DISCUSSION PAPER

ACCOUNTING FOR VARIABLE CONSIDERATION

FROM A PURCHASER'S PERSPECTIVE

September 2022

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- 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.

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EXECUTIVE SUMMARY

ES1 Transactions or contractual arrangements involving variable consideration[1] often occur in practice and can arise for a variety of reasons, for example, whenever there is a risk-sharing arrangement in an exchange transaction involving a buyer and seller.

ES2 There is currently divergence in practice on how a purchaser should account for the 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, 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" (see Appendix 3). In these discussions, the IFRS IC concluded that the matters raised were too broad to be addressed within the confines of existing IFRS Standards, and as a result, signalled the need for broader standard setting[2].

ES3 The IASB added the topic to its research pipeline after its 2015 Agenda Consultation. However, due to other priorities, the IASB did not include this project on its active research agenda. Moreover, following constituents' feedback to the IASB's 2021 Third Agenda Consultation, the project was excluded from the IASB's 2022-2026 work plan. Nevertheless, the accounting challenges related to variable consideration that are addressed in this Discussion Paper relate to transactions where diversity in practice still exists. These challenges may also pertain to emerging transactions. Thus, the IASB may have to include a project on variable consideration in its work plan in the future and/or address issues related to variable consideration within other projects (including narrow-scope projects and IFRS IC interpretations). Accordingly, this Discussion Paper can contribute to any future related work by the IASB.

OBJECTIVE AND SCOPE OF THIS DISCUSSION PAPER

ES4 The objective of this Discussion Paper is to consider possible alternative accounting requirements on challenges related to the accounting for variable consideration that can inform the IASB on any future standard-setting activities on this topic.

ES5 The Discussion Paper primarily focuses on and proposes alternatives for accounting requirements related to two main issues where divergence in practice exists in the accounting for variable consideration by purchaser entities. The two issues are:

a) **When to recognise a liability for variable consideration:** This issue relates to variable consideration that depends on the purchaser's future actions. The issue concerns the recognition of financial liabilities covered by IAS 32 *Financial Instruments: Presentation* and IFRS 9 *Financial Instruments* when the variable consideration is to be paid in cash or financial instrument by the purchaser entity. The IFRS IC discussions are indicative of different interpretations of when there would be a financial liability according to the IAS 32 requirements for exchange transactions where the variable consideration depends on the purchaser's future actions[3]. (This issue is hereafter referred to as 'the liability recognition issue').

b) **Whether/when subsequent changes in the estimate of variable consideration should be reflected in the cost of the acquired asset:** The second issue relates both to situations under which the variable consideration depends on the purchaser's future actions as well as situations under which the variable consideration is unrelated to the purchaser's future actions. The issue concerns whether/when the measurement of an asset acquired in exchange for

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1 Variable consideration encompasses contingent consideration. This Discussion Paper's definition of 'variable consideration' is provided in Chapter 1.

2 See IFRIC Update, March 2016.

3 In addition, some stakeholders who consider that IAS 32 would result in recognising a liability for variable consideration that depends on the purchaser's future actions when control of the acquire asset is received, would view that the recognition of the financial liability under IAS 32/IFRS 9 would be in conflict with the definition of 'cost' in the IFRS literature (IAS 16, IAS 38, IAS 40).

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 as it is generally for these assets that such an update to the carrying amount is relevant. (This issue is hereafter referred to as the 'measurement of the acquired asset' issue).

ES6 For these two issues, the scenario considered is where the purchaser has obtained control of an acquired asset, the economic substance of the transaction is that one single asset has been acquired and the purchaser will later have to pay consideration in cash (or another financial instrument) that would be covered by IAS 32/IFRS 9. These issues are the primary focus and are considered in the first part of the Discussion Paper in Chapters 2 and 3.

ES7 Chapters 2 and 3 propose alternatives for recognition and measurement requirements to address the two issues. These Chapters also provide an assessment of qualitative characteristics of useful information for these alternatives for requirements. The listed characteristics are neither exhaustive nor indicative of a preference for any of the alternatives. Assessing these characteristics for the alternatives is only meant to stimulate an initial discussion and to aid constituents' assessment of the mentioned two issues where there is diversity in practice.

ES8 Furthermore, complementing the first part of the Discussion Paper (Chapters 2 and 3), the second part of the Discussion Paper (Chapter 4 and Appendix 2) assesses the general IFRS requirements for accounting for variable consideration by purchaser entities 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 standard-setting responses that would address the currently lacking or inconsistent accounting requirements for variable consideration and possibly provide solutions to the liability recognition and measurement of the acquired asset issues. The Chapter also includes a review of matters of note in the requirements for transactions outside the scope of Chapters 2 and 3 (e.g. on the requirements for non-financial liabilities for variable payments made through the transfer of non-financial assets including by performing services).

ES9 This Discussion Paper does not address 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 such entities could be addressed during the forthcoming[4] IFRS 15 Post-implementation Review. A more detailed description of the scope of the Discussion Paper is outlined in Chapter 1.

When to recognise a liability for variable consideration

ES10 Chapter 2 of the Discussion Paper develops two alternatives for the 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. These alternatives are based on the definition of a liability in the *Conceptual Framework for Financial Reporting* ('the Conceptual Framework') and are as follows:

a) **Alternative 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.**

b) **Alternative 2: Recognising a liability when the purchaser performs the actions that trigger the variable consideration.**

ES11 The two alternatives are evaluated based on the qualitative characteristics of useful financial reporting information included in the Conceptual Framework (relevance, faithful representation, and cost-benefit considerations).

4 The IASB is expected to issue a Request for Information for the Post-Implementation Review of IFRS 15 in 2023.

ES12 Under Alternative 2, no liability for variable consideration is recognised when control of the acquired asset is obtained by the purchaser. Under this circumstance, if there is no fixed consideration, the acquired asset would be measured initially at nil as it is assumed that the measurement of the acquired asset is linked to recognition/measurement of the liability[5] for variable payment. As a result, no amortisation or depreciation expenses would be recognised in the statement of financial performance in subsequent periods. To the extent this fails to reasonably match the costs incurred to the income generated by the acquired asset, it could impair the predictions of future cash flows and the assessment of stewardship by users of financial statements.

