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DISCUSSION PAPER

ACCOUNTING FOR VARIABLE CONSIDERATION

[MONTH AND YEAR OF PUBLICATION]

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

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

EFRAG Research Activities in Europe

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 Exchange transactions involving variable consideration can arise for a variety of reasons (e.g., risk-sharing of exchange transactions between buyers and sellers). However, there is divergence in practice on how a purchaser entity should account for variable consideration related to some transactions. This has been evident from the discussions of the IFRS Interpretations Committee ('IFRS IC') held from 2011 to 2016, for example, on "IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets* – Accounting for contingent price for the purchase of single assets" and "Payments made by an operator in a service concession arrangement intangible asset and financial asset model". In these discussions, the IFRS IC concluded that the matters raised were too broad to be addressed within the confines of existing IFRS Standards, signalling the need for broader Standard setting. The IASB added the topic to its research pipeline after its 2015 Agenda Consultation.

ES2 To contribute to the development of IFRS requirements that can address the challenges arising in practice, this Discussion Paper primarily focuses on, and proposes approaches for, the development of requirements related to two main issues where the noted divergence in practice exists in the accounting for variable consideration by purchaser entities. The two issues are:

(a) ***Recognition of liabilities for variable consideration***: The first issue relates to the recognition of financial liabilities covered by IFRS 9 *Financial Instruments* when the variable consideration is to be paid in cash or financial instrument by the purchaser entity and the variable consideration depends on the purchaser's future actions. From the discussions of the IFRS IC, it appears that there are different views on when there would be a financial liability according to the requirements in IAS 32 *Financial Instruments: Presentation* under these circumstances. (This issue is referred to as 'the liability recognition issue').

(b) ***Inclusion of liabilities remeasurement in measurement of acquired assets***: The second issue is whether the measurement of an asset acquired in exchange for variable consideration should be updated to reflect remeasurements of the liability for variable consideration. The Discussion Paper focuses on acquired assets that are measured at cost for it is only for these assets that such an update in their initial measurement is relevant. (This issue is referred to as 'the measurement of the acquired asset issue').

ES3 For both the issues, the scenario considered is one where the purchaser has received control of an asset and will later have to pay a consideration in cash (or another financial instrument) that would be covered by IAS 32/IFRS 9.

ES4 The above two issues were also highlighted in the 2021 IASB Request for Information *Third Agenda Consultation* where variable and contingent consideration was included as a potential project for the IASB's active agenda. Following the 2021 agenda consultation, the IASB has not included this topic into its active agenda. However, the approaches proposed in this Discussion Paper and constituents' views to these, can inform future targeted amendments by the IASB and solutions to any related queries faced by the IFRS IC.

ES5 The primary focus of the Discussion Paper is on the aforementioned issues of liability recognition for variable consideration for which a liability would be covered by IAS 32/IFRS 9 and the inclusion of liability remeasurement in the measurement acquired assets. However, after taking account of the inconsistencies or lack of explicit IFRS requirements for accounting for variable consideration by purchaser entities that exist in a broader sense, the Discussion Paper also holistically assesses the related existing requirements including those that could be applied analogously (e.g., mirroring of IFRS

15 *Revenue from Contracts with Customers* requirements that are applicable for seller entities). It also assesses possible approaches to standard setting that could be considered in the future (e.g., whether to have a unified/consistent set of principles applicable across all Standards) should challenges associated with these transactions become pervasive to the extent that a standard setting project is needed.

ES6 This Discussion Paper is not focused on accounting for variable consideration by seller entities as these would generally be within the scope of IFRS 15 and any practical challenges that would arise in practice for sellers could be raised during the forthcoming IFRS 15 Post-implementation Review. The Discussion Paper also only has a limited analysis on issues arising from non-cash transactions. A more detailed description of the scope of the Discussion Paper is in Chapter 1.

Addressing the liability recognition issue

ES7 Chapter 2 of the Discussion Paper proposes approaches for the development of IFRS requirements for liability recognition when a liability for variable consideration would be covered by IAS 32/IFRS 9 and the variability depends on the purchaser's future actions. The proposed approaches are based on the definition of a liability in the *Conceptual Framework for Financial Reporting* ('the Conceptual Framework') and current IFRS requirements for variable consideration paid in cash or financial instruments (particularly IAS 19, IFRS 2, IFRS 3 and IFRS 16). The proposed approaches are:

(a) Approach 1: Recognising a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration. This approach is based on a possible application of the definition of a liability in the Conceptual Framework.

(b) Approach 2: Recognising a liability when the purchaser performs (or does not perform) the actions that trigger the variable consideration. This approach is based on a possible application of the definition of a liability in the Conceptual Framework and some existing IFRS requirements.

(c) Approach 3: Recognising a liability when the purchaser obtains control of the asset acquired. This approach is based on some existing IFRS requirements.

ES8 The three approaches are evaluated based on the qualitative characteristics of financial information/the EU endorsement criteria. In this regard, it is assessed that Approach 1 and Approach 3 could result in more relevant information than Approach 2. Under Approach 2 no liability for variable consideration is recognised when control of the acquired asset is received by the purchaser. If there is no fixed consideration, this asset would therefore be measured initially at nil, when the asset is measured at cost. Whether the cost price of the acquired asset should subsequently be updated when a liability for the variable consideration is recognised is a separate issue considered in the Discussion Paper. However, at least until this point in time, the measurement at nil of the asset would mean that there would also not be any amortisation or depreciation expenses recognised in the statement of financial performance. This could impair predictions of future cash flows and the assessment of stewardship to the extent the asset contributes/could contribute to the income in those periods. This is because the costs related to generating the income for the period will not be 'matched' with the income.

ES9 Such a situation could be avoided under Approach 3 and to some extent also Approach 1. One of the disadvantages of Approach 1 is, however, that it will require judgement to assess when the purchaser would have no practical ability to avoid taking the action that would trigger the variable consideration. Approach 3 would on the one hand always result in a liability for variable consideration being recognised when the purchaser receives the control of the related asset. It would therefore require less judgement and be less costly to apply than Approach 3. On the other hand, it may not be considered to result in a faithful representation to recognise a liability for variable consideration that can (easily) be avoided.

ES10 The Discussion Paper consults on the advantages and disadvantages of each of the approaches and on which would be the preferred approach. The Discussion Paper also consults on the type of requirements that could be introduced for Approach 1 to clarify when a purchaser would not have a practical ability to avoid taking an action that would trigger variable consideration.

Addressing the measurement of the acquired asset issue

ES11 Chapter 3 of the Discussion Paper examines different approaches for developing IFRS requirements on whether/when to include the remeasurement of liabilities for variable consideration in the measurement of acquired assets that are measured at cost.

ES12 One of the reasons for the divergence in practice is that the definition of 'cost' in IAS 16, IAS 38 *Intangible Assets* and IAS 40 *Investment Property* can be, and is, interpreted differently. Depending on the interpretation, the outcome could be that 'cost' should always be updated to reflect changes in the estimate of the amount that will eventually have to be paid or it could be that cost should never be updated (or something between these extremes).

ES13 Based on the different interpretations of the current definition of 'cost', guidance in the Conceptual Framework and requirements and IFRIC Interpretations (IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*) the following alternative requirements could be made regarding whether the cost of an acquired asset should be updated to reflect changes in the estimate of variable consideration the purchaser would have to pay:

(a) Approach 1: Not updating the cost estimate. This possible requirement would be based on an interpretation that the definition of cost in IFRS Standards states that the cost of is what is paid at the time of the acquisition of an asset. Accordingly, the cost should not subsequently be updated.

(b) Approach 2: Updating the cost to the extent a liability for variable consideration is included in the initial measurement of the asset. This possible requirement would be based on the consensus reach by the IFRS IC in relation to IFRIC 1 that changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation (in the case of IFRIC 1 an existing decommissioning, restoration or similar liability), should be added to or deducted from the cost of the related asset. It could therefore similarly be argued that changes in the estimate of outflows of variable consideration initially included in the measurement of an asset should update the cost of that asset.

(c) Approach 3: Updating the cost to reflect all subsequent changes in estimates of variable consideration. This possible requirement would be based on an interpretation that the definition of cost in IFRS Standards states that the cost of is the (final) amount of cash or cash equivalents paid to acquire an asset.

(d) Approach 4: Updating the cost to reflect subsequent changes in estimates of variable consideration until the asset is ready for its intended use. This possible requirement would be based on the requirements in IAS 16.20 and IAS 38.30 which state that 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.

(e) Approach 5: Updating the cost to the extent subsequent changes in estimates of variable consideration are associated with future economic benefits to be derived from the asset. This possible requirement would be based on the view that payments associated with future economic benefits are for additional assets/improvements to existing assets and should therefore update the cost of asset presented in the statement of financial position.

(f) Approach 6: Updating the cost to the extent subsequent changes in estimates of variable consideration are linked to the initial quality of the asset. This possible requirement would be based on the view that variable consideration can be introduced because there is uncertainty about the quality of the asset transferred. Accordingly, if an asset of a poor quality is transferred, the 'right' consideration and 'cost' of an asset should be low and vice versa if the quality is high. Accordingly, when the variable consideration depends on the initial quality of the asset, the variable consideration represents the 'right' cost of the asset. Changes in the estimate of variable consideration should therefore be reflected in the cost of the acquired asset.

ES14 While Approach 1 and Approach 3are mutually exclusive, any of the other approaches may be combined.

ES15 When assessing the advantages and disadvantages of each of the approaches listed above in paragraph ES13, this Discussion Paper, considers how the alternative requirements would affect profit or loss. It is thus considered that if future cash flows are expected to be derived from the acquired asset, it would be most useful for predicting future cash flows and assessing stewardship to include the changes in the estimate of variable consideration 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). On the other hand, if variable consideration depends on factors incurring in a period, the most useful information would result from recognising the changes in the estimate of variable consideration in profit or loss in the period it occurs.

A holistic approach to variable consideration requirements and possible standard setting implications

ES16 As noted above, the Discussion Paper assesses existing requirements applicable for the accounting for variable consideration by purchaser entities including those that could be applied analogously (e.g., mirroring of IFRS 15 requirements that are applicable for seller entities) and possible approaches to standard setting that could be considered in the future, should challenges associated with these transactions become pervasive to the extent that it is included in the IASB active agenda.

ES17 The Discussion Paper assesses the advantages and disadvantages of developing a unified set of principles to be applicable across different Standards with consideration of cost-benefit and impact on usefulness of information.

ES18 The analysis highlights the limitations of developing a unified set of principles to be applied across all include:

(a) 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 principles for accounting for variable consideration may have limited utility.

(b) Considering how to account for variable consideration when setting standards for particular accounting issues could result in tailor-made requirements, which could be more useful than general one-size-fits-all requirements that would apply for variable consideration in all circumstances.

QUESTIONS TO CONSTITUENTS

EFRAG invites comments on all matters in this Discussion Paper, particularly in relation to the questions set out below.

Comments are more helpful if they:

• address the question as stated;

• indicate the specific paragraph reference to which the comments relate; and/or

• describe any alternative approaches that should be considered.

All comments should be received by [to be included]

Areas for clarification or develop of requirements on variable consideration

Question 1: As stated in Chapter 1, the Discussion Paper focuses on two issues in relation to the accounting for variable consideration by purchaser entities for which diversity in practice exist, namely: ‘the liability recognition issue’ and ‘the measurement of the acquired asset issue’.

(a) Do you agree with the premise of this Discussion Paper that there is a need for clarification or development of IFRS recognition and measurement requirements on these two issues?

(b) Are there other areas in relation to the accounting for variable consideration where the clarification or development of IFRS requirements could be useful? If so, please elaborate.

Recognition under IFRS 9 for variable consideration that depends on the purchaser's future actions?

Question 2: Based on requirements for when to recognise a liability for variable consideration included in IFRS Standards other than IAS 32/IFRS 9 and the guidance included in the Conceptual Framework, Chapter 2 lists three approaches for a requirement on when to recognise a financial liability that would be covered by IAS 32/IFRS 9 for variable consideration that depends on the purchaser's future actions:

(a) Always recognise a liability when the related good or service is received.

(b) Recognise a liability when the related good or service is received, and the obligor does not have a practical ability to avoid taking the action(s) that would trigger the variable consideration (the Discussion Paper includes alternative proposals on when an obligor would not have the practical ability to avoid taking the action(s) that would trigger the variable consideration (see Question 4 below).

(c) Recognise a liability when the actions that trigger the variable consideration have been performed.

The Discussion Paper does not consider approaches for recognition that include additional recognition thresholds (for example, only to recognise a liability when it is probable / more likely than not, that an outflow of economic resources will occur). This is because IFRS 9 does not include such criteria for the recognition of other financial liabilities. Do you agree with the approach chosen in the Discussion Paper of not considering additional recognition criteria? If not, what recognition criteria do you think should be considered?

Do you think that other approaches for requirements for liabilities for variable consideration than those listed should be considered?

Which approach would you prefer and why?

Assessed advantages and disadvantages of the three different approaches for requirements on when to recognise a liability for variable consideration?

Question 3: Chapter 2 includes assessments of the advantages and disadvantages of basing requirements on when a purchaser should recognise a financial liability covered by IAS 32/IFRS 9 for variable consideration that depends on the purchaser's future actions on three different routes for requirements based on:

(a) Different interpretations of the definition of a liability included in the Conceptual Framework.

