DP). In paragraph B82 of the RFI, the IASB indicated it could either a) as a medium-sized project, amend IAS 16, IAS 38 and IFRIC 12 due to their limited requirements on variable and contingent consideration or b) develop a consistent approach to reporting variable and contingent consideration across all Standards. However, constituents' feedback[34] to the RFI shows that only some respondents considered this topic as a high priority for inclusion in the IASB agenda. Therefore, it is unlikely that this topic will be undertaken by the IASB in the near future.

34 https://efrag.org/Assets/Download?assetUrl=%2Fsites%2Fwebpublishing%2FMeeting%20Documents%2F2006231252506978%2F13-05%20ASAF%20Agenda%20Paper%20AP02D%20Feedback%20summary%20-%20Potential%20projects%20%28part%201%29%20%28for%20background%20only%29.pdf

4.80 It is also worth noting that the agenda consultation RFI highlighted the work that is ongoing by national standard setters (such as this Discussion Paper) and other professional bodies could inform the IASB's work. Furthermore, amongst those respondents that considered the topic as a high priority, there were mixed views on the way forward with some supporting a focus on amendments to IAS 16, IAS 38 and IFRIC 12, some supporting the development of a consistent set of principles, and some suggesting the following steps to be undertaken by the IASB in any of the following ways:

a) consider variable lease payments (in addition to IAS 16, IAS 38 and IFRIC 12);

b) consider variable and contingent consideration as part of a project on intangible assets;

c) combine this potential project with the potential projects on discount rates, foreign currencies, inflation and negative interest rates because these related matters are a high priority for countries with high economic volatility (such as volatile market prices and foreign exchange rates);

d) combine this potential project with the potential projects on intangible assets and cryptocurrencies and related transactions, because that would be more effective for emerging new assets which did not exist and were not considered when IAS 38 was developed; and

e) work with other national standard-setters that have started research for this potential project.

4.81 The analysis in this Chapter has only focused on assessing the consistency (or lack thereof) of existing requirements and below is an assessment of the advantages and disadvantages of aligning the requirements of variable consideration across IFRS Standards to ensure these are based on the same set of principles.

Advantages of potentially aligning requirements

4.82 The IASB has a project on targeted amendments of requirements for provisions under IAS 37 for liabilities and the assessment of the differences/consistency can inform the IASB's thinking around these requirements that are being developed.

4.83 As noted, several of the Standards do not have explicit requirements and this may lead to accounting policy choice and the application of different Standards by analogy exacerbating the diversity in practice.

4.84 The assessment of consistency can be the basis of formulating possible suitable approaches that can be applied across different types of variable consideration transactions. These approaches can contribute to the development of guidance that will ensure the relevance, comparability, consistency and faithful representation in reporting of variable consideration transactions.

4.85 Considering possible suitable and unified approaches across Standards can help to avoid piecemeal solutions to the challenges in accounting for variable consideration that may arise beyond those currently identified by the IFRS IC. For example, with the ongoing growth and development of the crypto-assets market, there may be an increase in transactions with non-cash variable considerations and this may result in need for interpretations due to lack of clear guidance.

4.86 The development of suitable approaches could be framed as principles that can be applied differently depending rather than being prescriptive or dictating a one-size-fits-all approach to accounting for all variable consideration transactions.

Disadvantages of potentially aligning requirements

4.87 The proposed approaches in Chapters 2 and 3 to respectively address the recognition for liabilities for variable consideration and the measurement of acquired assets are sufficient to facilitate targeted IFRS amendments and will capture most of the issues that currently arise in practice as reflected by IFRS Interpretations Committee queries.

4.88 Any revisions to current Standards are best addressed in the context of a review of the overall requirements within specific Standards including those related to variable consideration. For this reason, it is unlikely to be feasible or useful to have an objective of harmonising the requirements for variable consideration across different Standards.

4.89 A conceptually correct one-size-fits-all solution is unlikely to be adopted. As argued above, there are cost-benefit considerations and factors specific to transactions within the scope of each Standard that could make an ideal solution to be impractical.