ES13 Alternative 1 could result in the same timing for the recognition of a liability for variable payments irrespective of whether the variable payments depend on the purchaser's future actions.

ES14 Alternative 1 requires judgement to assess when the purchaser has no practical ability to avoid taking the action that triggers the variable consideration. Accordingly, the Discussion Paper suggests four criteria for assessing whether a purchaser entity has no practical ability to avoid taking action that would trigger variable consideration. Alternative 1 also requires the estimation of the amount of variable consideration at the time of recognition of a liability.

ES15 The Discussion Paper seeks constituents' views on their preferred alternative (i.e., either Alternative 1 or 2, or any other alternative). Views are also sought on the stated characteristics of useful information for each of the alternatives and on the suggested possible criteria that could be introduced under Alternative 1 to assess when a purchaser entity has no practical ability to avoid taking future actions that would trigger variable consideration.

Whether subsequent changes in the estimate of variable consideration should be reflected in the cost measurement of the acquired asset

ES16 Chapter 3 of the Discussion Paper examines the issue of whether/when to include the remeasurement of liabilities for variable consideration in the measurement of acquired assets that are measured at cost initially and subsequently.

ES17 Conflicting interpretation of existing requirements contributes to the divergence in practice on this issue. IFRS 9 requires remeasurements of the financial liability for variable consideration to be recognised in profit or loss. However, there is also an interpretation that the requirements in IAS 16, IAS 38 and IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* support the reflection, generally or under certain circumstances, of the remeasurements of the liability for variable consideration in the cost of the acquired asset.

ES18 In addition, the guidance in the Conceptual Framework and the definition of 'cost' in IAS 16, IAS 38 and IAS 40 *Investment Property* and the accompanying requirements in these standards on the measurement of cost can be 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 alternatively that it should either never or only sometimes be updated. If cost is not updated, the changes in a liability for variable consideration would be recognised in profit or loss.

ES19 Based on the guidance in the Conceptual Framework, different interpretations of the current definition of 'cost', and requirements (e.g., IAS 16, IAS 38 and IFRS 9) and IFRIC Interpretations (IFRIC 1), the following alternatives for requirements regarding whether the cost of an acquired asset should be updated to reflect changes in the estimate of variable consideration (remeasurements of liability for variable payments) are explored:

a) **Alternative 1: Not updating the cost estimate** (that is, recognising an expense or gain for changes in a liability for variable consideration). This possible requirement is based on an interpretation as stated in paragraphs ES17 and ES18 that the definition of cost in IFRS Standards means that the cost of an asset is what is paid at the time of its acquisition. Accordingly, the cost should not subsequently be updated.

5 As explained in Chapters 1 and 3, this Discussion Paper assumes that the acquired asset is measured based on the measurement of the related liability. Otherwise, a day-1 gain would occur if an acquired asset is recognised at an amount greater than zero without a corresponding recognition of the liability for the variable payment.

b) **Alternative 2: Updating the cost to reflect all subsequent changes in estimates of variable consideration.** This possible requirement would be based on a different interpretation as stated in paragraphs ES17 and ES18 that the definition of cost in IFRS Standards means that the cost of an asset is the final amount of cash or cash equivalents paid to acquire an asset and is not limited to payments estimated at the time of acquisition.

c) **Alternative 3: Sometimes updating the cost of an asset.** The Discussion Paper suggests the following criteria on when the cost of the asset should be updated. The criteria are not mutually exclusive as each criterion can be used individually or in combination with the rest of the criteria to determine when the cost of the asset should be updated:

(i) Updating the cost if an estimate of the liability for variable consideration is included in the initial measurement of the asset. This possible criterion is based on the analogous application of IFRIC 1 requirements.

(ii) Updating the cost for changes in estimates of variable consideration that occur before the asset is ready for its intended use. This possible criterion is based on the IAS 16 and IAS 38 requirements on what cost should comprise of.

(iii) Updating the cost to the extent variable payments are associated with changes in future economic benefits to be derived from the asset. This possible criterion is one of the alternatives from past IFRS IC discussions.

(iv) Updating the cost to the extent the variable consideration is linked to the initial quality of the asset. This possible criterion is based on the view that variable consideration represents what could be considered to be the correct cost of the asset. Hence, changes in the estimate of variable consideration should be reflected in the cost of the acquired asset.

ES20 When assessing the qualitative characteristics of useful information for each of the alternatives for accounting requirements listed in paragraph ES19, this Discussion Paper also considers how these alternatives would affect profit or loss. For instance, if future cash flows are expected to be derived from the acquired asset; for predicting future cash flows and assessing stewardship, it would be most useful to include the changes in the estimate of variable consideration in the cost of the asset. Doing so will match the costs of the asset with the future income (i.e., by matching the amortisation and depreciation of the carrying value of the acquired asset with its cash generation). On the other hand, if changes in estimates of variable consideration reflect factors occurring in a particular period, recognising the changes in estimates of variable consideration in profit or loss in the period it occurs would result in the most useful information.

General IFRS requirements and standard-setting implications

ES21 The first part of the Discussion Paper (Chapters 2 and 3) addresses the two issues in accounting for variable consideration where there is diversity in practice[6] as enumerated above (i.e., when to recognise a liability for variable payments that depend on the purchaser's future actions, and whether to update the cost of the acquired asset).

ES22 The second part of the Discussion Paper (Chapter 4) assesses the general requirements for the accounting for variable consideration including an assessment of the consistency (or lack thereof) of requirements for liabilities recognition and acquired asset measurements as part of assessing possible standard-setting responses. In addition to considering the alternatives for requirements presented in Chapters 2 and 3, the IASB could consider either developing a unified set of principles that align IFRS requirements for variable consideration or undertaking Standard-by-Standard amendments. Either of these options could also address the two issues that are the primary focus of this Discussion Paper.

ES23 The Discussion Paper assesses the advantages and disadvantages of respectively developing a unified set of principles to align IFRS requirements and undertaking Standard-by-Standard amendments. This assessment of advantages and disadvantages takes account of cost-benefit considerations and possible impact on the usefulness of reported information. The Discussion Paper seeks constituents' views on these two possible broad standard-setting responses.

6 See Agenda Paper 10 for the January 2011 meeting of the IFRS Interpretations Committee.

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 31 May 2023.