(b) Current requirements for liabilities for variable consideration not covered by IAS 32/IFRS 9.

Do you agree with these assessments?

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

How to assess that an entity has no practical ability to avoid taking an action

Question 4: The Conceptual Framework states that when an entity's duty or responsibility to transfer an economic resource is conditional on a particular future action that the entity itself may take, the entity has an obligation if it has no practical ability to avoid taking that action. Approach 1 suggested in the Discussion Paper builds on this. However, for a requirement based on Approach 1 to be operational, it is considered necessary to provide additional guidance on when an entity has no practical ability to avoid taking an action. Chapter 2 therefore provides five alternatives for when it could be said that a purchaser would have no practical ability to avoid taking an action which would trigger a variable consideration (when the purchaser is not legally or constructively obliged to perform the future actions). The five alternatives are:

(a) When avoiding taking an action would mean that the purchaser would have to cease its activities

(b) When avoiding taking an action would have significant unfavourable economic impact for the entity

(c) When avoiding taking an action would have significant unfavourable economic impact related to the acquired asset

(d) When avoiding taking an action would result in using an acquired asset in a manner that would not reflect the economic purpose for acquiring the asset

(e) When avoiding taking an action would be marginally economically unfavourable.

Do you think there are other alternatives than those listed that should be considered when assessing whether a purchaser would not have the practical ability to avoid performing a future action that would trigger variable consideration?

Which alternative would you prefer and why?

Interpretations of cost

Question 5: Chapter 3 notes that the definition of 'cost' 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" and related guidance is interpreted differently.

How do you interpret the requirements in relation to whether/when the measurement at cost of an asset should be updated to reflect changes in estimates of variable consideration?

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

Possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration

Question 6: Chapter 3 lists the following six possible requirements for when the cost of an asset should be updated in situations where the asset is acquired in exchange for variable consideration in cash or another financial instrument:

(a) Approach 1: Not updating the cost estimate.

(b) Approach 2: Updating the cost to the extent a liability for variable consideration is included in the initial measurement of the asset.

(c) Approach 3: Updating the cost to reflect all subsequent changes in estimates of variable consideration.

(d) Approach 4: Updating the cost to reflect subsequent changes in estimates of variable consideration until the asset is ready for its intended use.

(e) Approach 5: Updating the cost to the extent subsequent changes in estimates of variable consideration are associated with future economic benefits to be derived from the asset.

(f) Approach 6: Updating the cost to the extent subsequent changes in estimates of variable consideration are linked to the initial quality of the asset.

Do you think that other possible requirements than those listed should be considered? If so, what should the requirement be?

Advantages and disadvantages of possible requirement for when measurement at cost should be updated to reflect changes in estimates of variable consideration?

Question 7: Chapter 3 lists advantages and disadvantages for six possible requirements for when measurement at cost should be updated to reflect changes in estimates of variable consideration (see Question 6). Do you agree with the assessed advantages and disadvantages? When do you think 'cost' should be updated to reflect changes in estimates of variable consideration?

Reasons for differences in current IFRS Standards on when to recognise a liability for variable consideration that depends on the purchaser's future actions?

Question 8 – Chapter 4 includes the assessment that differences in current IFRS Standards on when to recognise a liability for variable consideration that depends on the purchaser's future actions do not seem to reflect that user's have different information needs regarding the different types of transactions covered by these IFRS Standards or particular cost/benefit considerations should apply. Rather the differences in current IFRS Standards regarding how to account for variable consideration may be a result of the requirements being developed at different points in time. Do you agree with this assessment?

General principles to align requirements on accounting for variable consideration?

Question 9: Chapter 4 observes that Chapters 2 and 3 of the Discussion Paper only considers some types of variable consideration. For example, the Discussion Paper only considers how a purchaser should account for variable consideration that is paid in cash or another financial instruments. Some contracts would require that variable consideration is settled by transferring other assets than financial instruments and the seller of a good or service would also have to account for the variable consideration to be received. Although there are requirements to cover variable consideration in other situations, these requirements do not seem to be aligned. Chapter 4 therefore examines the advantages and disadvantages of approaching the issues covered by Chapters 2 and 3 in a holistic manner by developing general principles for how to account for variable consideration.

Do you agree with the advantages and disadvantages identified?

Do you think that requirements do deal with the issues mentioned in Chapters 2 and 3 should be based on some general principles for how to account for variable consideration?

Applying an IFRS 15 mirroring approach

Question 10: Chapter 4 notes that, with the exception of the constraint to only include in the transaction price the amount of variable consideration that is highly probable not to result in a significant reversal in the amount of cumulative revenue recognised, requirements on variable consideration included in IFRS 15, could be 'mirrored' to provide guidance on how to account for a liability for variable consideration.

Do you think such an approach would result in useful information? Why/why not?

CHAPTER 1: BACKGROUND AND SCOPE

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

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 actions; and*
- *Whether changes in the estimate of variable consideration should be reflected in the cost of the acquired asset[1] 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.

The Discussion Paper examines how requirements could be introduced to deal with each of the two issues listed above. Any requirement that would be introduced would, however, be different from requirements on variable consideration in some other IFRS Standards. The Discussion Paper therefore also considers whether the solution to the two issues should be based on general principles that would apply to all requirements on variable consideration across the various IFRS Standards.

What are the accounting issues with variable consideration?

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

a) When the value for the purchaser of a transferred asset or some of the characteristics (including condition and quality) 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, (s)he will play for the purchaser's team.

b) When the seller wants to retain some of the risks and rewards related to an asset. For example, when a seller cannot afford to maintain and/or develop an asset, (s)he can transfer the asset to another party in return for a consideration that will depend on the performance of the transferred asset. 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 As mentioned earlier, the motivation for this Discussion Paper arises because of the inconsistent or lack of explicit current IFRS requirements on accounting for variable consideration by purchaser entities. As a result, two issues have arisen in past discussions of the IFRS Interpretations Committee[2], namely:

[1] This Discussion Paper sometimes refers to the acquired asset as an acquired good or service. Both terms also include a right to charge users of a public service under the intangible asset model in a service concession arrangement according to IFRIC Interpretation 12 Service Concession Arrangements.

[2] See Appendix 3.

a) The liability recognition issue, which in this Discussion Paper refers to the question of when to recognise a financial liability within the scope of IAS 32/IFRS 9 for variable consideration that will depend on the purchaser's future actions. The issue arises as current IFRS requirements (IAS 32 Financial Instruments: Presentation) are interpreted differently. Possible interpretations range from recognising a liability when the purchaser has obtained control over the asset acquired in exchange for the variable consideration to only recognising a liability when the future actions that will trigger the variable consideration have occurred.

b) The measurement of the acquired asset issue, which relates to the diversity in practice on whether changes in the estimate3 of variable consideration should either (i) result in updating the cost of the acquired asset that is held by the purchaser or (ii) be recognised in profit or loss. This issue can arise when the asset is acquired in exchange for variable consideration paid by transferring either cash (or another financial instrument) or another type of asset (including performing a service). The issue arises as the definition of 'cost' can be interpreted differently – to require or prohibit changes in the amount given to acquire an asset to be updated after the time of the transfer of the asset. In addition, existing IFRS requirements provide inconsistent guidance on the issue. Some recognition and measurement requirements on liabilities (e.g., IFRS 9 Financial Instruments) state that changes in the estimate of future outflows of a liability should be recognised in profit or loss, while other requirements state that such changes should be included as an adjustment in the carrying amount of the asset. 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.

Objective and scope of this Discussion Paper

1.3 With the noted problem of inconsistent or lacking requirements for the accounting for variable consideration by purchaser entities, the objective of this Discussion Paper is to conceptualise approaches for developing possible requirements on accounting for variable consideration that address the liability recognition issue and the measurement of the acquired asset issue mentioned in paragraph 1.11.1.

1.4 The aforementioned issues 1.1 relate to recognition and measurement requirements for the accounting for variable consideration by purchaser entities. Correspondingly, the Discussion Paper does not consider disclosure requirements.

1.5 Chapters 2 and 3 consider how solutions to the two issues can be based on current requirements for variable consideration for other types of transactions. Chapter 4 addresses possible standard setting approaches after an assessment of IFRS requirements for accounting for variable consideration by purchaser entities.

1.6 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*.

[3] 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.

Definition of variable consideration

1.7 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*[4].

1.8 Whether the acquirer will have to transfer additional assets to the seller 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.

1.9 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'.

b) 'Contingent consideration' could be interpreted as meaning that any additional assets that may have to be transferred in exchange for a good or service received would be fixed (for example, a given amount of money). The term 'variable consideration' not only includes those circumstances, but also includes situations under which any additional amount would be variable (for example, if it depends on the development in the market price of the transferred good or service).

1.10 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[5]. 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.

1.11 The fact that only variable consideration to the seller is included in the discussion means that if the purchaser as part of acquiring an asset also incurs a restoration obligation to a third party (for example, the society) this obligation is not considered to be variable consideration in this Discussion Paper.

[4] 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."

[5] 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*.

Changes in the value of consideration

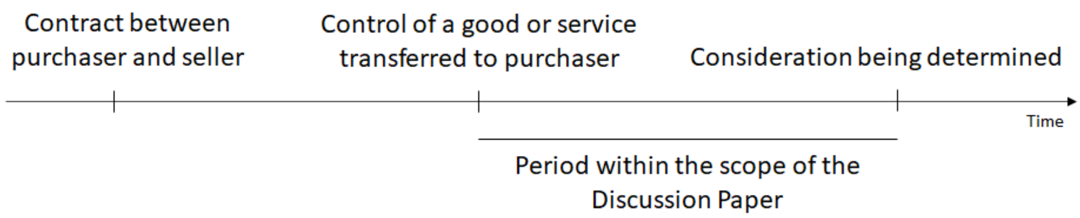
1.12 Not considering value changes of the asset(s) to be transferred can result in a transaction that would have similar economic consequences to a transaction involving variable consideration would not be covered by the scope of the Discussion Paper. For example, if a purchaser acquires 10 bottles of apple cider and have to pay an amount in its functional currency corresponding to the price of apples in 10 months, this consideration would be considered to be variable consideration in this Discussion Paper. However, if the purchaser would instead have to deliver 25 kilos of apples in 10 months, the consideration would not be considered to be variable in this Discussion Paper.

1.13 The accounting for changes in the value of variable consideration is not separately considered in the Discussion Paper as it would raise additional complex issues that go beyond and are not necessary for formulating solutions to the primarily issues being addressed in the scope of the Discussion Paper. Those complex issues would include, but would not be limited to, discussions about which current IFRS Standard the obligation would be covered by and how hedging policies of the purchaser should affect the measurement at cost of the acquired asset[6].

Non-executory contracts

1.14 The Discussion Paper only considers variable consideration in non-executory contracts[7] because the purchaser has received the good or service (that is, the asset) 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



1.15 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.

1.16 If a contract is executory the combined right and obligation constitute a single asset or liability[8]. 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.

[6] Only considering variable consideration to include transfer of additional asset also means that it is outside the scope of this Discussion Paper to consider how to account for changes in foreign exchange rates.

[7] 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.

[8] See the Conceptual Framework paragraph 4.57.

Exclusion of fixed consideration

1.17 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 (see paragraph 1.1 above)a), 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

Recognition of Liabilities for variable consideration- Chapter 2

1.18 Although there are either varied or no explicit IFRS requirements for when to recognise liabilities for variable consideration, the discussion in Chapter 2 related to the timing of liabilities recognition issue is limited to liabilities covered by IFRS 9/IAS 32 for variable consideration where the variable consideration will depend on the purchaser's future actions. The interpretation challenges raised before IFRS IC as detailed in Chapter 2 have arisen for financial liability requirements in the scope of IAS 2/IFRS 9 where the liability depends on the purchasers' future actions.

1.19 When a variable consideration does not depend on the purchaser's future actions, a financial liability would be recognised in accordance with IAS 32/IFRS 9 when control of the asset to which the variable consideration relates has been received by the purchaser. Accordingly, there is no ambiguity in the timing of when to recognise a liability.

Measurement of the acquired asset - Chapter 3

1.20 The inclusion of liabilities remeasurement in the measurement of the acquired asset issue does not depend on the nature of the variable consideration (i.e., it can be paid by the transfer of cash, another financial instrument, or a non-financial asset, or by performing a service). However, for consistency of analysis across the Discussion Paper, the analysis in Chapter 3 only focuses on liabilities remeasurements for the liabilities for variable consideration that are addressed in Chapter 2 (i.e., those that would be covered by IAS 32/IFRS 9).

1.21 The measurement of the acquired good or service issue only arises when the acquired asset is initially and subsequently measured at cost (e.g., typically for assets covered by IAS 16 and IAS 38). If the acquired asset is measured at fair value, the measurement of the acquired asset is updated to reflect changes in the fair value of the acquired asset and not changes in the estimate of the consideration (including variable 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[9]. Accordingly, while this issue is relevant for most PPE and intangible assets acquired in exchange for variable consideration, it is not relevant to situations when the purchaser acquires a financial instrument (except for trade receivables) to which the requirements in IFRS 9 apply where such an asset would be measured at fair value at the initial recognition or amortised cost that considers the fair value of the asset.

