ICAEW
REPRESENTATION 112/23

ACCOUNTING FOR VARIABLE CONSIDERATION FROM A PURCHASER'S PERSPECTIVE

Issued 29 November2023

ICAEW welcomes the opportunity to comment on the Discussion Paper: Accounting for Variable Consideration from a Purchaser's Perspective, published by EFRAG on 27 September 2022, a copy of which is available from this link.

For questions on this response please contact crf@icaew.com quoting REP 112/23.

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ICAEW
Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK
icaew.com

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Registered office: Chartered Accountants' Hall Moorgate Place London EC2R 6EA UK

KEY POINTS

A WORTHWHILE EXERCISE

1. We welcome EFRAG's efforts to tackle this challenging and sometimes controversial area of accounting. The discussion paper presents a good summary of the areas of difficulty, supported by some detailed analysis.
2. Our response below represents our high-level views rather than a detailed response to the questions posed in the discussion paper.

NO SINGLE CONCEPTUAL ANSWER

3. We acknowledge that an ideal solution would be one that results in a single conceptual answer for all variable payment scenarios. However, we do not believe this is a feasible solution. An answer that is appropriate for one type of transaction or asset will not necessarily be an appropriate solution for another. Instead, we think that there should be greater focus on finding pragmatic solutions that result in accounting which faithfully represents the underlying transactions.
4. We note that there are a number of relevant considerations when determining the best approach to accounting for variable consideration, such as consistency between similar transactions and across different standards, cost-benefit factors, and usefulness to primary users. Inevitably, compromises are needed in order to find the best answer and it is unlikely that there will be one accounting solution that can fully satisfy all stakeholders.
5. We think it is important to highlight that the inconsistent accounting treatment for variable consideration is one part of a broader group of inconsistencies within IFRS accounting standards, including the lack of consistent approach to the recognition of liabilities, and the lack of consistent definition of cost.
6. We understand that the scale of actions needed to address these broader inconsistencies would be substantial. Therefore, given that standard-setting resources are not infinite and recognising the relative priority of this issue against a backdrop of more pressing and emerging issues, we would support practical and incremental solutions for particular problem areas in the short term, with an underlying long-term aim of finding a more overarching, principles-based solution for all. In our experience, the most common issues related to the accounting for variable consideration are seen in the area of intangibles – an area of accounting that is already in the IASB research project pipeline - so this would be a good place to start.

JUDGEMENTS AND GUIDANCE

7. In considering the discussion points and various alternatives presented throughout the discussion paper, we think they often fall into one of two approaches:
    - accounting solutions that are more rules-based which remove or reduce the need for judgement (eg, only recognising a liability when the purchaser performs actions to trigger the variable consideration); or
    - accounting solutions that are more principles-based but heavily rely on the need for judgement (eg, updating the cost of an asset only when the variable consideration is associated with future economic benefits to be derived from the asset).

    There are good arguments for both approaches and ultimately the IASB must assess their respective merits when determining the best way forward.
8. If a decision is taken to make accounting requirements for variable consideration more principles-based, we believe such requirements would need to be supported by guidance on

how to make consistent judgements. By this we mean consistency between different reporting entities as well as consistent judgements year-on-year.

WHEN TO RECOGNISE A LIABILITY

9. The discussion paper considers when to recognise a liability for variable consideration and two alternatives are presented. The first explores the option of recognising a liability when the purchaser obtains control of the asset acquired unless the purchaser would have a practical ability to avoid taking action that would trigger the variable consideration. While we can see this working well for certain scenarios, there are existing areas of accounting standards that do not currently place any weight on whether or not the cash flows can be avoided (for example IFRS 2 *Share based Payment*). A practical ability to avoid triggering the variable consideration does not necessarily make it a likely outcome and so we are not convinced that placing emphasis on ‘a practical ability to avoid’ is necessarily an ideal base concept.
10. The second alternative is to recognise a liability when the purchaser performs the actions that trigger the variable consideration. We can see that this is a simpler approach that would remove the need to make any significant judgements and estimates about future actions or interpretations of a ‘practical ability to avoid’. In our view, for this alternative to be viable, disclosure of matters such as the different variables that affect the likelihood and timing of the liability, the range of different potential outcomes and how sensitive the obligation is to these variables, would be critical in the interests of transparency.
11. We note that the discussion paper only considers recognition and measurement requirements and does not consider the disclosure requirements explicitly. However, with the level of uncertainty involved when accounting for something such as variable consideration, we think that the recognition and measurement requirements need to be considered hand in hand with disclosure requirements and that the two cannot be separated.

WHEN TO UPDATE THE COST OF AN ASSET

12. The discussion paper also explores three possible alternatives for scenarios in which the cost of an asset should be updated where an asset is acquired in exchange for variable consideration:
    - Alternative 1: never update the cost.
    - Alternative 2: always update the cost to reflect subsequent changes in estimates of the variable consideration.
    - Alternative 3: update the cost of the asset some of the time according to certain criteria.
13. We believe it’s possible that all three of these alternatives may have a place in the suite of IFRS Standards, but it is unlikely that one will work for all transaction types and for all Standards. Alternatives 1 and 2 seem to be more ‘rules-based’ and for situations in which they may be deemed appropriate, our view is that adequate disclosure requirements would be critical to support the approach.
14. Generally, we are more supportive of an approach that enables purchasers to update the cost of an asset in certain situations and according to certain criteria and therefore we are attracted to alternative 3.
15. When deciding on the criteria for updating the cost of an asset, it will be important to consider the range of different scenarios to which it might apply and how practical it would be to identify and distinguish between these criteria in practice. Judgement is likely to be required to apply any of the criteria proposed, according to the particular facts and circumstances. As

stated above, the IASB should be encouraged to produce guidance to support reporters on how to make judgements and encourage consistency.

USING THE IFRS 16 THOUGHT PROCESS

16. IFRS 16 *Leases* arguably represents the most recent IASB thinking when it comes to variable payments more generally and therefore it might be the most logical place to start when considering consistency between accounting standards as it relates to variable consideration. We embrace the solution in IFRS 16 as a practical one that is appropriate and works well for lease accounting. However, we are not confident this would be a good approach for all scenarios.

MIRRORING IFRS 15

17. We do not support an approach that mirrors IFRS 15 *Revenue from Contracts with Customers* where variable consideration is recognised only to the extent that it is highly probable that a significant reversal will not occur. There are a number of principles in IFRS 15 that are designed to create an outcome in the P&L (ie, avoiding revenue reversal) rather than accurately estimating the cost of an asset.

STANDARD BY STANDARD APPROACH

18. We note the advantages and disadvantages presented in the discussion paper of both a unified set of principles that spans multiple standards and a standard-by-standard review approach (paragraphs 4.63 to 4.80). We agree with this assessment but do not think that these two standard-setting approaches are mutually exclusive. In fact, a standard-by-standard review to address the existing issues using an agreed conceptual basis could be the ideal methodology. We like the suggestion in paragraph 4.71 that a suite of different accounting approaches could be developed to be applied differently depending on certain characteristics of the transaction and believe this could be used to help guide a standard-by standard review.
19. As noted above, the challenges related to accounting for variable consideration most commonly arise with intangible assets and therefore a focus on addressing the issue in IAS 38 *Intangible Assets* ought to be of higher priority.
20. Finally, we feel that priority should be placed on reduction of diversity and inconsistent accounting when applying one standard before reduction of inconsistencies between standards.