QUESTION 1 - WHEN TO RECOGNISE A LIABILITY FOR VARIABLE CONSIDERATION

Chapter 2 explores two alternatives for requirements on when to recognise a financial liability for variable consideration that depends on the purchaser's future actions under IAS 32/IFRS 9:

a) Alternative 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. (The Discussion Paper includes suggested criteria on when a purchaser entity would not have the practical ability to avoid taking the action(s) that would trigger the variable consideration (see Question 2 below)).

b) Alternative 2: Recognising a liability when the purchaser performs the actions that trigger the variable consideration.

The Chapter also includes assessments of qualitative characteristics of useful information for each of the two alternatives. Do you agree with these assessments?

Do you think that other alternatives for requirements for liabilities for variable consideration than those listed should be considered? If so, please specify these other alternatives.

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.

Are you aware of any issues relating to the measurement of a recognised financial liability for variable consideration? If so, please elaborate on these issues.

QUESTION 2 - HOW TO ASSESS THAT AN ENTITY HAS NO PRACTICAL ABILITY TO AVOID TAKING AN ACTION

Chapter 2 suggests five alternative criteria for assessing when 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 suggested criteria 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 a significant unfavourable economic impact on the entity.

c) When avoiding taking an action would have a significant unfavourable economic impact in the context of 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 of acquiring the asset.

e) When avoiding taking an action would have marginal economically unfavourable consequences for the entity.

Do you agree that the above criteria are valid for assessing whether a purchaser would not have the practical ability to avoid performing a future action that would trigger variable consideration?

Are there other criteria that should be considered? If so, please elaborate on these other criteria.

Which of the above criterion/criteria would you prefer and why?

QUESTION 3 - INTERPRETATIONS OF THE DEFINITION OF COST

Chapter 3 notes that the definition of 'cost' included in IAS 16, IAS 38 and IAS 40 ("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*") is interpreted differently.

How do you interpret current requirements in relation to whether/when the measurement at cost of an asset covered by IAS 16 or IAS 38 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 across all IFRS Standards?

QUESTION 4 - POSSIBLE REQUIREMENTS FOR WHEN MEASUREMENT AT COST SHOULD BE UPDATED TO REFLECT CHANGES IN ESTIMATES OF VARIABLE CONSIDERATION

Chapter 3 explores the following three possible alternatives for 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) Alternative 1: Not updating the cost estimate.

b) Alternative 2: Updating the cost to reflect all subsequent changes in estimates of variable consideration.

c) Alternative 3: Sometimes updating the cost of an asset. The Discussion Paper lists the following criteria which could be used to determine when the cost of the asset should be updated. One or several of the criteria could be used:

- Update if estimates of variable consideration are included in the measurement of the asset's cost at initial recognition.
- Update if the change in estimates of variable consideration takes place before the asset is ready for its intended use.
- Update the cost to the extent that variable payments are associated with future economic benefits to be derived from the asset.
- Update the cost to the extent that variable consideration is linked to the initial quality of the asset.

Do you think that other possible requirements than those explored in the Discussion Paper should be considered? If so, what are these other requirements?

Chapter 3 presents the qualitative characteristics of useful information for the three possible alternative requirements (including the four different criteria under Alternative 3) for when measurement at cost should be updated to reflect changes in estimates of variable consideration. Do you agree with the assessed characteristics of useful information for the alternatives? If not, which elements should be considered and which assessments do you disagree with?

When do you think 'cost' should be updated to reflect changes in estimates of variable consideration? If you think that 'cost' should sometimes be updated, under what circumstances should it be updated?

QUESTION 5 - GENERAL REQUIREMENTS ON ACCOUNTING FOR VARIABLE CONSIDERATION

Chapter 4 complements Chapters 2 and 3 of the Discussion Paper by assessing the broader requirements for accounting for variable consideration. Chapter 4 examines the advantages and disadvantages of respectively developing a unified set of principles for IFRS requirements to account for variable consideration and undertaking Standard-by-Standard amendments that could apply to the two issues covered in Chapters 2 and 3 (i.e., liability recognition when payment depends on purchaser's future actions and measurement of the acquired asset).

Do you agree with the advantages and disadvantages identified?

Based on your assessment and the outlined advantages and disadvantages of respectively developing a unified set of principles for IFRS requirements to account for variable consideration and undertaking a Standard-by-Standard amendment, which of the standard-setting responses do you support?

Do you think that requirements to deal with the issues mentioned in Chapters 2 and 3 should be based on a unified set of principles for how to account for variable consideration?

QUESTION 6 - APPLYING AN IFRS 15 MIRRORING APPROACH

Chapter 4 notes that requirements on variable consideration included in IFRS 15, could be 'mirrored' to provide guidance on how to account for a liability for variable consideration (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).

Do you think such an approach would result in useful information? Please explain why or 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 a variable amount for an acquired asset (a good or a service).

There is currently divergence in practice in relation to how to account for some types of variable consideration. Specifically in respect of 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/when changes in the estimate of variable consideration should be reflected in the cost of the acquired asset[7] recognised in the statement of financial position of the purchaser.*

This Discussion Paper explores different alternatives for requirements to address the above areas where divergence in practice exists and examines the related consequences.

The second part of the Discussion Paper also considers general requirements on variable consideration across the various IFRS Standards and whether a unified set of principles could be developed or a standard-by-standard amendment could be undertaken to address the accounting challenges including the two issues where there is current diversity in practice.

WHAT ARE THE ACCOUNTING ISSUES WITH VARIABLE CONSIDERATION?

1.1 Variable consideration arrangements can have many different purposes. For example:

a) When either the value for the purchaser of a transferred asset or some of the characteristics (including condition and quality of the asset) are unknown at the date of the transaction. An example would be where the price of a football player depends on the number of matches, (s)he will play for the purchaser's team.

b) When the seller entity wants to retain some of the risks and rewards related to an asset. For example, when a seller entity cannot afford to maintain and/or develop an asset, it 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 entity wants to retain some risks and rewards related to the price development of 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 IC[8], namely:

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 *Financial Instruments: Presentation*/IFRS 9 *Financial Instruments* for variable consideration that will depend on the purchaser's future actions[9]. The issue arises as current IFRS requirements (IAS 32) are interpreted differently. Possible interpretations range from recognising a liability when the purchaser has

7 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.*

8 See Appendix 3.

9 Depending on the interpretation of IAS 32, a financial liability for variable consideration may not arise until the purchaser will perform the actions that will trigger the variable consideration. Until then, the liability will accordingly not be covered by IAS 32 and IFRS 9. When referring to a financial liability within the scope of IAS 32/IFRS 9, this Discussion Paper accordingly refers to a liability for variable consideration that eventually will be covered by the scope of IAS 32/IFRS 9.