4.90 The accounting for variable consideration has not been identified as a priority topic for near-term or medium-term standard setting. Hence, the formulation of a "conceptually correct" possible approaches may have limited utility.

Possible questions for constituents

4.91 Do you agree or disagree that there should be an alignment in the requirements across different Standards for the recognition of liabilities for variable consideration and inclusion of variable consideration in the measurement of acquired assets? If you disagree, what other standards development approach could be considered- should the requirements be addressed within individual Standards or should a selection of particular Standards that address transactions with variable consideration be targeted?

Questions for EFRAG FR TEG

4.92 Does EFRAG FR TEG have any comments on the structure and content of this Chapter?

4.93 Should the assessment of incremental complexity of non-cash variable consideration relative to the cash variable consideration (considered in Chapter 2) remain in this chapter or is it better situated in a separate chapter?

4.94 Should the DP be neutral after enumerating the advantages and disadvantages of developing a consistent set of principles and ask constituents for their views on this option and any alternative views for developing variable consideration requirements including those that were proposed in the feedback to the IASB agenda consultation RFI (i.e., amend IAS 16, IAS 38 and IFRIC 12); or should the DP conclude that, from a cost-benefit perspective, there is no justification for developing a consistent set of principles for accounting for variable consideration across different IFRS Standards?

4.95 To further understand the impact on relevance of information, should the user panel input be consulted on the implications of the differences in the requirements for accounting for variable consideration on the relevance of financial statement information?

OVERVIEW OF CURRENT REQUIREMENTS

This section provides an illustrative overview of current requirements (and lack of current guidance) applying to examples of common types of variable consideration. This overview thus illustrates where there is lack of (clear) requirements/requirements are 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 requirements 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 requirements 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).

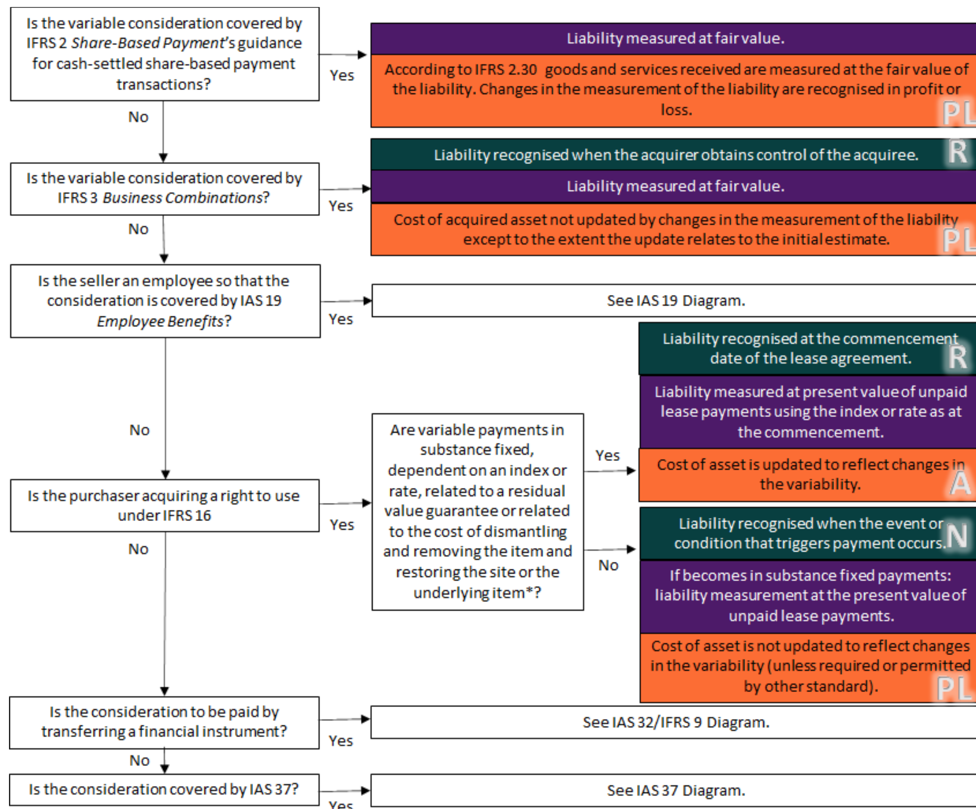
e) A good or service acquired in exchange for a variable consideration in cash or another financial instrument. For example, if an entity is acquiring a building in exchange for consideration that would depend on the estimated market value of that particular building in two years. Another example, would 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)[35].