1.22 When variable consideration depends on the purchaser's future actions, there would be some interlinkage between the liability recognition issue and the measurement of the acquired asset issue. This is because, as further explained in Chapter 3, this Discussion Paper considers that variable consideration can only be reflected in the measurement of the acquired asset to the extent a liability is recognised for the variable consideration. Accordingly, it is not possible to reflect variable consideration and changes in estimates of variable consideration in the cost of the acquired asset until a liability for the variable consideration is recognised. This issue is further addressed in Chapter 3.

1.23 To the extent no liability can be recognised when the purchaser obtains control of an acquired asset, this Discussion Paper considers that the acquired asset is recognised in the financial statements, but measured at nil. This means that when the liability is recognised this is considered as a change in the estimate of variable consideration related to the asset.

Holistic assessment of IFRS requirements-Chapter 4

1.24 Chapter 4 and associated Appendix 2 complement Chapters 2 and 3 by assessing the IFRS requirements on accounting for variable consideration by purchaser entities more broadly (i.e., requirements not limited to variable consideration transactions that are to be paid in cash or another financial instruments and where variable consideration depends on the purchaser's future actions). The objective of the analysis in this chapter is to assess possible standard setting approaches including whether or not there is a need for the development of a unified set of principles for the accounting for variable consideration after taking into account cost-benefit and impact on usefulness of the information. Although the primary focus of the Discussion Paper is on the issues addressed in Chapters 2 and 3, the review of the broader set of requirements gives a holistic picture of the related gaps in IFRS requirements. Furthermore, these sections of the Discussion Paper also have a brief analysis on the additional complexities that may arise from variable consideration that is not paid in either cash or another financial instrument.

Transactions that are carried out on market terms

1.25 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.

[9] 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

1.26 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

1.27 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 a) 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)).

1.28 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

1.29 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.

1.30 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.

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

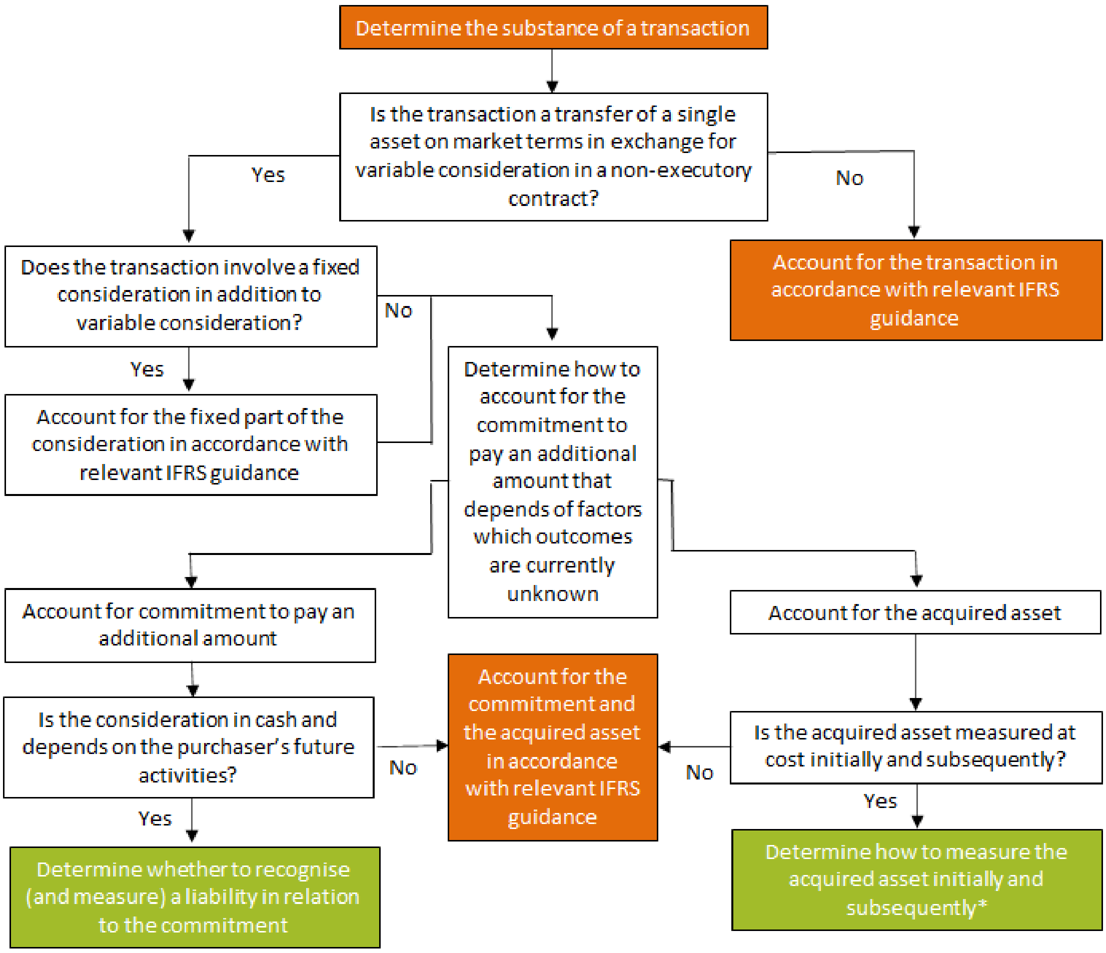
1.32 This Discussion Paper does not consider how to distinguish and determine the various assets that could be included in a transaction. It also does not focus on distinguishing whether a profit-sharing arrangement involves variable consideration or not. It is thus outside the scope of the Discussion Paper to consider the views presented in paragraphs 1.30 and 1.31 above.

Risk sharing/collaborative arrangements

1.33 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.

1.34 The scope of the Discussion Paper can be illustrated by the shaded boxes in the diagram below and the following table. The issues listed in the orange boxes in the diagram 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 3 of the Discussion Paper is limited to situations under which the variable consideration is paid in cash or another financial asset

Coverage / Issue	The liability recognition issue	The measurement of the acquired asset issue
Variable consideration to:		
- the seller	✓	✓
- a party other than the seller	✗	✗
Variable consideration includes:		
- transfer of additional assets	✓	✓
- value changes of the asset(s) to be transferred	✗	✗
Variable consideration depends on:		
- the purchaser's future actions	✓	✓
- factors other than the purchaser's future actions	✗	✓
A liability for variable consideration would be covered by:		
- IFRS 9	✓	✓
- an IFRS Standard other than IFRS 9	✗	✗
The acquired asset is measured initially and subsequently at:		
- cost	✓	✓
- something else than cost	✓	✗
Transaction is:		
- carried out on market terms	✓	✓
- not carried out on market terms	✗	✗
Consideration is:		
- an asset	✓	✓
- own shares	✗	✗
Acquisition is:		
- part of a business combination	✗	✗
- outside a business combination	✓	✓

CHAPTER 2: RECOGNITION OF A LIABILITY FOR VARIABLE CONSIDERATION

As explained in Chapter 1, there is currently divergence in practice on the interpretation of IAS 32 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 actions. The central question relates to when a financial liability exists in order for it to be recognised following IFRS 9 as the purchaser would be a party to the contractual provisions of the instrument.

In order to develop (clear) requirements on when to recognise a financial liability covered by IAS 32/IFRS 9 for variable consideration that depends on the purchaser's future actions, the definition of a liability and the related guidance in the IASB's Conceptual Framework for Financial Reporting[10] could be considered. However, this guidance is interpreted inconsistently. Current requirements in other IFRS standards on when to recognise a liability for variable consideration that depends on the purchaser's future actions could also be examined, but current guidance also points in different directions. Based on the different interpretations of the Conceptual Framework's definition of a liability and current guidance in IFRS Standards other than IAS 32/IFRS 9 that deals with when to recognise a liability for variable consideration, this Chapter accordingly examines the following possible alternative requirements for when to recognise a liability for variable consideration that depends on the purchaser's future actions:

- *A requirement under which a financial liability for variable consideration that depends on the purchaser's future actions is recognised when the purchaser would receive control of the acquired asset unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration. This requirement would be based on a possible interpretation of the definition of a liability in the Conceptual Framework (and is referred to as Approach 1).*

- *A requirement under which a financial liability for variable consideration that depends on the purchaser's future actions is recognised when the purchaser would perform (or not perform) the actions that would trigger the variable consideration. This requirement would be based both on a possible interpretation of the definition of a liability in the Conceptual Framework as well as some requirements in current IFRS Standards other than IAS 32/IFRS 9 (and is referred to as Approach 2).*

- *A requirement under which a financial liability for variable consideration that depends on the purchaser's future actions is recognised when the purchaser would receive control of the acquired asset. This requirement would be based on some requirements in current IFRS Standards other than IAS 32/IFRS 9 (and is referred to as Approach 3).*

Introduction

2.1 There is currently diversity in practice on when to recognise a liability that would be covered by IAS 32/IFRS 9 for variable consideration that depends on the purchaser's future actions. This issue was discussed during past IFRS IC meetings and Appendix 3 of this Discussion Paper provides a summary. This Chapter explains why this diversity exists and explores possible approaches on when the liability should be recognised.

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

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

2.3 Thereafter, in order to develop requirements that could be introduced to deal with the issue, this Chapter considers:

a) the definition of a liability as per the Conceptual Framework;

b) current requirements on when to recognise a liability for variable consideration that are included in IFRS Standards other than IAS 32/IFRS 9.

2.4 As the definition of a liability included in the Conceptual Framework can be interpreted in different ways and as relevant requirements in IFRS Standards other than IAS 32/IFRS 9 are different, this Chapter develops alternative possible requirements to deal with the issue based on different interpretations of the definition of a liability in the Conceptual Framework and the different current requirements in other IFRS Standards. The Chapter then includes an assessment of advantages and disadvantages of these alternative requirements.

2.5 This Chapter does not look at measurement of a liability for variable consideration as there is currently no divergence in practice.

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[11]) 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[12].

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 a liability for variable consideration, that depends on the purchaser's future actions, should be recognised.

[11] 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.

[12] (50 000 – 10 000) jars * CU 1 = CU 40 000.

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[13], and if not, at what time.

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.

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 when the purchaser (Entity A) does not have the unconditional right to avoid delivering cash or another financial asset. There are different interpretations on this as reflected below.

2.17 For example:

a) Some consider that when the purchaser has received the related asset, 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 when the asset is received**.

[13] 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 should be considered separately from a fixed part.

b) Also, some consider that paragraph 25 of IAS 32 means that a financial liability should generally be recognised when the related asset is received in circumstances where variable consideration depends on the purchaser's future activities. An argument presented in favour of this view is that paragraph 25 of IAS 32 states that the purchaser's future revenues, net income or debt to equity ratio, are beyond the control of both the purchaser and the seller of the instrument. Therefore, by analogy[14], in relation to variable consideration, the purchaser's future actions (or future performance) is also beyond the control of the purchaser and a financial liability ought to be recognised[15].

c) On the other hand, some consider that paragraph 25 of IAS 32 means that if variable consideration depends on the purchaser's future actions, no liability should be recognised when the related asset is received regarding the commitment to pay an additional amount depending on the future actions. It is argued that if variable consideration depends on the purchaser's future actions, the event of the occurrence or non-occurrence of uncertain future events is within the control of the purchaser. Therefore, **a liability would be recognised only when the event that triggers the variable payment occurs**.

d) Some consider that paragraph 25 of IAS 32 means that if variable consideration depends on the purchaser's future actions, an equity component should be recognised when the related asset is 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 at that point in time. However, it is argued that if no financial liability exists at that point in time, a residual would exist, i.e. an equity component which should be recognised. This equity component should be derecognised and a financial liability recognised when/if the purchaser would perform the future actions that would trigger the variable consideration.

2.18 Due to the above different interpretations on IAS 32, there is divergence in practice on when a liability should be recognised in accordance with IAS 32/IFRS 9 for variable consideration when the variability depends on the purchaser's future actions.

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. These approaches are 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 might thus also be an opportunity for the IASB to clarify when a financial liability for variable consideration that would depend on the purchaser's future actions should be recognised.

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[14] 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.

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

How could the issue be addressed by considering the definition of a liability or applying current requirements for liabilities outside the scope of IAS 32/IFRS 9?

Guidance based on the definition of a liability in the Conceptual Framework

2.20 As mentioned in paragraph 2.19, considering the criteria for the definition of a liability in the Conceptual Framework could be an approach that could be applied when developing requirements for recognising a financial liability for variable consideration that depends on the purchaser's future actions.

Definition and guidance 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 as in the situations considered in this Discussion Paper, there is a contract and the variable consideration could result in a financial liability covered by IAS 32/IFRS 9 being recognised. Paragraph 4.37 of the Conceptual Framework thus 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 when the entity has a practical ability to avoid taking the actions requiring the entity to transfer economic resource. For example, if the variable consideration would have to be paid if the purchaser starts using the acquired asset:

a) One view is that the purchaser has no practical ability to avoid the variable payment after receiving the asset as it would `be economically disadvantageous to acquire an asset and not use it. In other words, the purchaser should recognise a liability when the acquired asset is received.

b) A contrasting view is that the purchaser would generally not have an obligation when the asset is received for the following reasons:

   (i) Even if the purchaser obtains control of the asset, this does not necessarily mean that (s)he 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 might 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, if a requirement would be based on the definition of a liability in the Conceptual Framework, it would have to be decided when an action that would trigger variable consideration is practically unavoidable. This issue is therefore considered further in paragraphs 2.40 – 2.42 below.