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[10].

b) The measurement of the acquired asset issue, which relates to the diversity in practice on whether changes in the estimate[11] 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[12]). The issue arises as:

(i) There are different interpretations on whether the notion of 'cost' as defined in IFRS literature requires or prohibits an update of any changes in the amount given to acquire an asset after the transfer of control of the asset to the purchaser.

(ii) Existing IFRS requirements either lack or provide inconsistent guidance on whether the measurement of an acquired asset is to be updated for changes in estimates of variable consideration. Some requirements on the remeasurement of liabilities (e.g., IFRS 9) 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 develop alternatives for possible requirements that address the liability recognition issue and the measurement of the acquired asset issue mentioned in paragraph 1.2. This is done in the first part of the Discussion Paper (Chapters 2 and 3). The second part of the Discussion Paper (Chapter 4) also considers whether the solution to the two issues should be based on a unified set of principles that would apply to all requirements on variable consideration across the various IFRS Standards or whether a Standard-by-Standard amendment is necessary.

1.4 As noted in the Executive summary, in Chapters 2 and 3, this Discussion Paper provides assessments of qualitative characteristics of useful information for various possible alternatives for accounting requirements. The presented characteristics are neither exhaustive nor indicative of a preference for any of the alternatives for accounting requirements. These assessments are only meant to stimulate an initial discussion and to aid constituents' assessment of the issues considered.

1.5 As noted earlier, this Discussion Paper does not address the accounting for variable consideration from the seller's 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*

10 In addition, some stakeholders who consider that IAS 32 would result in recognising a liability for variable consideration that depends on the purchaser's future actions when control of the acquire asset is received, would view that the recognition of the financial liability under IAS 32/IFRS 9 would be in conflict with the definition of 'cost' in the IFRS literature (IAS 16, IAS 38, IAS 40).

11 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.

12 IFRS 15.BC118(a) clarifies that "[b]oth goods and services are assets that a customer acquires (even if many services are not recognised as an asset because those services are simultaneously received and consumed by the customer)".

from Contracts with Customers and any accounting challenges for the seller entities can be addressed within the forthcoming post-implementation review of IFRS 15.

1.6 The Discussion Paper only considers recognition and measurement requirements, and it does not consider disclosure requirements. However, when considering different alternatives for the recognition and measurement requirements, it is assumed that appropriate accompanying disclosures would also be provided.

Definition of variable consideration

1.7 The Discussion Paper defines variable consideration as arising when the purchaser of a good or service may have to transfer additional assets in exchange for the specified good or service to the seller. This definition is based on the contingent consideration definition[13] included in IFRS 3 *Business Combinations*.

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 because:

a) Although the definition of variable consideration used in this Discussion Paper is based on the IFRS 3 definition of 'contingent consideration', the analyses performed in this Discussion Paper are neither necessarily restricted to (nor do they necessarily cover) all the aspects of the definition of 'contingent consideration'.

b) 'Contingent consideration' could be interpreted as meaning a fixed amount that is only due upon the occurrence or non-occurrence of a future event. The term 'variable consideration' not only includes these circumstances but also those under which any additional amount would be variable. This could be the case, for example, if the amount of consideration would depend on changes in the market price of the good or service received.

1.10 Under this definition, the consideration to be exchanged does not have to be an amount transferred 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 transferred is not fixed[14]. Accordingly, consideration would be deemed variable only when the quantity (and not the value) of assets the entity would have to transfer could change as elaborated in paragraphs 1.13 to 1.14 below.

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, to society), such an obligation is not considered to meet the variable consideration definition applied in this Discussion Paper.

1.12 In this Discussion Paper, the transfer of variable consideration from the purchaser to the seller is interchangeably referred to as variable payments.

Changes in the value of consideration

1.13 The definition of variable consideration used in this Discussion Paper excludes changes in the value of the asset(s) to be transferred by the purchaser. Excluding changes in the value of the asset(s) to be transferred can result in a transaction that would have similar economic consequences to a transaction involving variable consideration not being covered by the scope of the Discussion Paper. For example, if a purchaser acquires 10 bottles of apple cider and has 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 as the

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13 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."

14 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*.

quantity (not the value) of assets to be delivered (25 kilos of apples) is fixed. This 'changes in the value of consideration' issue would also apply to variable payments in the form of foreign currency and other financial instruments besides cash including equity and bonds.

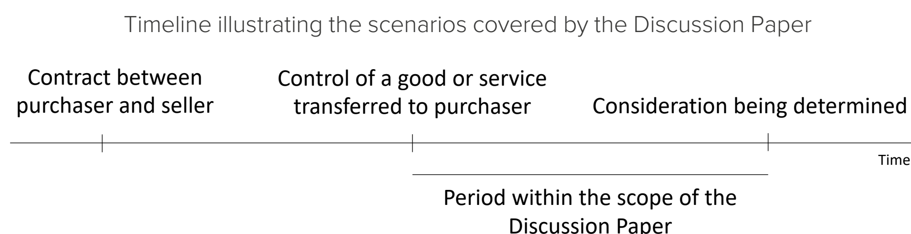
1.14 The accounting for 'changes in the value of consideration' which relates to measurement is not separately considered in the Discussion Paper as it would raise additional complex issues that are not necessary for formulating solutions to the primary issues being addressed within the scope of the Discussion Paper. For example, there would be a need to determine which current IFRS Standard the changes in value would be covered by and how any hedging policies undertaken by the purchaser should affect the cost of the acquired asset. The definition of variable consideration applied in this Discussion Paper (i.e., the need for the purchaser to transfer additional assets) would also necessitate considering how to account for changes in the foreign exchange rate in situations where the payment is made in foreign currency. The analysis of these additional issues falls beyond the scope of the Discussion Paper.