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).

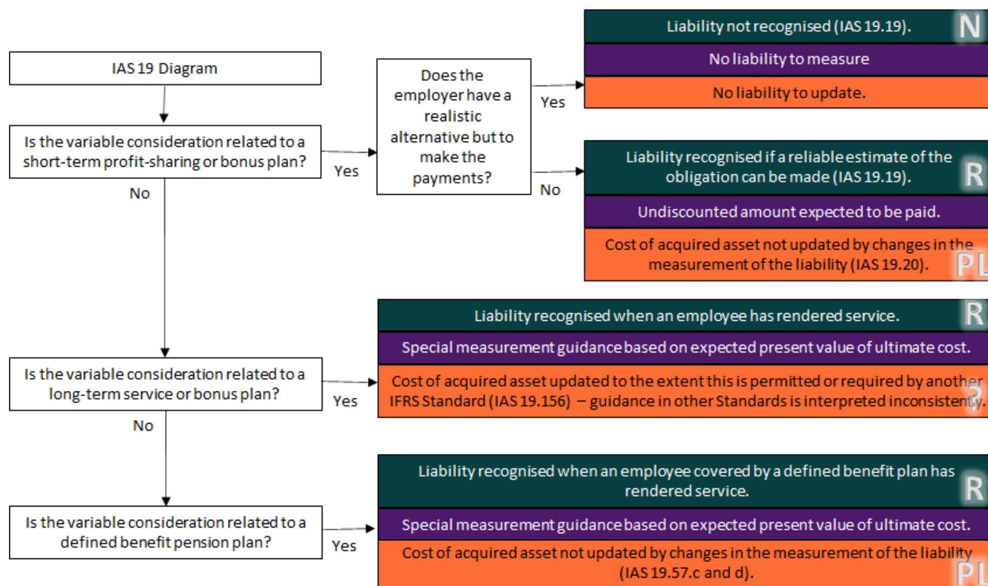
[35] In some cases a variable component in a contract would be an embedded derivative – and thus not variable consideration covered by this Discussion Paper.

