

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG Board or EFRAG TEG. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## **Variable payments reflecting step acquisitions Issues Paper**

### **Objective**

- 1 The objective of this paper is to ask EFRAG TEG whether EFRAG's Discussion Paper on variable consideration (Discussion Paper) should include a discussion on when an arrangement for variable payments can reflect that a good or service has not been entirely acquired.
- 2 The EFRAG Secretariat suggests that EFRAG TEG could decide on either of the following:
  - (a) Not to mention the issue in the Discussion Paper; or
  - (b) Mentioning the issue as part of the items outside the scope of the Discussion Paper ; or
  - (c) Including an analysis of the issue, including under which circumstances the payment terms and other factors would indicate that step acquisitions of an asset have occurred.

### **Background**

- 3 When discussing examples of variable consideration, the point was made by an EFRAG TEG member, that sometimes variable consideration could reflect that a good or service has not been completely acquired.
- 4 For example, if a physical asset is transferred to a purchaser in exchange for a fixed consideration plus a given percentage of the income the asset is generating over the next five years, it could be considered that the purchaser initially only acquires part of the of the physical asset and then after five years acquires the remaining part.
- 5 In the above example, it could be argued that there is no variable consideration. The initial fixed consideration can, for example, be the full payment for a part of the physical asset<sup>1</sup> (that is, the asset purchased is the right to receive a given percentage of the income the physical asset generates).. Over the next five years, the remaining rights to the income of the physical asset are paid in advance by transferring a given percentage of the income the asset is generating to the seller (the owner of the remaining rights) . After the five years, the remaining rights to the income generated by the asset are then transferred to the purchaser who subsequently will be entitled to 100% of the income generated by the asset.

### **Possible approaches**

- 6 The three possible approaches mentioned above in paragraph 2 that have been identified by the EFRAG Secretariat on whether/how to consider the issue of step acquisitions in the Discussion Paper are explained in the following paragraphs.

#### *Not mentioning the issue in the Discussion Paper*

- 7 It has previously been decided to exclude discussions on what is transferred in an arrangement (and hence whether the consideration is variable or not) in the Discussion Paper. It was thus decided that only accounting issues arising after it would be determined that an agreement would be a transfer of a good or service in exchange for variable consideration (and not something else). The current scope accordingly excludes a discussion on whether payment terms and other circumstances reflect that only part of the income potential of a physical asset has been acquired. If circumstances are such that only a part of a physical asset has been acquired, the analysis starts by considering whether the payment for the part of the physical asset contains a variable component or not. If there is a variable component, the Discussion Paper considers how to account for the liability related to the variable component and how variable consideration should be reflected in the measurement of the acquired asset (for example, the right to receive a certain percentage of the income generated by a physical asset).

#### *Mentioning the issue as an example of an issue the Discussion Paper does not consider further*

- 8 An alternative to not mentioning the issue, would be to mention it as a topic that would be outside the scope of the Discussion Paper. When mentioning that the Discussion Paper excludes an assessment on what is transferred in an arrangement, it could be mentioned that sometimes what could be seen as variable consideration reflects that an asset is acquired in steps but that it is outside scope to further consider when this would be the case.

#### *Include an analysis of the issue, including under which circumstances the payment terms and other factors would indicate that an asset is purchased in steps*

- 9 Finally, a debate on when rights related to an asset are acquired in steps could be included in the Discussion Paper along with some suggestions for criteria for/indications of the existence of such a step acquisition. At a previous EFRAG TEG meeting, it has already been mentioned that a step acquisition could probably not be said to take place when the payment of, for example, a percentage of the income generated by an asset would be infinite. In addition, the EFRAG Secretariat assesses that it would also be necessary to consider:
- (a) the purchaser's abilities to sell an asset
  - (b) the purchaser's ability to change how the asset is used; and
  - (c) how the payments will be determined. For example, it could be considered that the step-acquisition approach would only be applicable when payments to the seller of an asset would be closely linked to the (net) cash flows generated by the particular asset that is transferred by means of a step acquisition.

### **Examples in the Discussion Paper**

- 10 Regardless of which of the three above-mentioned approaches EFRAG TEG would recommend, the EFRAG Secretariat and EFRAG TEG would have to ensure that the examples of *variable consideration* to be included in the Discussion Paper would not include cases that could be characterised as either step-acquisitions or where it could be considered that the seller retains an interest in the transferred asset. Accordingly, the EFRAG Secretariat will avoid including examples in the Discussion

Paper where the consideration would depend on the (net) income generated by an asset.

**Questions for EFRAG TEG**

- 11 Does EFRAG TEG suggest other approaches to discuss step acquisitions than those mentioned in paragraph 2 above?
- 12 Which of the approaches mentioned in paragraph 2 above (and any additional approaches following from the responses to the question above) would EFRAG TEG recommend?
- 13 To avoid providing an example of variable consideration that could be considered to be an example of either a step acquisition for fixed amounts or of the seller retaining an interest in or some of the rights related to a specified asset, are there other characteristics that should be avoided in the examples to be included in the Discussion Paper?