Non-executory contracts

1.15 The Discussion Paper only considers variable consideration in non-executory contracts[15] 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 in Figure 1.1 below.

Figure 1.1 Diagram illustrating the scope of the Discussion Paper

Timeline illustrating the scenarios covered by the Discussion Paper



1.16 As illustrated in Figure 1.1, 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.

1.17 If a contract is executory the combined right and obligation constitute a single asset or liability[16]. 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 for onerous contracts.

Exclusion of fixed consideration

1.18 The price of a good or service may consist of both a fixed part and variable part(s). When discussing the liability recognition issue, the conclusion could be affected by whether the fixed and variable components of consideration are looked at together or separately. This Discussion Paper separately considers the accounting issues for the variable consideration component to ensure that it is accounted for similarly regardless of 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 explicit requirements on how to account for the fixed consideration.

15 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.

16 See the Conceptual Framework paragraph 4.57.

Scope of the Discussion Paper

Recognition of Liabilities for variable consideration - Chapter 2

1.19 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 under IFRS 9/IAS 32 requirements for variable consideration that depends on the purchaser's future actions as it is for these financial liabilities that interpretation challenges have been raised before IFRS IC. Effectively, liabilities covered by other Standards (e.g., IFRS 2 and IFRS 16) are out of the scope of Chapter 2.

1.20 When a variable consideration does not depend on the purchaser's future actions, a financial liability would generally be recognised under IAS 32/IFRS 9 when control of the asset to which the variable consideration relates has been received by the purchaser[17]. Accordingly, there is no ambiguity in the timing of when to recognise a liability.

1.21 An 'action' can also include 'inaction at a particular date'. For example, if a purchaser would have to pay an additional amount should a certain activity not be performed before a certain date. The Discussion Paper does not define when variable consideration will depend on the purchaser's future actions. When the IFRS IC discussed the issues (see Appendix 3), the reference was made to 'activities' instead of 'actions'. In this Discussion Paper, these two terms are used interchangeably. A discussion on the meaning of 'actions' is provided in Chapter 2.

Measurement of the acquired asset – Chapter 3

1.22 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 or another financial instrument, or by the transfer of a non-financial asset including by performing a service). Nevertheless, for consistency of analysis across the two issues that are the primary focus of the Discussion Paper, the analysis in Chapter 3 only focuses on 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). Chapter 3 is, however, not limited to assessing variable consideration that depends on the purchaser's future actions. In other words, all forms of payment of variable consideration and the remeasurements of all liabilities for variable payments (i.e., irrespective of whether these depend on the purchaser's future actions) could be in the scope of Chapter 3.

1.23 The measurement of the acquired asset issue generally only arises when the acquired asset is initially and subsequently measured at cost (e.g., typically for assets covered by IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*)[18]. 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 to 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[19]. Accordingly, while the measurement of the acquire asset issue is relevant for most tangible assets (i.e., Property, Plant and Equipment-PPE) and intangible assets acquired in exchange for variable consideration, it is not relevant to situations in which the purchaser acquires a financial asset (except for trade receivables) to which the requirements in IFRS 9 apply. These financial assets would be measured at fair value at the initial recognition.

1.24 Furthermore, the acquisition of a right-of-use asset would, in principle, be within the scope of Chapter 3. However, IFRS 16 *Leases* has explicit requirements on how to reflect changes in the estimate of variable consideration in the carrying amount of the right-of-use assets and these assets are therefore out of the scope.

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17 According to paragraph 3.1.1 of IFRS 9, an entity shall recognise a financial liability in its statement of financial position when, and only when, the entity becomes party of the contractual provision of the instrument. The paragraph is then referring to paragraphs B3.1.1 and B3.1.2). It follows from paragraph B3.1.2 of IFRS 9 that liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognised until at least one of the parties has performed under the agreement.

18 When an asset is subsequently measured in accordance with the revaluation model in IAS 16 and IAS 38, the measurement of the acquired asset issue would also be relevant to determine the part of changes in fair value that should be included in equity. To simplify the scope of the Discussion Paper, this issue is not specifically addressed.

19 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.

1.25 When variable consideration depends on the purchaser's future actions, there is an interlinkage between the 'liability recognition' and 'the measurement of the acquired asset' issues[20]. This is because, as 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.

1.26 This Discussion Paper considers that if no liability can be recognised when the purchaser obtains control of the acquired asset, the acquired asset would be recognised in the financial statements but measured at nil. This means that when the liability is then recognised in a subsequent period, it would also be considered as a change in the estimate of variable consideration related to the asset and the carrying value of the asset might be updated (i.e., depending on the criterion/criteria chosen for whether the cost of the acquired asset should be updated).

General IFRS requirements and standard-setting implications - Chapter 4

1.27 Chapter 4 and the associated Appendix 2 complement Chapters 2 and 3 by assessing the general IFRS requirements for variable consideration by purchaser entities (i.e., requirements for transactions within and outside the scope of Chapters 2 and 3). Although the primary focus of the Discussion Paper is on the two issues addressed in Chapters 2 and 3 (liability recognition issue and measurement of the acquired asset issue), the review of the general IFRS requirements gives a picture of the inconsistencies and any underlying reasons for these inconsistencies. Another objective of this Chapter is to assess possible standard-setting responses including whether there is a need for a unified set of principles that aligns IFRS requirements for variable consideration after taking into account cost-benefit and the impact on the usefulness of the information or for undertaking a Standard-by-Standard amendment These standard-setting responses could provide solutions to the two issues.

1.28 Furthermore, Chapter 4 also has a review of matters of note on the requirements for transactions outside the scope of Chapters 2 and 3 (e.g., variable consideration that is paid through the transfer of a non-financial asset including by performing a service, business combinations under IFRS 3, transactions where the economic substance of the acquired asset is a multiple element asset- such as acquired tangible assets with rights). These aspects of note would likely have to be considered in a possible future standard-setting project.

Transactions that are carried out on market terms

1.29 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.

Form of consideration transferred

1.30 The Discussion Paper only considers transactions where the purchaser has to deliver assets (including services) in exchange for the acquired good or service and it excludes situations where the purchaser pays using own shares. A discussion about acquisitions through own shares would need to take into account the special nature of own shares (i.e., these are not considered as assets of the entity), which would broaden the scope of this Discussion Paper.