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 depends on the purchaser's future actions. And whether the past event should be the transfer of the asset or the action of the purchaser that triggers the payment (or both) [16]. There are differing views on this:

a) One view is that the **past event giving rise to the liabilities arises when the purchaser receives the right to use/control the underlying assets** rather than when the purchaser would perform the actions that would actually trigger the variable payment. 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. As a consequence, from that point in time the purchaser may (if it performs the actions that will trigger the variable consideration) have to transfer an economic resource. Accordingly, a present obligation exists due to a past event. This view is consistent with the reasoning the IASB applied when developing its proposals for the recognition of regulatory liabilities in the IASB Exposure Draft *Regulatory Assets and Regulatory Liabilities*[17].

b) In contrast, another view is that if the variable consideration would depend on the purchaser achieving some specific performance targets, the **past event would only be when the entity performs the actions on which the variable payments depend**. For example, if some specific performance targets (or conditions) need to be met in the future such as the increased sales of chocolate spread jars in the earlier cited example, it would be unknown whether those targets would be met at the time of obtaining control of the acquired asset. Therefore, the future performance target would only be deemed a past event only at the time it is met. It is only at that point in time that the present obligation for the variable consideration would exist and a liability recognised.

Possible approaches based on the Conceptual Framework

2.31 Based on the above-discussed different interpretations of the liability definition criteria of 'there being an obligation' and 'existing as a result of past events', the following are possible approaches for requirements on when to recognise a liability for variable consideration that depends on the purchaser's future actions:

a) Recognising a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration (Approach 1); or

b) Recognising a liability when the purchaser would perform (or not perform[18]) the actions that would trigger the variable consideration (it is assumed that at this point in time, the purchaser will not have a practical ability to avoid the variable consideration) (Approach 2).

[16] 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.

[17] 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.

[18] There may be circumstances whereby the purchaser may have to compensate the seller if they do not perform certain actions.

2.32 These two possible approaches focus on the criteria in the liability definition related to what is the past event and the duty or responsibility that an entity has no practical ability to avoid.

2.33 The criterion relating to the practical ability to avoid the action is applicable to both Approaches. However, the distinguishing factor between the two approaches is what is the past event. Approach 1 considers the past event to be when the purchaser would obtain control of the good or service. While Approach 2 considers that the past event would only occur when the purchaser would perform (or not perform) the actions that would trigger the variable consideration.

Recognising a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking the action that would trigger the variable consideration (Approach 1)

2.34 Under this Approach, there are two aspects to be met for a liability to be recognised:

a) When the purchaser has control of the acquired asset; and

b) When the purchaser does not have a practical ability to avoid taking the action that would trigger the variable consideration.

2.35 Under this approach, the purchaser should recognise a liability at the earliest point in time, the two conditions are met.

2.36 In the case of the of the chocolate spread recipe (see paragraphs 2.7 to 2.9), a liability, for the amount of cash the purchaser has to transfer to the seller for its future sales of chocolate spread jars in excess of 10 000 jars in the next five years, would be recognised when the purchaser receives the recipe and when it concludes that it does not have a practical ability to avoid the payment.

Recognising a liability upon the purchaser's actions that would trigger the variable consideration (Approach 2)

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

2.38 Therefore, under this Approach, there is only one aspect to be met in order to recognise a liability for variable consideration and this is the purchaser's actions that would trigger the variable payment. As stated above, it is assumed that under this approach, the purchaser would not have a practical ability to avoid the variable consideration because the action triggering the payment would have taken place.

2.39 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.

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

2.40 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[19] (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.

2.41 It is therefore assessed that if Approach 1 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 worth 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.

[19] As part of the IASB project on Financial Instruments with Characteristics of Equity, they are developing factors (not intended to be exhaustive) for an entity to consider in assessing whether a decision of shareholders is within the control of the entity in classifying financial instruments as financial liabilities or equity.

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 be 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.

2.42 Other current requirements are looked at below on when a liability for variable consideration is recognised.

Requirements based on current requirements on when to recognise a liability for variable consideration in IFRS Standards other than IAS 32/IFRS 9

2.43 As mentioned in paragraph 1.7 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 for liabilities related to consideration that would meet that definition is presented in Appendix 1: Overview of current requirements. Current requirements related to when to recognise a liability for variable consideration in cash that would/could depend on the purchaser's future activities are 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[20]	Variable consideration in the form of:	When is a liability recognised?
IAS 19 *Employee Benefits* Paragraph 71	Benefits from defined benefit pension scheme.	When asset is received *****
IAS 19 *Employee Benefits* Paragraphs 155 and 157	Long-term employee benefits (e.g., profit-sharing and bonus plans).	When asset is received *****
IAS 19 *Employee Benefits* Paragraphs 11 and 19	Short-term employee benefits (profit sharing and bonus plans).	When asset is received, the obligation can be estimated reliably and the entity has no realistic alternative but to make the payments

[20] 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.

Standard[20]	Variable consideration in the form of:	When is a liability recognised?
IFRS 2 *Share-based Payment* Paragraph 7	Cash-settled share-based payments.	When asset is received *****
IFRS 3 *Business Combinations* Paragraphs 39 and 7	Contingent consideration in a business combination.	When asset is received *****
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.	When the underlying asset is made available for use
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 the action or event that triggers the variable payment occurs

* The requirements do not distinguish between variable consideration depending on the purchaser's future activities and variable consideration depending on factors outside the control of the purchaser.

2.44 In addition, there are other current requirements, for example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* on contingent liabilities[21] that could be analogously applied for the recognition of liabilities for variable consideration. Under IAS 37.27, contingent liabilities are not recognised. Provisions should, according to IAS 37.14, be recognised when/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.

2.45 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).

[21] 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.

2.46 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).

2.47 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. These requirements do not distinguish between whether the variability is linked to the purchaser's future actions or not**. However, under the most recent IFRS requirements on variable consideration, IFRS 16, no liability is recognised for variable consideration that depends on the purchaser's future actions when the purchaser receives control of the acquired asset (i.e., when the underlying asset is made available for use).

2.48 The following section explores different approaches on when to recognise a liability related to variable consideration that depends on the purchaser's future activities applying current requirements.

Possible approaches based on current requirements

2.49 The requirements on when to recognise a liability for variable consideration could be based on the current requirements in other IFRS Standards.

2.50 Based on the table in paragraph 2.43 above, current requirements can be categorised as:

a) a liability for variable consideration that depends on the purchaser's future actions being recognised when the purchaser receives the control of the related good or service (Approach 3); or

b) a liability for variable consideration that depends on the purchaser's future actions being recognised only when the actions that trigger the variable consideration have been performed (This approach is the same as Approach 2 mentioned in paragraph b) above).

2.51 Some of the current requirements also include recognition thresholds, e.g., under IAS 37, a recognition threshold is that a reliable estimate can be made of the amount of the obligation. As IFRS 9 does not include such thresholds, it could be considered to be inconsistent with the general requirements in IFRS 9 for recognition to include recognition thresholds for liabilities for variable consideration that would depend on the purchaser's future actions. Accordingly, this Discussion Paper considers the current requirements without taking any recognition thresholds into account.

Recognising a liability when the purchaser obtains control of the related good or service (Approach 3)

2.52 For most of the current requirements in the table following paragraph 2.43 2.43 above, a liability is recognised when a good or service is received. Therefore, one of the approaches to consider is to recognise a liability when the purchaser obtains control of the related good or service.

2.53 In the case of the of the chocolate spread recipe (paragraphs 2.7 to 2.9), a liability, for the amount of cash the purchaser has to transfer to the seller for its future sales of chocolate spread jars in excess of 10 000 jars in the next five years, would be recognised when the purchaser receives the recipe.

2.54 This Approach would be different to Approach 1 which bases the requirements on an interpretation of the definition of a liability included in the Conceptual Framework because Approach 1 also considers when the purchaser does not have a practical ability to avoid taking the action that would trigger the variable consideration in order to recognise a liability. As a result, a different outcome would thus arise when the purchaser has a practical ability to avoid taking the action that would trigger the variable consideration. That is, at the same point in time, under Approach 1, a liability would not be recognised and under Approach 3, a liability would be recognised.

2.55 The advantages and disadvantages of the three approaches are summarised in a table below.

Advantages and disadvantages of the approaches

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

2.57 The basis for the assessment of the criteria in the table below is explained as follows:

a) Relevance:

(i) 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 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. Also, 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.

(ii) In addition, 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.

(iii) The first row in the table below considers the above aspects, and as a result, recognising a liability for variable consideration when the purchaser obtains control of the related asset would result in the most relevant information.

(iv) The second row in the table below considers that recognising an expense when the purchaser would take a beneficial action could be considered to result in a counterintuitive accounting outcome. Such an outcome could arise if a liability for variable consideration is only recognised when the actions triggering the variable consideration take place, the liability is not reflected in the measurement of the acquired asset (see Chapter 3) and the actions triggering the variable consideration are expected to affect the purchaser positively. The latter could generally be assumed to be the case, as the purchaser would otherwise not take those actions. 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.

b) *Faithful representation*: Faithful representation would be achieved if 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. Also, this criterion considers measurement uncertainty.

c) *Comparability*: This criterion assesses to what extent there would be a different accounting treatment compared with existing requirements and also considers the extent of consistency with IFRS 15.

d) *Prudence*[22]: This criterion is considered as caution in conditions of uncertainty.

e) *Costs*: This criterion looks at cost implications of applying the Approaches.

	Approach 1 Recognise a liability when the purchaser has control of the asset acquired unless the purchaser has a practical ability to avoid taking the action that would trigger the variable consideration	Approach 2 Recognise a liability upon the purchaser's actions that would trigger the variable consideration	Approach 3 Recognise a liability when the purchaser obtains control of the related asset
Relevance	Based on paragraph 2.57 (i)-(iv), Approach 1 would result in more relevant information than Approach 2, but would provide less relevant information than Approach 3	Based on paragraph 2.57 (i)-(iv), Approach 2 would result in the least relevant information of the three approaches	Based on paragraph 2.57 (i)-(iv), Approach 3 would result in the most relevant information.

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

	Approach 1 Recognise a liability when the purchaser has control of the asset acquired unless the purchaser has a practical ability to avoid taking the action that would trigger the variable consideration	Approach 2 Recognise a liability upon the purchaser's actions that would trigger the variable consideration	Approach 3 Recognise a liability when the purchaser obtains control of the related asset
	Based on paragraph 2.57(iv), Approach 1 could sometimes result in an accounting outcome that could be considered counterintuitive as it could result in the same outcome as Approach 2.	Based on paragraph 2.57(iv), Approach 2 could result in an accounting outcome that could be considered counterintuitive, as it could (depending on the requirements for the measurement of the acquired asset – see Chapter 3) result in an expense being recognise when the purchaser takes a favourable action.	Based on paragraph 2.57(iv), Approach 3 could mitigate the issue on counterintuitive accounting.
Faithful representation	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. Measurement uncertainty could be high when a liability is recognised before the activities that would trigger the variable consideration take place.	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. The measurement uncertainty would be low.	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 it). The measurement uncertainty could be high but less high compared to Approach 1 because Approach 3 does not need to consider judgement relating to whether the purchaser has the practical ability to avoid the action or not.
Comparability	Would result in a different accounting treatment compared with existing requirements.	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).	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 left).

	Approach 1 Recognise a liability when the purchaser has control of the asset acquired unless the purchaser has a practical ability to avoid taking the action that would trigger the variable consideration	Approach 2 Recognise a liability upon the purchaser's actions that would trigger the variable consideration	Approach 3 Recognise a liability when the purchaser obtains control of the related asset
	Would sometimes be consistent with how the seller would recognise a contract asset for 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.	Generally consistent with how the seller would recognise a contract asset for the variable consideration under IFRS 15.
Prudence	Less prudent than Approach 3 but more prudent than Approach 2.	This approach is less prudent as a liability is recognised at a later point in time.	It is prudent to recognise liabilities earlier rather than later, especially in conditions of uncertainty.
Costs	Would be more costly than Approaches 2 and 3 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.	Less costly for preparers as estimates would not have to be made and updated.	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.

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 there are no explicit/clear requirements on the issue, and the requirements that do exist are interpreted differently and/or are conflicting.

This Chapter considers these issues and possible approaches that could be considered, should clearer requirements be introduced. It is first noticed that there are different interpretations of what 'cost' is and that the requirements that do exist on the topic point in different directions or can be considered to be inconsistent. The Conceptual Framework is also not assessed to provide much guidance on the issue.

Six possible approaches, based on current requirements and different interpretations of what 'cost' is 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 IC. 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 IC has discussed variable payments for the purchases of PPE and intangible assets in the past but decided not to add the issue to its agenda. The IFRS IC also considered variable payments for asset purchases and payments made by an operator to a grantor in a service concession arrangement (IFRIC 12 Service Concession Arrangements). The IFRIS IC noted that the issue was too broad and should be addressed by the IASB is a separate project covering variable payments. Refer to Appendix 3 for more information.