Illustration of current guidance

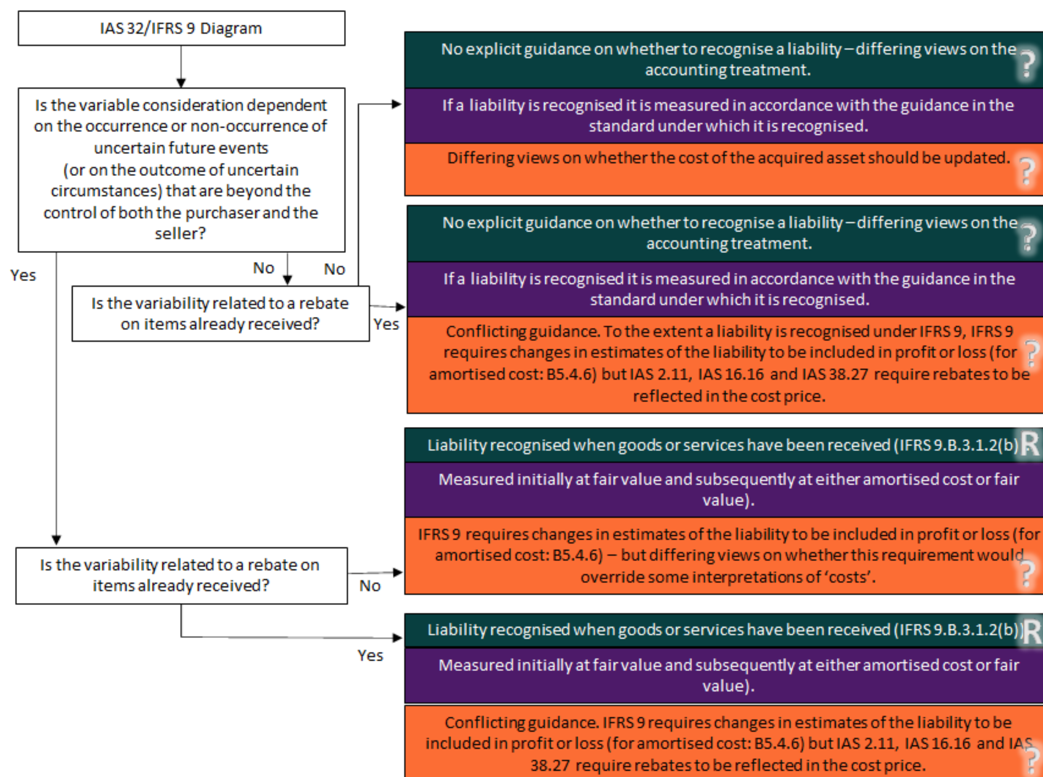
Main Diagram



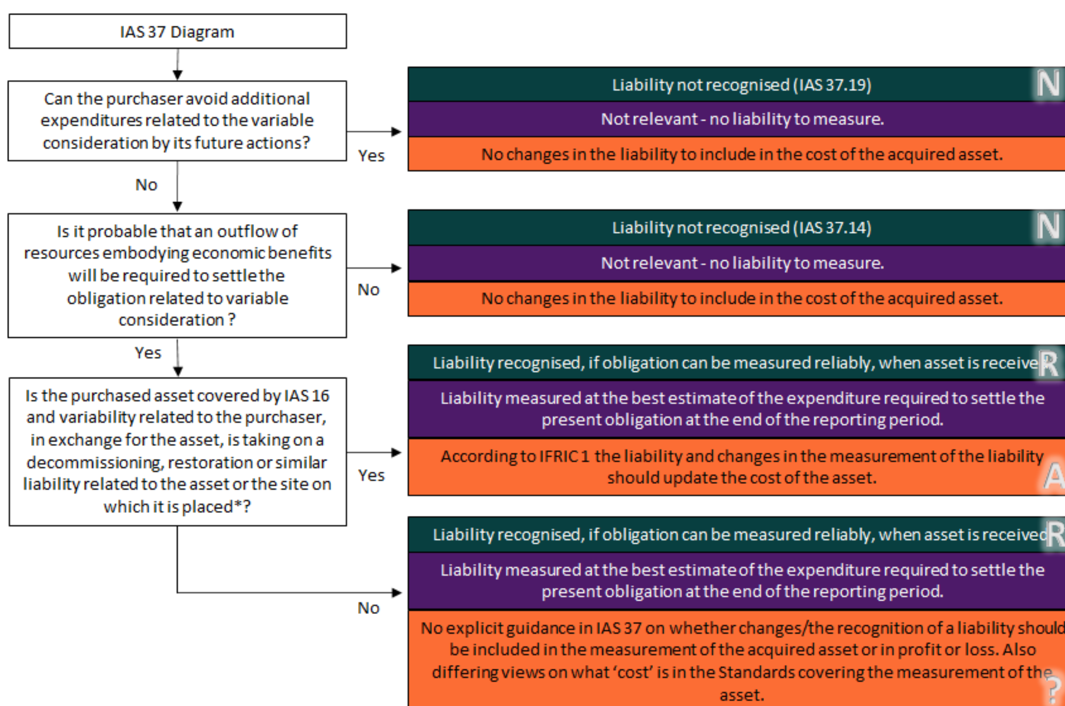
IAS 19 Diagram



IAS 32/IFRS 9 Diagram



IAS 37 Diagram



In the diagram '?' means that there are no clear requirements 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.

*: This Discussion Paper only considers decommissioning, restoration or similar liabilities to be variable consideration to the extent the counterparty is the seller of the asset.

EFRAG receives financial support of the European Union - DG Financial Stability, Financial Services and Capital Markets Union. The content of this document is the sole responsibility of EFRAG and can under no circumstances be regarded as reflecting the position of the European Union.