Business combinations covered by IFRS 3

1.31 Variable consideration related to the acquisition of a business covered by IFRS 3 is outside the scope of this Discussion Paper. IFRS 3 includes requirements on how to account for contingent consideration to be paid for a business. Accordingly, requirements exist on when to recognise a liability for variable consideration in a business combination and on the measurement of the carrying amounts of the acquired assets (which are generally also initially measured at fair value).

1.32 In addition, including the acquisition of businesses in scope would have required a discussion on how changes in the estimate in variable consideration should be allocated to the various assets (and liabilities), including goodwill acquired

20 When the variable consideration does not depend on the purchaser's future action, a liability would always be recognised. Therefore, changes in the estimate of variable consideration could always be reflected in the carrying amount of the acquired asset.

in the business combination when discussing the measurement of the acquired asset issue. This aspect would only increase the complexity of the Discussion Paper without being essential for developing the alternatives for requirements for the two issues where there is current diversity in practice.

1.33 While business combinations covered by IFRS 3 are excluded from the scope of this Discussion Paper, accounting for the acquisition of an investment in a subsidiary (and associates and joint ventures) in the separate financial statements is implicitly addressed by this Discussion Paper (in both Chapter 2 for all acquisitions paid in cash (another financial instrument) and Chapter 3 to the extent the acquisition of these interests are measured at cost).

1.34 Although variable consideration that is paid for business combination transactions under IFRS 3 is outside the scope of this Discussion Paper, IFRS 3 requirements are part of the existing IFRS requirements considered when assessing possible requirements for the transactions addressed in Chapters 2 and 3 and the general IFRS requirements in Chapter 4.

Economic substance of transactions

1.35 This Discussion Paper **only considers the situations where it has been determined that a purchaser has acquired one particular asset (i.e., the acquired asset does not include unrecognised additional rights) and the consideration for that particular asset is variable.** Considering the acquisition of assets with additional rights will introduce additional complexity that is beyond the scope of the Discussion Paper (e.g., there will be a need to develop principles for appropriately allocating the changes in estimates of the variable consideration if the measurement of the recognised acquired asset is being updated).

1.36 The application of judgement is often required to determine what is transferred in a transaction. In some cases, subsequent payments might thus not be variable consideration for the asset transferred but might be payments for additional assets.

1.37 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.

1.38 Another view could be that the above arrangement does not involve variable consideration but is instead a profit-sharing arrangement of some sort.

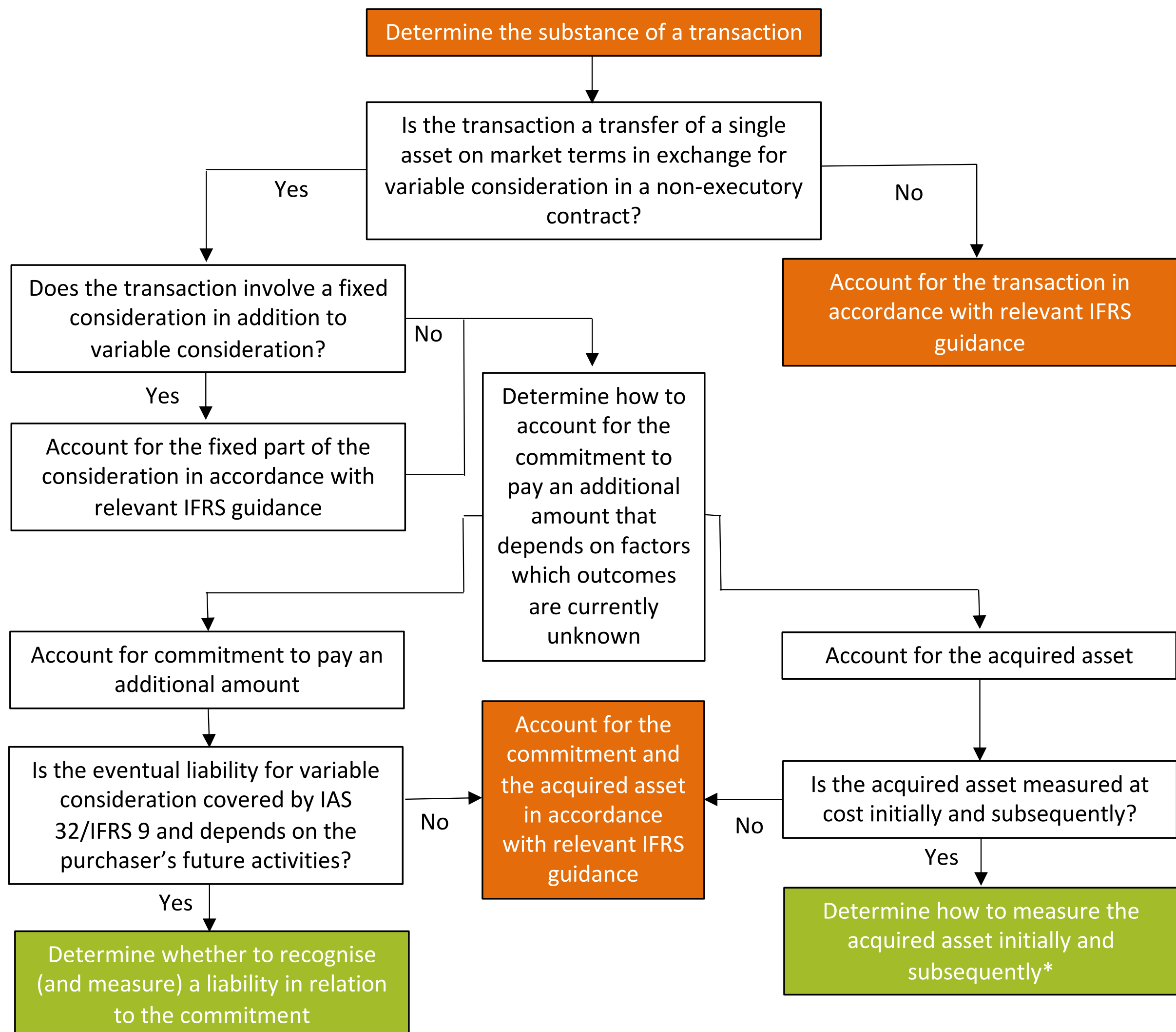
1.39 This Discussion Paper does not consider how to distinguish and determine the various assets that could be included in a transaction. It also does not focus on distinguishing whether a profit-sharing arrangement involves variable consideration. It is **thus outside the scope of the Discussion Paper to consider whether a transaction is the acquisition of multiple assets (including several rights) and/or a step acquisition.**

Risk-sharing/collaborative arrangements

1.40 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 has addressed one form of risk-sharing transactions. It, however, does not consider broader risk-sharing/collaborative arrangements where the risk sharing is also related to an activity/activities (that is an agreement regulating how two parties cooperate within a business activity). There are distinctive accounting issues related to broader risk-sharing/collaborative arrangements but the assessment of these has been excluded to keep a targeted scope.