3.3 This Chapter first explains reasons for the diversity in practice on the issue. Then current requirements are examined on whether the cost of the acquired asset should be updated to reflect changes in the estimate of variable consideration. In this regard, only requirements under which the measurement of the acquired asset is linked to the measurement of a recognised liability are considered. Also, it is assessed whether the Conceptual Framework's guidance on 'cost' can provide guidance on the requirement that could be introduced.

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

What are the issues?

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

3.6 Divergence in practice exists on this issue as there is no explicit requirements on the matter and/or the requirements that do 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).

Illustrative example from Chapter 2

3.7 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.

3.8 As noted in paragraph 3.30 of the Discussion Paper, 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 these intellectual rights of the recipe, accounted for as an asset, measured at cost should be updated subsequently to reflect changes in the measurement of a recognised liability for variable consideration following 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 the change in the measurement of a recognised liability for variable consideration and/or a subsequent recognition of the liability for variable consideration be recognised in profit or loss or be capitalised as part of the asset?

3.9 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 be updated after the entity sells 10 001 jars of spread and for subsequent sales?

3.10 The definition of ‘cost’ is looked at below which illustrates the divergence in practice on this issue.

Different interpretations of ‘cost’

3.11 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.

3.12 ‘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*.

3.13 However, this definition of ‘cost’ could be interpreted in different ways.

3.14 For example, the definition of cost could be interpreted to include in cost 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 (paid by transfer of a non-financial asset or by performing a service) either at acquisition or construction of the asset or when applicable as described in paragraph 3.12). Therefore, this definition encompasses all amounts expected to be paid in cash or cash equivalents even when these are dependent on when the asset is received (i.e., variable consideration). This interpretation would mean that the **cost of the asset should be updated** to reflect the remeasurement of the liabilities for variable consideration.

3.15 The fact that both IAS 16 (paragraph 16), IAS 38 (paragraph 27) and IAS 2 Inventories (paragraph 11) require entities to 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 ultimately paid for the acquired asset. According to IAS 2:

> Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

3.16 It follows that volume rebates (which is a type of variable consideration), for which the exact amount, in many cases, would only be known subsequently to the acquisition of inventory, should be reflected in cost.

3.17 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. By analogy, 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 to also adjust the cost of those goods and services.

3.18 A question could arise regarding to what extent would the cost of the asst be updated to reflect changes in variable consideration.

3.19 A different view considers that 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 does not envisage that 'cost' could be updated as a result of changes in the amount paid (or given) to acquire an asset. A corollary of this view is that the cost of the asset should not be updated to reflect the remeasurement of the liabilities for variable consideration.

3.20 In addition, both IAS 16 and 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 (paragraph 74 of IAS 38 and paragraph 30 of IAS 16). Neither IAS 16 nor IAS 38 thus mentions that the measurement of an asset accounted for by the Standards should be adjusted by changes in the estimate related to variable consideration.

3.21 There are also some arguments that the **cost of an asset should be updated** to reflect changes in estimates related to variable consideration **until the asset is ready for its intended use**. The time when the asset is ready for its intended use could thus be seen as the point in time at which the cost of the acquired asset can no longer be revised except for reflecting the amortisation/depreciation and impairment losses associated with the asset.

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

3.22 Another reason for divergence in practice is that those explicit requirements that do exist for some transactions or types of variable consideration point in different directions or are inconsistent.

3.23 The different current requirements are illustrated in Appendix 1: 'Overview of current requirements'.

3.24 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 estimate of variable consideration differ across IFRS Standards. The table below indicates whether the cost should be updated (ü) or not (û). 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.

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[23]).
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[24].	×	Changes in the estimated outflow related to variable consideration are recognised in profit or loss.

3.25 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[25] are reflected in the cost of the asset (paragraph 55 of the ED).

[23] Paragraph 156 of IAS 19.

[24] 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.

[25] 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.

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

Linkage with the recognition/measurement of the related liability

3.26 If requirements were to be developed on when/whether to reflect changes in the estimate of variable consideration in the measurement of the acquired asset, it would have to be decided whether the measurement of the acquired asset at cost should be linked or not to the recognition/measurement of the related liability.

3.27 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. It could thus be considered whether including variable consideration in the initial measurement of an asset should – or should not – take place independently on whether the variable consideration is reflected in the related liability.

3.28 The different theoretical options are illustrated in the table below. In the table a ü in column two or three indicates that variable consideration is reflected in the initial cost measurement of the asset and/or is recognised as a liability, respectively.

	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.

3.29 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. A day-one gain/loss may not be useful information to users of financial statements as such gains and losses would only reflect differing measurement approaches towards the related asset and liability, and not reflect any real economic events.

3.30 Of the options listed above, this Discussion Paper therefore only considers approaches under which measuring the cost of an asset is based on the measurement of the related liability.

Conceptual Framework guidance

3.31 If requirements were to be developed on when/whether the cost of an acquired asset should be updated to reflect changes in estimates of variable consideration, the Conceptual Framework's guidance on measurement at historical cost could be consulted.

3.32 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).

3.33 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.

3.34 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.

3.35 It could be argued that cost is only updated for the four criteria in paragraph 3.33 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.

3.36 However, the list in paragraph 3.33 could also be argued not to be exhaustive or could be said only to deal with what ‘cost’ is and hence that the Conceptual Framework does not present clear guidance on the subject.

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

3.37 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.

3.38 As noted in paragraphs 3.26 – 3.30, this Discussion Paper considers the measurement at cost of an acquired asset to be linked to the recognition/measurement of the related liability for variable consideration in the following ways:

a) To the extent a liability for variable consideration that depends on the purchaser’s future actions is recognised at a later point in time than when the asset is acquired, the variable consideration cannot be reflected in the initial measurement of the acquired asset.

b) Similarly, to the extent it would be required that subsequent changes in the cost of an acquired asset is updated to reflect changes in estimate of variable consideration, such changes cannot be reflected until the liability is recognised.

3.39 Accordingly, there is a linkage between the issue on when to recognise a liability under IAS 32/IFRS 9 for variable consideration that depends on the purchaser's future actions (discussed in Chapter 2) and the issue on when/whether to update the measurement of cost to reflect the remeasurements of liabilities for variable consideration. This linkage is, to some extent, considered in the following assessments of different approaches on whether/when to update the cost measurement of an acquired asset, especially considering variable consideration that depends on the purchaser's future actions.

Approach 1 - Not updating original cost estimate

3.40 An approach on whether/when to update the measurement at cost of an acquired asset to reflect changes in the related liability for the estimate of variable consideration could be to require that such changes are not reflected in the cost.

3.41 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.

3.42 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.

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

3.44 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. This approach would therefore also reflect the current requirements in IAS 19, IFRS 2, IFRS 3, IFRS 9 on how to account for changes in estimates related to the liability (see the table following paragraph 3.24 above).

3.45 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.

3.46 Applying this approach to the chocolate spread recipe example in paragraph 3.9:

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.

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

3.47 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.

3.48 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.

3.49 The Basis for Conclusions of IFRIC 1 (paragraph BC10), notes that the IFRS IC 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.

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

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 all subsequent changes in an estimate related to variable consideration.

3.51 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.

3.52 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.

3.53 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.

3.54 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.

3.55 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.

3.56 Applying the chocolate spread recipe example[26]:

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.

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

3.57 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.

3.58 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.

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

3.60 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).

3.61 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.

3.62 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.

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

[26] 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.

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

3.64 To the extent variable payments are associated with future economic benefits, they could be regarded as payments for an improvement/additional asset. This additional asset would then be recognised at cost (the variable consideration) and presented together with the originally acquired asset.

3.65 During the past IFRS IC 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.

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

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

3.67 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. The quality of the acquired asset could be interpreted as the capability of doing what the asset is supposed to do.

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

3.69 This possible requirement would be based on the view that variable consideration can be introduced because there is uncertainty about the quality of the asset transferred. Accordingly, if an asset of a poor quality is transferred, the 'right' consideration and 'cost' of an asset should be low and vice versa if the quality is high. Accordingly, when the variable consideration depends on the initial quality of the asset, the variable consideration represents the 'right' cost of the asset. Changes in the estimate of variable consideration should therefore be reflected in the cost of the acquired asset.

3.70 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 number of units per minute.

Advantages and disadvantages of the approaches

3.71 Advantages and disadvantages of the above six Approaches are listed in the table below.

	Approach 1 Not updating original cost estimate	Approach 2 Updating estimates included in the measurement of the asset's cost at initial recognition	Approach 3 Updating the cost of the asset to reflect all subsequent changes in an estimate	Approach 4 Updating estimates until the asset is ready for its intended use	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	Approach 6 Update of cost of the asset to the extent the variability is linked to the initial quality of the asset
Relevance	If variable consideration depends on factors relating to a particular period, recognising an income or expense in that period (i.e., following Approach 1 of not updating original cost estimate of the acquired asset) would provide more relevant information for predicting future cash flows and assessing stewardship than updating the cost of the acquired asset (in which case the increase or reduced expense would impact the profit or loss in the future).	Following the argumentation provided for Approach 1, Approach 2 provides less relevant information compared to Approach 1 if variable consideration is included in the asset's cost at initial recognition and depends on factors related to a particular period. Approach 2 also provides less relevant information if variable consideration is included in the asset's cost at initial recognition but is positively related to future cash flows	Approach 3 provides less relevant information compared to Approach 1 if variable consideration depends on factors not positively related to future cash flows. In other cases, Approach 3 provides more relevant information than Approach 1.	Approach 4 provides less relevant information than Approach 1 when the change in estimate takes place after the asset is ready for its intended use and is positively related to future cash flows, or if the change in estimate takes place before the asset is ready for its intended use and is not positively related to future cash flows.	Following the argumentation provided for Approach 1, Approach 5 would generally result in relevant information for estimating future cash flows and assessing stewardship.	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.

	Approach 1 Not updating original cost estimate	Approach 2 Updating estimates included in the measurement of the asset's cost at initial recognition	Approach 3 Updating the cost of the asset to reflect all subsequent changes in an estimate	Approach 4 Updating estimates until the asset is ready for its intended use	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	Approach 6 Update of cost of the asset to the extent the variability is linked to the initial quality of the asset
	To the extent that the variability is related to 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). In these cases, Approach 1 accordingly does not provide the most relevant information.	derived from the acquired asset. Approach 2 provides more relevant information than Approach 1 if variable consideration is included in the asset's cost at initial recognition and is positively related to future cash flows derived from the acquired asset, or if variable consideration is not included in the asset's cost at initial recognition and the variable consideration is not positively related to future cash flows to be derived from the asset.		In other cases, Approach 4 provides more relevant information than Approach 1.		

Approach 1 Not updating original cost estimate	Approach 2 Updating estimates included in the measurement of the asset's cost at initial recognition	Approach 3 Updating the cost of the asset to reflect all subsequent changes in an estimate	Approach 4 Updating estimates until the asset is ready for its intended use	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	Approach 6 Update of cost of the asset to the extent the variability is linked to the initial quality of the asset
To the extent a liability for the variable consideration is recognised and varies positively with expected future cash flows to be derived from the acquired asset, counterintuitive information may arise due to recognising an income (decrease in liability) when there is a decline in expected future cash outflows and an expense when there is an increase in expected future cash outflows (see the table in paragraph 2.56).	To the extent that a liability for variable consideration is recognised when the acquired asset is recognised, there may not be counterintuitive information for changes in estimates that have been included in the asset's cost at initial recognition. This is because there would be a reduction in the asset when there is a decline in expected future cash outflows and an increase of the asset when there is an increase in expected future cash outflows.	Counterintuitive information of the type described for Approach 1 would not arise. Also, not in cases where a liability for variable consideration is recognised later than the acquired asset.	Counterintuitive information of the type described for Approach 1 would not arise until the asset is ready for its intended. Thereafter it could arise.	Counterintuitive information of the type described for Approach 1 would not arise.	Counterintuitive information if variability is not linked to the initial quality of the asset because an income would be recognised there is a decline in expected future cash outflows and an expense when there is an increase in expected future cash outflows.

	Approach 1 Not updating original cost estimate	Approach 2 Updating estimates included in the measurement of the asset's cost at initial recognition	Approach 3 Updating the cost of the asset to reflect all subsequent changes in an estimate	Approach 4 Updating estimates until the asset is ready for its intended use	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	Approach 6 Update of cost of the asset to the extent the variability is linked to the initial quality of the asset
		To the extent the liability for variable consideration is recognised after the recognition of the acquired asset, the approach could result in counterintuitive information for the reasons described for Approach 1.				
	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.	No significant volatility in profit or loss compared to Approach 1 to the extent the liability for variable consideration is recognised at the time the acquired asset is recognised. If the liability for variable consideration is recognised later than the acquired asset, the approach could create significant volatility in profit or loss.	Would have the least volatility in profit or loss compared to the other approaches. But could also result in gains and losses not being recognised that are related to the period.	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 after the asset is ready for its intended use	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	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.