1.41 The scope of the Discussion Paper can be illustrated by the shaded boxes in Figure 1.2 below and Table 1.1.

Figure 1.2 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.

Outside the scope of the Discussion Paper.

Included in the scope of the Discussion Paper.

Table 1.1 Illustrates aspects that are in the scope of either Chapters 2 or 3 (✔) and those that are not in the scope of Chapters 2 or 3 (✘)

	The liability recognition issue in Chapter 2	The measurement of the acquired asset issue in Chapter 3
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 is paid by:		
- transfer of cash or another financial instrument	✔	✔
- transfer of a non-financial asset including performing a service	✘	✘
Variable consideration depends on:		
- the purchaser's future actions	✔	✔
- factors other than the purchaser's future actions	✘	✔
The recognition and measurement of a liability for variable consideration would be covered by:		
- IAS 32/IFRS 9	✔	✔
- an IFRS Standard other than IAS 32/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	✘	✘
Economic substance of the transaction is:		
- the acquisition of one single asset	✔	✔
- the acquisition of multiple assets (including rights) and/or step acquisitions	✘	✘
Acquisition is:		
- covered by IFRS 3	✘	✘
- not covered by IFRS 3 (e.g., accounting for the acquisition of subsidiaries (and associates and joint ventures) in separate financial statements)	✔	✔

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.

In order to develop requirements on when to recognise a financial liability for variable consideration that depends on the purchaser's future actions and is within the scope of IAS 32/IFRS 9 requirements, the definition of a liability and the related guidance in the IASB Conceptual Framework for Financial Reporting[21] *along with the different possible interpretations of this guidance are considered. Other IFRS requirements besides the IAS 32/IFRS 9 requirements on when to recognise a liability for variable consideration are also reviewed.*

Based on the different interpretations of the Conceptual Framework's definition of a liability, 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 obtain 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 is referred to as Alternative 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 is referred to as Alternative 2).*

INTRODUCTION

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

2.2 The Chapter is structured as follows. First, an example that illustrates the issue is provided as an introduction to the Chapter. Then the causes of the liability recognition issue, specifically, the different interpretations of IAS 32 requirements are discussed.

2.3 Thereafter, in order to develop possible alternatives for requirements to deal with the issue, this Chapter considers the definition of a liability in the Conceptual Framework along with the accompanying guidance on the elements of the definition (i.e., the entity has an obligation including the notion of having no practical ability to avoid payment; and the obligation being a present obligation as a result of past events). In addition, other current IFRS requirements besides IAS32/IFRS 9 requirements on when to recognise a liability for variable consideration are reviewed.

2.4 As the definition of a liability included in the Conceptual Framework is interpreted differently, this Chapter develops possible alternatives for requirements to deal with the issue based on these different interpretations. The Chapter then includes an assessment of the qualitative characteristics of useful information for these alternatives for requirements.

2.5 This Chapter does not analyse the measurement of a liability for variable consideration. In the review of past discussions of the IFRS IC and audit firm guidance, there was no indication of accounting challenges (e.g., interpretation challenges and diversity in practice) in the measurement of financial liabilities related to variable consideration under IAS 32/

21 The Conceptual Framework for Financial Reporting describes the objective of, and the concepts for, general purpose financial reporting.

IFRS 9. However, this Discussion Paper has a question for constituents on whether they are aware of any issues with the measurement of financial liabilities related to variable consideration.

ILLUSTRATIVE EXAMPLE

2.6 Below is a simple example provided to illustrate and discuss the accounting issues and possible alternatives to be considered.

2.7 In exchange for fixed consideration, Entity A (purchaser) has acquired from Entity B (seller) the intellectual rights of a recipe that Entity B has developed (i.e., the contract is non-executory[22]). The recipe will make chocolate spread preserve its consistency at higher temperatures. Entity A is not contractually restricted from selling the recipe to other parties, but as the recipe only works for the products that Entity A is producing, it is unlikely to do so. 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 sold above the first 10 000 jars sold 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[23] Entity B CU 40 000.

Question to consider in this Chapter

2.9 The question considered in this Chapter is when a liability for variable consideration that depends on the purchaser's future actions should be recognised.

2.10 In the illustrative example, Entity B has transferred the control of the use of the intellectual rights of the recipe to Entity A which will then have to transfer cash to Entity B depending on its future sales. The variable consideration is based on Entity A's sales of one of its products – a particular chocolate spread.

2.11 The question arises of whether/when a liability should be recognised when Entity A has acquired the recipe[24].

WHAT IS THE ISSUE?

2.12 In the illustrative example of the chocolate spread recipe, the variable payment from Entity A to Entity B is contractually agreed upon and will be in the form of a financial asset, namely cash. Therefore, unless the variable payment is covered by other transaction-specific standards (such as IAS 19 *Employee Benefits*, IFRS 2 *Share-based Payment*, IFRS 3 or IFRS 16), a liability to transfer an amount of cash would be covered by IAS 32/IFRS 9.

2.13 IAS 32 paragraph 11 defines a financial liability and this includes a contractual obligation to deliver cash or another financial asset to another entity.

2.14 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:

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22 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.

23 (50 000 – 10 000) jars * CU 1 = CU 40 000.

24 As stated in Chapter 1, this Discussion Paper considers the variable consideration component separately from the fixed consideration component.

(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.

2.15 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. The discussions of the IFRS IC (see Appendix 3) and interviews with audit firms showed that there are different interpretations of IAS 32.25 as reflected below.