Faithful representation	Could be said to be in accordance with the definition of 'cost'. As all changes in variable consideration would be reflected in profit or loss, no subjective judgement would be needed to determine whether a change in estimate should be included or not.	Could be said to be in accordance with the definition of 'cost'. Whether or not an estimate of variable consideration is originally included in the cost of an asset could often be determined relatively objectively (particularly if no liability for the variable consideration is recognised). However, it could be envisaged that in some cases, it could involve some subjectivity if there would be doubts about the scope of variable consideration included in the initial measurement.	Could be said to be in accordance with the definition of 'cost'. As all changes in variable consideration would be reflected in the cost of the asset, no subjective judgement would be needed to determine whether a change in estimate should be included or not.	Could be said to be in accordance with the additional requirements on measurement at 'cost'. Subjectivity for the Approach would mainly relate to when the purchaser would consider that the asset would be ready for its intended use.	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?	The assessment of whether variable consideration is related to the initial quality of an asset would often be subjective. This Approach would often be subjective especially relating to whether changes in the variable consideration are linked to the initial quality of the asset or not.
Comparability	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)[1].	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	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	Approach 4 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.	Approach 5 would result in variable consideration being accounted for in a similar manner to improvements/acquisition of additional assets.	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

	Approach 1 Not updating original cost estimate	Approach 2 Updating estimates included in the measurement of the asset's cost at initial recognition	Approach 3 Updating the cost of the asset to reflect all subsequent changes in an estimate	Approach 4 Updating estimates until the asset is ready for its intended use	Approach 5 Update the original cost estimate to the extent those payments are associated with future economic benefits to be derived from the asset	Approach 6 Update of cost of the asset to the extent the variability is linked to the initial quality of the asset
	However, it would result in variable consideration, e.g., related to rebates or obligations to dismantle and remove an item or restore a site not being accounted for in a comparable manner to many other types of variable consideration (unless these requirements would be changed).	how IFRS 16 accounts for changes in estimates of variable consideration. However, 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.	which any new guidance would be introduced. However, 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.		However, 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 for rebates and obligations to dismantle and remove an intem or restoring a site in IAS 16 and IAS 38 and the requirements included IAS 19, IFRS 2, IFRS 3 and IFRS 16.	restoring a site is accounted for. However, 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

[1] 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.

Costs	Recognising changes in estimates in profit or loss may be less costly than updating cost of an asset. This is because an entity would not need to continuously link obligations with the asset. However, at this stage it is not assessed whether those costs would be material or not.	Approach 2 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 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.	The approach would be costly before the asset is ready for its intended use and thereafter, would be less costly for reasons explained in both Approaches 1 and 3.	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 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.

CHAPTER 4: HOLISTIC ASSESSMENT OF VARIABLE CONSIDERATION REQUIREMENTS

Chapters 2 and 3 have 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.

This Chapter (and Appendix 2) complements the earlier two chapters that are the primary focus of this Discussion Paper and whose scope is on variable consideration paid in cash or another financial instrument and where variable payments depend on the purchaser's future actions.

This Chapter (and Appendix 2) assess the consistency (or lack thereof) of IFRS recognition and measurement requirements for variable consideration in a holistic manner to inform the thinking on whether there is a need to develop a unified set of principles for variable consideration requirements that can be applied across different IFRS Standards.

To assess the implications for standard setting, this Chapter discusses the advantages and disadvantages of either developing a unified set of principles for the recognition and measurement requirements of variable consideration across IFRS Standards or addressing requirements on a Standard-by-Standard basis (e.g., amending IAS 16 and IAS 38) as supported by some respondents to the IASB Third Agenda Consultation. Stakeholders' views on the best way forward for possible standard setting will be sought after they take account of the presented advantages and disadvantages including cost-benefit and impacts on usefulness of information.

Finally, this chapter also presents issues of note that may arise for transactions that were not the primary focus of Chapters 2 and 3 which would also have to be considered were standard setting to occur. Specifically, the incremental complexity for the accounting for liabilities for variable consideration to be paid by the transfer of non-financial assets or by performing services in the future.

The analysis shows that:

- *There are mostly no reasons provided for the differences in recognition and measurement requirements for liabilities for variable consideration and acquired assets in different IFRSs except in a few cases where conceptual reasons, cost-benefit considerations, or the objective of achieving consistency across some Standards is cited. There are factors unique to particular transactions (for example IFRS 3 initial measurement by the acquirer can be updated for variable consideration within 12 months if there is new information). Hence, some of the differences could be because these Standards were developed at different points in time, under different prevailing circumstances.*

- *there is incremental complexity in accounting for non-cash (another financial instrument) variable consideration, when compared to accounting for cash (another financial instrument) consideration. There is the difficulty in distinguishing the functional currency equivalent of the variable consideration component for barter transactions involving the exchange of non-financial assets or services in a manner that is consistent with the definition of variable consideration applied in this Discussion Paper. There are also challenges in the valuation/ measurement of non-financial liabilities.*

- *the approaches to determining when to recognise a liability proposed in Chapter 2, could conceptually be extended whilst considering the requirements for transactions to be paid through the transfer of a non-financial asset or by performing a service.*

Introduction

4.1 This chapter complements the solutions provided in Chapters 2 and 3 by doing an analysis of general requirements for accounting for variable consideration that can be applicable to the variable transactions in these chapters and those that are not. This Chapter (and Appendix 2) specifically assesses:

a) the consistency (or lack thereof) of recognition and measurement requirements for the liability for variable consideration across different IFRS Standards;

b) 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;

c) implications for possible standard setting; and

d) issues of note that may arise for transactions outside the scope of Chapters 2 and 3.

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

4.2 As noted above, this Chapter (and Appendix 2) review the recognition and measurement requirements for liabilities for variable consideration in a holistic sense. The review goes beyond assessing the requirements for liabilities for variable consideration to be paid in cash (or another financial instrument) and where the variable consideration depends on the purchaser's future actions that are within the scope of Chapter 2. The purpose of this review is not to broaden the scope of the Discussion Paper's primary areas of focus but to assess the consistency (or lack thereof) of applicable IFRS requirements for liabilities for variable consideration in a manner that informs the thinking on possible standard setting approaches.

4.3 As highlighted in Chapter 2, the applicable IFRS requirements for liabilities for variable consideration (i.e., for when variable payments depend on the purchaser's future actions and when they do not) are:

a) IAS 19 when respectively applied for short-term and long-term employee benefits, and for defined benefit plans;

b) IAS 32 and IFRS 9 for financial liabilities (i.e., liabilities for variable consideration to be paid in cash (or another financial instrument), which is the focus of chapter 2 with a pointed focus on when the purchaser entity has the practical ability to avoid actions that trigger variable payments;

c) IFRS 2 when an entity acquires goods or services in exchange for future cash-settled share-based payment;

d) IFRS 3 when an acquirer entity has an obligation to transfer additional assets or equity interests if specified future events occur or conditions are met;

e) IFRS 16 for variable lease payments that are deemed to be in-substance, variable lease payments that depend on an index or rate, and residual value guarantees;

f) IAS 37 for variable consideration that is to be paid by the transfer of a non-financial asset or by performing services that do not fall within the scope of IAS 19, IFRS 2, IFRS 3 and IFRS 16.

4.4 Appendix 2 has details of the recognition and measurement requirements of the above Standards except for IAS 32/IFRS 9, whose details are included in Chapters 2 and 3.

4.5 Also included in Appendix 2 are the recognition and measurement requirements of standards that can be applied analogous (i.e., IFRS 15 *Revenue from Contracts with Customers* that can be applied through a mirroring approach and the principles applied in the IASB Exposure Draft *Regulatory Assets and Regulatory Liabilities*).

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

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

4.7 *Differing recognition timing 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.

4.8 *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.

4.9 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 15 differs from that of regulatory liabilities.

4.10 *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

4.11 The reasons for the recognition requirements of particular IFRS Standards are listed in Table 4.1 below to the extent that such reasons are 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:

Current guidance	Reasons in the Basis for Conclusions
	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[1]).
IAS 19 (short-term benefits)	For simplification purposes. The IASB thus considered that short-term benefits could be accounted for under a simplified measurement approach without resulting in measuring those benefits at an amount different from the general measurement requirements of IAS 19 (paragraph BC 17).
IFRS 16	Exclusion of variable lease payments linked to future performance for the following reasons: - For some IASB members, this decision was made solely for cost-benefit reasons. - Other IASB members did not think that variable lease payments linked to future performance or use meet the definition of a liability for the lessee until the performance or use occurs. (paragraph BC 169)

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

4.12 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.

[1] 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)."

4.13 As can be seen in the Appendix 3-*summary of past IFRS IC discussions*, the IFRS IC has mainly addressed issues related to the measurement of acquired PPE, intangible assets, and service concession arrangements where the operator has to make variable payments to the grantor. It is for these assets 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.

4.14 Appendix 2 details the IFRS recognition and measurement requirements (or mostly lack thereof) for inclusion of variable consideration in the measurement of these different types of assets when they are acquired in exchange for variable consideration. The analysis focuses on IFRS Standards for assets where the initial measurement is at cost (IAS 2, IAS 16, IAS 38, IAS 40, IAS 27, IAS 41, IFRS 6, and IFRS 16) because, as explained in Chapters 1 and 3, the inclusion of variable consideration in the measurement of the acquired asset issue only features for assets that are initially and subsequently measured at cost. This issue is not at play if an entity acquires a financial asset in exchange for variable consideration. IFRS 9 requires the initial measurement of acquired assets at fair value and their subsequent measurement at either amortised cost or fair value.

4.15 The analysis in Appendix 2 shows that only IFRS 16 has explicit requirements for the update of initial measurement of the right-of-use asset after the remeasurement of liabilities for variable lease payments.

4.16 Similar to analogous application of the IFRS 15 and the principles for recognising regulatory liabilities in the IASB Exposure Draft Regulatory Assets and Regulatory Liabilities, the principles for recognising regulatory liabilities could be analogously applied as a basis of updating the initial measurement of acquired assets.

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

4.17 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	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) the IFRS IC 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).

Current requirements	Reasons in the Basis for Conclusions
(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)	
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.
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

4.21 As shown in Tables 4.1 and 4.2 above; there are usually no reasons provided in the Basis for Conclusions for the requirements for liabilities for variable consideration and acquired assets except for a few cases where the reasons are conceptual (inclusion of variable lease payment that depend on an index or rate in the lease liability measurement, 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, differences in requirements could arise because these Standards were developed at different points in time, under different prevailing circumstances and this can explain some of the differences.

4.22 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.

4.23 The IASB Third Agenda Consultation request for information (RFI) sought views on whether variable and contingent consideration could be included in its project agenda. Paragraph B 81 of the RFI highlighted the challenges discussed by IFRS IC 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). As noted in the summary of past IFRS IC discussions in Appendix 3- in addition to variable payments for asset purchases, there have also been questions related to how an operator accounts for variable payments to a grantor under IFRIC 12.

4.24 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.

4.25 However, constituents' feedback[2] 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. Nonetheless, the agenda consultation RFI highlighted the work that is ongoing by national standard setters (such as this EFRAG 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:

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2 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

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.

4.26 The analysis in this Chapter has 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.

4.27 In addition, as indicated by the IASB RFI and some respondents on approaches. Therefore, also below is an analysis of the advantages and disadvantages of a Standard-by-Standard amendment.

Advantages of a developing a unified set of principles that can align IFRS requirements

4.28 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.

4.29 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.

4.30 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.

4.31 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-financial asset variable considerations and this may result in need for interpretations due to lack of clear guidance.

4.32 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 developing a unified set of principles that can align IFRS requirements

4.33 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.

4.34 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.

4.35 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.

4.36 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.

Advantages of a Standard-by-Standard review

4.37 As discussed in the IASB Third Agenda consultation RFI, amendments to IAS 16, IAS 38 and IFRIC 12 were a possible approach for standard setting. Some respondents to the RFI suggested that variable consideration could be considered as part of a project on intangibles. Given that the IASB has decided to add a project on intangibles to its research agenda, there could be an opportunity to address variable consideration within the intangibles project. If this were the case, it could also provide guidance that could be analogously applied for challenges related to other asset purchases or service concession arrangements that have variable payments (i.e., IFRIC 12 and IAS 16).

4.38 Addressing one of the challenges in accounting for variable consideration (measurement of acquired asset issue) during the review of IAS 38 would at least yield solutions quicker for one of the two issues addressed in this Discussion Paper than waiting for a time that a unified set of principles can be developed.

4.39 A standard-by-standard review will allow the application of the Conceptual Framework principles to develop requirements for the update of liabilities remeasurements in the measurement of acquired assets after taking into account the specific characteristics of each asset class.

Disadvantages of a Standard-by-Standard review

4.40 It may take a lot longer to provide solutions that address both the liability recognition and inclusion of liabilities remeasurements in the measurement of acquired assets issues through a standard-by-standard review.

4.41 Such an approach could contribute to diverse requirements for similar transactions and fail to provide the comparable reporting that benefits users of financial statements.

Issues of note that may arise for transactions outside the scope of Chapters 2 and 3

4.42 Chapter 2 only considered the recognition and measurement requirements for liabilities that would be covered by IAS 32/IFRS 9 for variable consideration where the variability of consideration depends on the purchaser's future actions. While discussing the inclusion of liabilities remeasurement in the measurement of the acquired asset, Chapter 3 also focused on the liabilities addressed in Chapter 2.

4.43 As noted earlier, Chapters 2 and 3 are the primary focus of this DP as they touch on areas where interpretation has been sought. However, payments through the transfer of non-financial assets or by performing services can also occur for transactions that are outside the scope of Chapter 2. Hence, even though matters related to these transactions may not have been among the issues presented before the IFRS IC, this chapter points to issues of note that may arise for transactions not discussed in the earlier chapters as these issues would also need to be considered while developing suitable IFRS requirements. Ultimately, this Discussion Paper aims to inform the enhancement of IFRS even while providing targeted solutions as done in Chapters 2 and 3.

4.44 Furthermore, non-cash (financial instrument) variable consideration transactions may become widespread, and more interpretation matters may arise. For instance, if the use of digital/crypto assets as a means of exchange becomes pervasive for IFRS reporting entities. Some of the main digital assets that are used as a means of exchange are neither financial assets nor cash/cash equivalents (e.g., bitcoin is classified as an intangible asset under IFRS requirements).

4.45 Thus, there could be transactions where an asset is acquired in exchange for variable consideration to be paid in a non-financial asset/crypto-asset (i.e., the quantity of crypto-asset to be paid can vary depending on a predetermined factor). Illustratively, a 2021 Journal of Accountancy article[3] points to accounting challenges that may arise if creators of non-fungible tokens sell limited membership of their assets or where there is contingent consideration (i.e., the right to receive a recurring revenue stream if there are future resales of the non-fungible token by the purchaser to others) meaning the purchaser has variable payments to the seller.

4.46 One of the challenges is distinguishing what is variable consideration when payment is through transfer of a non- financial asset or by performing a service, which is less straightforward than it is for functional currency cash-settled transactions. For example, there is a challenge to determine the variable consideration component in functional currency-equivalent terms for barter transactions involving the exchanges of non-financial assets or services In this Discussion Paper, variable consideration refers to a change in the quantity (and not unit price) of the asset or service to be transferred in exchange for an acquired asset. Unlike consideration that is to be paid in the functional currency, the additional/reduced quantity of a unit of a non-financial asset or service that a purchaser is entitled to pay may reflect a price-adjusted quantity. Thus, it has to be assessed whether the variable consideration paid in a non-financial asset or by performing a service translates to variable consideration in functional currency equivalent terms. And that the components of variability due to unit price changes are not accounted for as variable consideration. This challenge would also arise for payments made in foreign currency as was noted in Chapter 1 or for financial instruments besides cash (equity, bonds) that are in the scope of discussion in Chapter 2.

[3] https://www.journalofaccountancy.com/news/2021/jul/nft-nonfungible-token-valuation-challenges.html

4.47 That being said, it is easier to determine the functional currency equivalent of variable consideration for foreign currency, equity and bonds compared to non-financial assets or services. This is because entities can readily determine the fair value of foreign currency, equity and bonds due to these asset classes having observable markets but this is not usually the case for non-financial assets and services. In sum, there would be similar complexities associated variable consideration that is contractually specified/ paid in foreign currency, equity, bonds versus when it is paid in non-financial assets and transfer of services. But additional complexity would arise for the latter due to difficulties in determining their fair value.

4.48 Notwithstanding the noted complexity of identifying the variable consideration component for barter transactions involving the exchange of non-financial assets or services, as is the case for liabilities for variable consideration to be paid in cash (or another financial instruments) under Chapter 2, purchaser entities that acquire assets in exchange for variable consideration to be paid through the transfer of a non-financial asset or by performing a service could face challenges in determining the timing for liability recognition if the variable payments depend on the purchaser's future actions and the purchaser has the practical ability to avoid such actions.

4.49 Hence, although this Discussion Paper focuses on variable consideration that is paid in cash (or another financial instrument), the analysis and approaches proposed in Chapter 2, could conceptually be extended whilst considering the requirements for transactions to be paid through the transfer of a non-financial asset or by performing a service.

Specific IFRS requirements for liabilities for non-cash (another financial instrument) consideration

4.50 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.

4.51 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).

4.52 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[4] (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.

4.53 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] 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

4.54 The 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[5] 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 (another financial instrument) consideration

4.55 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 or any other point time when the purchaser entity has a practical ability to avoid actions that would trigger variable payments) that is addressed in Chapter 2 does not depend on the type of consideration. Thus, the three approaches, criteria proposed in Chapter 2 could also be applicable for liabilities for non-cash variable consideration.

4.56 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.

4.57 However, as enumerated in the 2019 IVSC *IVS 220 Non-Financial Liabilities* Exposure Draft[6], 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[7] analysed in Chapter 2.

4.58 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[8] that distinguish non-financial liabilities from financial liabilities.

4.59 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).

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[5] 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.

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

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

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

APPENDIX 1 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

A1.1 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 (■).

These examples illustrate in what types of transactions the variable consideration covered by the requirements in the diagram could arise:

d) 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).

e) 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).

f) 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).

g) 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).

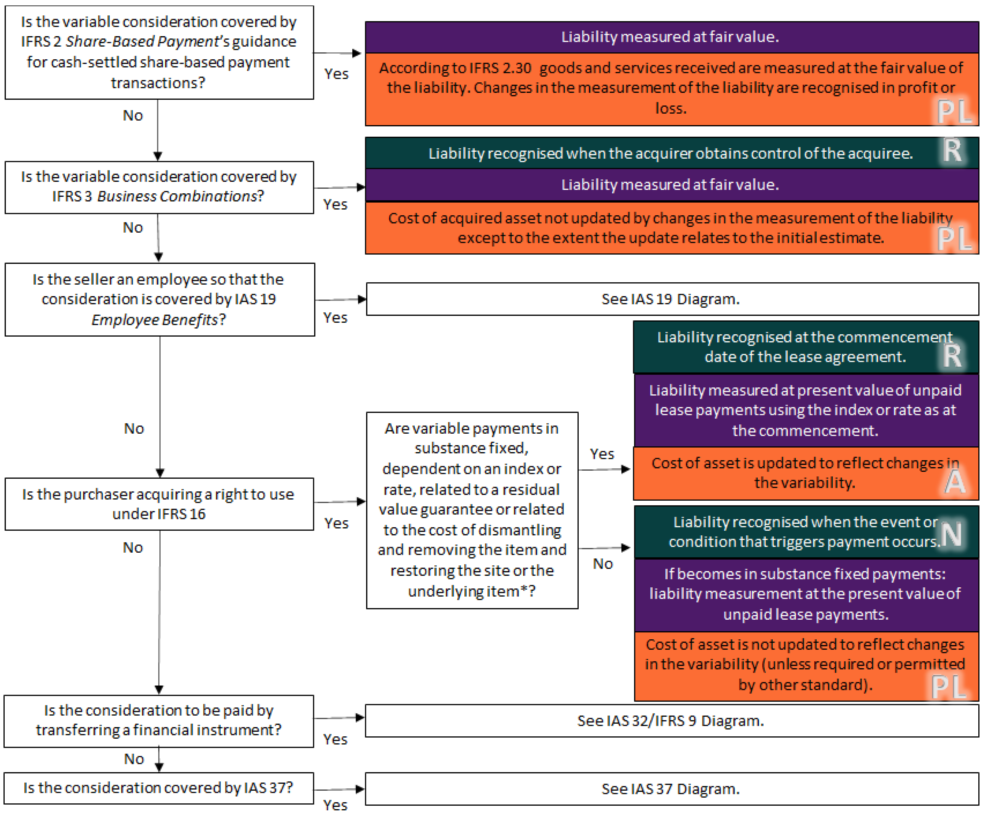
h) A good or service acquired in exchange for a variable consideration in cash or another financial instrument. For example, if an entity is acquiring a building in exchange for consideration that would depend on the estimated market value of that particular building in two years. Another example, would 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)[9].

i) 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).

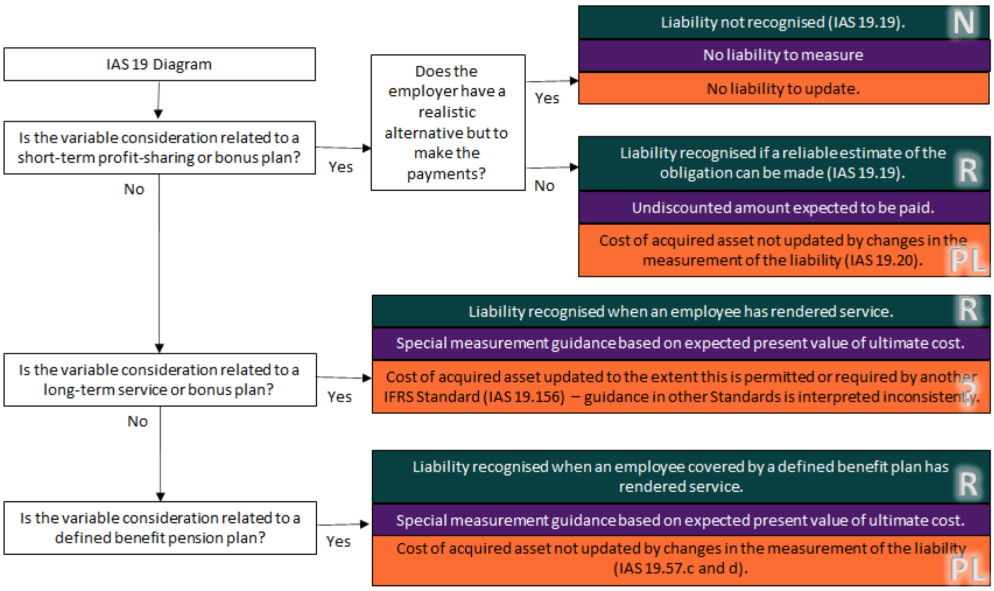
[9] In some cases a variable component in a contract would be an embedded derivative – and thus not variable consideration covered by this Discussion Paper.

Illustration of current guidance

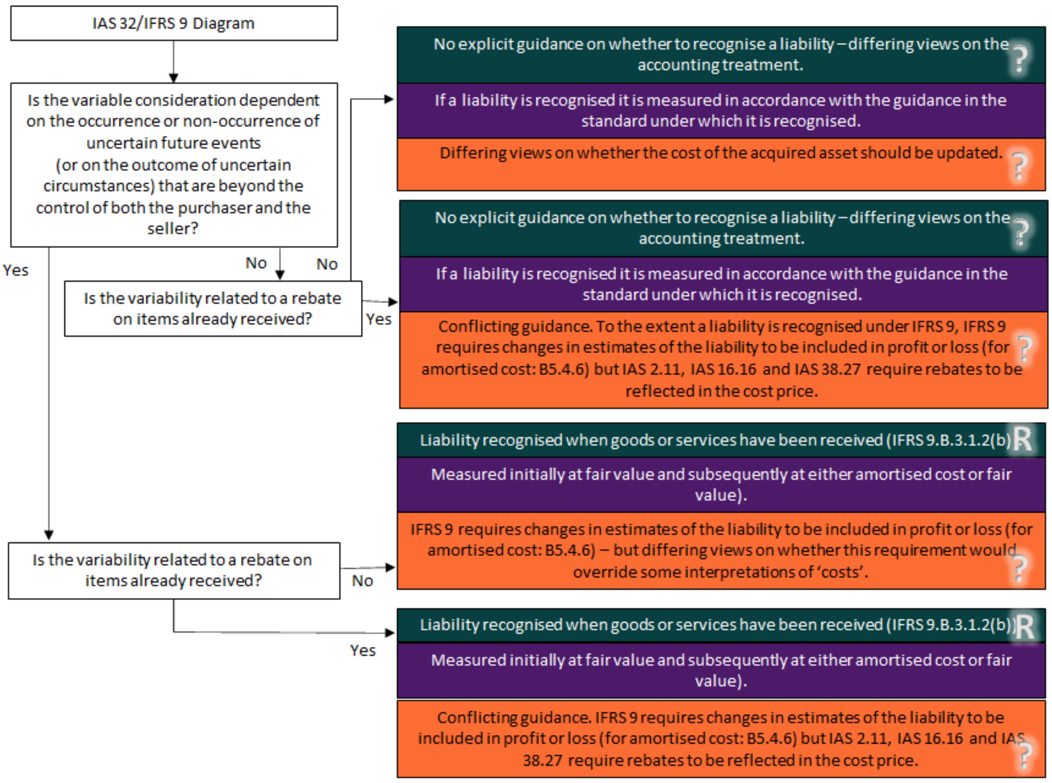
Main Diagram



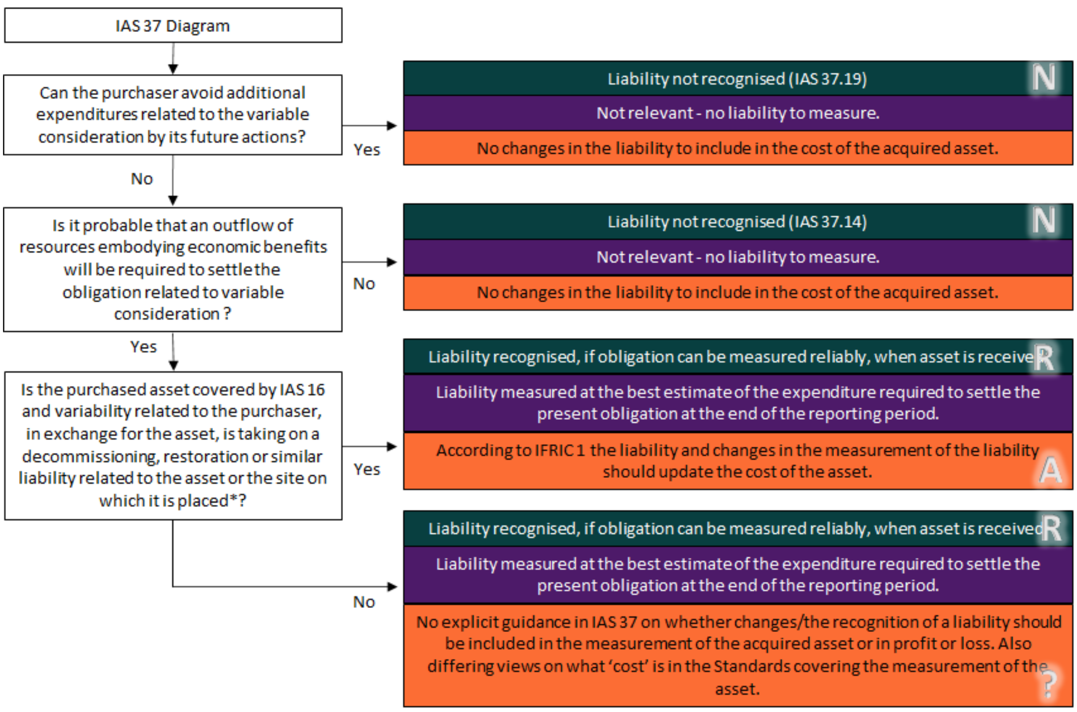
IAS 19 Diagram



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.

APPENDIX 2 IFRS RECOGNITION AND MEASUREMENT REQUIREMENTS CONSIDERED IN CHAPTER 4

Recognition and measurement requirements for variable consideration liabilities

IAS 19

A2.1 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

A2.2 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.

A2.3 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.

A2.4 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

A2.5 IAS 19.157 addresses long-term disability benefits. It notes that if the benefit depends on the length of service, <u>an obligation arises when the service is rendered</u>. 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.

A2.6 The <u>initial and subsequent measurement of liabilities for long-term employee benefits is the present value of a reliable estimate of the ultimate cost</u>.

Defined benefit plans

A2.7 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.

A2.8 The initial and subsequent measurement of defined benefit plan liabilities is the present value of a reliable estimate of the ultimate cost.

IAS 37

A2.9 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.

A2.10 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.

A2.11 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.

A2.12 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.

A2.13 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

A2.14 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.

A2.15 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

A2.16 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.

A2.17 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).

A2.18 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

A2.19 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.

A2.20 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.

A2.21 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.

A2.22 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.

A2.23 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

A2.24 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.

A2.25 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).

A2.26 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) <u>is the present value of expected future payments</u>.

A2.27 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 IFRS Standards

IFRS 15 mirroring approach

A2.28 It is possible that the IFRS 15 requirements for the treatment of variable consideration[10] whilst determining transaction price for the purposes of recognising revenue by seller entities can be applied analogously for the accounting for liabilities for variable consideration by purchaser entities (i.e., the IFRS 15 mirroring approach).

A2.29 IFRS 15 requires that:

a) When (or as) a performance obligation is satisfied, an entity shall recognise as revenue the amount of the transaction price (which excludes estimates of variable consideration that are constrained (see) that is allocated to that performance obligation.

b) The amount of variable consideration shall be estimated using either the expected value or the most likely amount approach, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled.

c) An entity shall include in the transaction price some or all of the amount of variable consideration 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 variable consideration is subsequently resolved.

d) An entity shall recognise revenue for a sales-based or usage-based royalty promised in exchange for a licence of intellectual property only when (or as) the later of the following events occurs:

(i) the subsequent sale or usage occurs; and

(ii) the performance obligation to which some or all of the sales-based or usage-based royalty.

A2.30 If a complete IFRS 15-mirroring approach was used to account for a commitment to pay variable consideration it would mean:

a) To the extent that a purchaser's acquisition of a licence of intellectual property in exchange for a sales-based or usage-based royalty would meet the definition of variable consideration in this Discussion Paper, a liability for the variable consideration should only be recognised when the subsequent sale or usage occurs.

[10] 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.

b) In other cases (i.e., for transactions other than those related to the acquisition of licences for intellectual property in exchange for sales-based or usage-based royalties), a liability for variable consideration would be recognised when the related asset is received by the purchaser including when the variability would depend on the purchaser's future actions. The liability might, however, initially be measured at nil as the measurement of the liability should be constrained to the amount it is highly likely will not be significantly reduced as a result of changes in the estimate of variable consideration. This is because under IFRS 15 the seller would only recognise an amount of variable consideration 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 variable consideration is subsequently resolved. Similarly, the purchaser should therefore constrain the measurement of the liability to pay variable consideration to the amount it is highly likely will not be significantly reduced.

c) Subject to the IFRS 15 constraint mentioned above in b), the liability of variable consideration should be measured at the expected value or most likely amount depending on which method the purchaser expects to better predict the amount of consideration it will have to pay.

d) The purchaser shall update the estimated variable consideration (including updating its assessment of whether an estimate of variable consideration is constrained according to b) above) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

A2.31 Although a complete IFRS 15 mirroring could be introduced, it might not be considered beneficial to constrain the measurement of the liability to the amount it is highly likely will not be significantly reduced as a result of changes in the estimate of variable consideration. The constraint was introduced because users of financial statements that were consulted when IFRS 15 was developed indicated that the most relevant measure for revenue in a reporting period would be one that will not result in a significant reversal in a subsequent period. This is because an amount that would not reverse in the future would help users of financial statements better predict future revenues of an entity. It seems very questionable whether users would have the same preferences when it comes to the measurement of a liability as a requirement to constraint the measurement of the liability could result in a general understatement of the liability. Also, when the IFRS IC has examined[11] and concluded that a full mirroring approach would not be appropriate for the recognition of liabilities for variable consideration.

A2.32 However, it could be considered develop requirements for how a purchaser should account for variable consideration by 'mirroring' the other variable consideration requirements included in IFRS 15.

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

A2.33 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

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

customers) might be analogously applicable for the recognition and measurement of liabilities for variable consideration and for the cost of the acquired asset.

A2.34 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.

A2.35 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.

c) 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 expenses.

Requirements for variable consideration in the measurement of acquired assets

IAS 16

A2.36 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.

A2.37 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

A2.38 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.

A2.39 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

A2.40 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

A2.41 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.

A2.42 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

A2.43 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.

A2.44 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.

A2.45 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.

A2.46 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

A2.47 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.

APPENDIX 3: SUMMARY OF PAST IFRS INTERPRETATIONS COMMITTEE ISSUES

Issues relating to liability recognition

Variable payments for asset purchases (IAS 16 and IAS 38)[12]

A3.1 The IFRS Interpretations Committee ('the IFRS IC') received a request to address the accounting for variable payments to be made for the purchase of an item of property, plant and equipment or an intangible asset that is not part of a business combination ('asset purchases'). The IFRS IC observed significant diversity in practice in accounting for these variable payments.

A3.2 The IFRS IC discussed this issue at several meetings between 2011 and 2013 and decided to put the project on hold because the accounting for variable payments was being considered by the IASB as part of its projects on leases and a revised Conceptual Framework. The IFRS IC revisited the issue at its meetings in September and November 2015 subsequent to the completion of the redeliberation in the Leases Exposure Draft (published May 2013).

A3.3 The IFRS IC observed that the obligation to make a variable payment for the separate acquisition of an asset arises from a contract. As a result, such a variable payment should be accounted for in accordance with the requirements in IAS 32/IAS 39/IFRS 9.

A3.4 The IFRS IC noted that the core issue regarding the initial accounting for variable payments is to decide whether the purchaser has an obligation on the date of purchase of the asset to pay the variable payment. The IFRS IC observed that there were two diverging interpretations of the current requirements in IAS 32/IAS 39/IFRS 9 regarding the timing of accounting for variable payments for the separate acquisition of tangible/intangible assets:

a) Alternative 1: all variable payments meet the initial recognition criteria of a financial liability on the date of purchase of the asset; and

b) Alternative 2: variable payments that are dependent on the purchaser's future activity do not meet the initial recognition criteria of a financial liability until the activity requiring the payment is performed[13].

A3.5 The IFRS IC tentatively agreed that the purchaser must recognise a financial liability at the date it purchases the asset for variable payments that do not depend on its future activity.

A3.6 Furthermore, as per the March 2016 IFRS IC Agenda Decision:

a) The IFRS IC considered the proposed definition of a liability in the May 2015 Exposure Draft *The Conceptual Framework for Financial Reporting* as well as the deliberations of the IASB Board on its project on leases, in deliberating the accounting for variable payments that depend on the purchaser's future activity.

[12] Source: IASB March 2016 Agenda Decision and March 2016 IFRS IC Staff paper

[13] Source: November 2015 IFRS IC Staff paper

b) The IFRS IC was unable to reach a consensus on whether an entity (the purchaser) recognises a liability at the date of purchasing the asset for variable payments that depend on its future activity or, instead, recognises such a liability only when the related activity occurs.

c) In addition, the IFRS IC noted that there are questions about the accounting for variable payments subsequent to the purchase of the asset. Accordingly, the IFRS IC concluded that the IASB Board should address the accounting for variable payments comprehensively.

d) The IFRS IC determined that the issue is too broad for it to address within the confines of existing IFRS Standards. Consequently, the IFRS IC decided not to add this issue to its agenda.

Variable payments for asset purchases and payments made by an operator to a grantor in a service concession arrangement[14]

A3.7 The IFRS IC received a request to clarify how an operator accounts for contractual payments that it makes to a grantor in a service concession arrangement (SCA) within the scope of IFRIC 12 *Service Concession Arrangements*.

A3.8 In 2015, the IFRS IC Staff[15] considered:

a) the principles in the Leases project to be applied to the initial accounting for variable payments for asset purchases; and

b) the principles in accounting for contingent consideration in business combinations.

A3.9 The IFRS IC considered whether a solution could be developed to address the accounting for payments made by an operator to a grantor without the need to address the broader issue of variable payments for asset purchases. However, members of the IFRS IC expressed mixed views on this approach.

a) Some members were of the view that the issue could not be addressed without addressing the broader issue of accounting for variable payments for asset purchases.

b) Other members were of the view that service concession arrangements represent a unique type of arrangement that shares some characteristics with lease contracts. These members were of the view that the IFRS IC could consider developing guidance by utilising principles similar to those developed by the IASB for the accounting for variable payments in lease contracts. However, on balance the IFRS IC concluded that the issue was too broad for it to address[16].

A3.10 In 2016, the IFRS IC noted that in situations in which the intangible asset model is applicable, and the payments to be made by the grantor are variable, the issue of concession fees is linked to the broader issue of variable payments made for asset purchases. This is because the IFRS IC thinks that the operator has, in substance, made a payment to acquire an intangible asset (i.e., the right to charge users of the public service).

[14] Source : July 2016 IFRS IC Staff paper and July 2016 IASB Agenda Decision

[15] Source : November 2015 IFRS IC Staff paper 02A

[16] Source : November 2015 IFRS Update

A3.11 As per the July 2016 Agenda Decision, the IFRS IC observed that, when the intangible asset model in IFRIC 12 applies, the accounting for variable payments to be made by the operator in a service concession arrangement is linked to the broader issue of accounting for variable payments for asset purchases. However, the IFRS IC noted that it had determined in March 2016 that the issue of accounting for variable payments for asset purchases is too broad for the IFRS IC to address within the confines of existing IFRS Standards and, consequently, decided not to add the issue to its agenda. Therefore, the IFRS IC concluded that addressing how an operator accounts for variable payments that it makes to a grantor when the intangible asset model in IFRIC 12 applies is too broad for the IFRS IC to address within the confines of existing IFRS Standards. the IFRS IC decided not to add this issue to its agenda.

Issues relating to the measurement of the acquired asset

Subsequent recognition and measurement of variable payments for asset purchases

A3.12 The IFRS IC also looked at subsequent accounting for a financial liability to make variable payments.

A3.13 As per the IFRS IC Staff paper, the initial accounting for variable payments affects the subsequent accounting for those variable payments:

a) If the variable payments are recognised on the date of purchase of the asset, then the issue regarding the subsequent accounting is to decide how to account for adjustments of the financial liability that result from the revision of the estimates of payments.

b) If the variable payments are recognised only when the activity requiring the payment is performed, then the issue is to decide how to account for the recognition of variable payments that were previously excluded from the initial measurement of the financial liability.

A3.14 The IFRS IC Staff also considered the following in parallel with the issue regarding initial recognition described in paragraph A3.7:

a) applying the leasing principles to the subsequent recognition and measurement of variable payments for asset purchases; and

b) applying the business combination principles to the subsequent recognition and measurement of variable payments for asset purchases.

A3.15 However, as per the November 2015 IFRS Update, the IFRS IC concluded that the issue was also too broad for it to address. Refer to paragraph A3.9 and A3.11 which also applies for this issue.

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