2.16 For example:

a) *Interpretation supporting recognition of a liability when the asset is received:* There is an interpretation 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. This view is consistent with IAS 32.19 where a financial liability would be recognised when the asset is received.

Also, there is an interpretation that IAS 32.25 implies that a financial liability should be recognised when the related asset is received, and the variable consideration depends on the purchaser's future activities. This is because IAS 32.25 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. By extension, the purchaser's future actions (future performance) in relation to variable consideration would also be deemed to be beyond the control of the purchaser. Therefore, a financial liability would be recognised[25].

b) *Interpretation supporting recognition of a liability when the event that triggers variable payment occurs:* A different interpretation of IAS 32.25 is that it means that if variable consideration depends on the purchaser's future actions, no liability should be recognised when the related asset is received. This is because if variable consideration depends on the purchaser's future actions, the occurrence of uncertain future events is within the control of the purchaser. Therefore, a financial liability would only be recognised when the event that triggers the variable payment occurs.

Another argument against the interpretation that a financial liability is recognised because an entity's future revenue is beyond the control of both the purchaser and the seller of the instrument (as stated above)- would be that IAS 32.25 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*". However, SIC-5 did not address the accounting for financial liabilities that arise during the acquisition of a non-financial asset as is the case for the transactions considered in this Discussion Paper.

Furthermore, there are several questions that could arise including whether the reference to an entity's revenue deemed to be beyond the control of the purchaser entity encompasses the revenue or sale of a single type of goods or services? Whether it is only reaching a given revenue threshold that is beyond the control of the purchaser? Whether having no revenue would be deemed as being beyond the control of the purchaser?

At past IFRS IC discussions, proponents[26] of not recognising a liability when the related asset is received pointed to IAS 37 requirements[27] where liabilities are only recognised when the obligating/past event exists independently of the entity's future actions. Therefore, it can be interpreted that, in an exchange involving variable consideration, the purchaser and the seller have agreed on a form of joint arrangement relating to the variable consideration that is

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25 This was one of the reasons considered by some as indicated in Agenda Paper 06A for the September 2015 meeting of the IFRS IC.

26 See Agenda Paper 02A for the November 2015 meeting of the IFRS IC.

27 According to IAS 37.19, it is only those obligations arising from past events that exist independently of the entity's future actions (i.e., the future conduct of its business) that are recognised as liabilities.

distinct from the initial purchase of the asset (and that it should be accounted for separately from the initial purchase of the asset).

2.17 The above different interpretations of IAS 32 requirements have led to divergence in practice on when a liability should be recognised under IAS 32/IFRS 9 for variable consideration when the variability depends on the purchaser's future actions.

2.18 Figure 2.1. below summarises the different interpretations of IAS 32 that have been explained above:

Figure 2.1 Cause of the liability recognition issue – Differing interpretations of IAS 32 requirements*

Interpretations	Reasons
Recognise liability when asset is received	• Purchaser does not have a right to avoid paying cash as it is a non-executory contract. • The purchaser's future action is beyond the control of the purchaser since IAS 32 considers this to be the case for the purchaser's future revenues, net income or debt to equity ratio.
Recognise liability when event that triggers the variable payment occurs	• The event of the occurrence or non-occurrence of uncertain future events is within the control of the purchaser so recognise only when the event occurs.

* Interpretations that are based on the IAS 32.19 'unconditional right to avoid' and the IAS 32.25 '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'.

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

2.19 The criteria for the definition of a liability in the Conceptual Framework 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

2.20 As per paragraph 4.26 of the Conceptual Framework:

A liability is a present obligation of the entity to transfer an economic resource as a result of past events.

2.21 Paragraph 4.27 of 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.

2.22 The criterion - '*the obligation is to transfer an economic resource*' of paragraph[28] 4.27 of the Conceptual Framework is met for transactions in this Discussion Paper. For these transactions, there is a contract between the purchaser and the seller that specifies the variable consideration that the purchaser of a good or service would have to transfer.

2.23 Therefore, only the application and interpretation of the criteria in sub-paragraphs a and c of paragraph 4.27 of the Conceptual Framework (i.e., the entity has an obligation, the obligation is a present obligation that exists as a result of past events) are further 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 interpretations of when the entity has a practical ability to avoid taking the actions requiring the entity to transfer an economic resource. For example, if the variable consideration would have to be paid should the purchaser start using the acquired asset:

a) One interpretation would be 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 interpretation would be that even if the purchaser entity obtains control of the asset, this does not necessarily mean that it does not have a practical ability to avoid using the asset. In most cases, it is possible not to use something you have acquired. Only in a few cases, the adverse economic consequences of not using an acquired asset might be sufficiently severe to conclude that an entity does not have a practical ability to avoid using the asset.

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 2.49 and 2.50 below.

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

2.29 Paragraph 4.43 of 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.

28 Paragraph 4.37 of the Conceptual Framework 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 this potential to exist, it does not need to be certain, or even likely, that the entity will be required to transfer an economic resource. 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.

2.30 The following questions arise: 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 is the past event the transfer of the asset or is it the action of the purchaser that triggers the payment (or both)[29]? There are differing views on these questions:

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 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*[30] (RRA ED).

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 a target of increased sales in the earlier-cited chocolate spread example, at the time of obtaining control of the acquired asset, it would be unknown whether such targets would be met. Therefore, the future performance target would only be deemed a past event at the time it is met. It is only then that the present obligation for the variable consideration would exist, and a liability would be recognised.

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

2.31 The primary focus of this Chapter is on financial liabilities for variable consideration that depend on the purchaser's future actions that are under the scope of IAS 32/IFRS 9. Other current IFRS requirements (i.e., excluding IFRS 9) that could be applicable for determining when to recognise a liability for variable payments in cash or another financial instrument that would/could depend on the purchaser's future activities are summarised in Table 2.1 below. A more detailed outline of these requirements is presented in Appendices 1 and 2.

29 One view could be that the establishment of the contract should be considered as the past event. An argument in favour of this view, is that after the establishment of the contract there could be a liability for an onerous contract. A different view would be that there is no separable liability before the seller entity has fulfilled its performance obligation. This latter view is consistent with the IFRS 16 Basis for Conclusions stating 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.

This Discussion Paper does not further consider the argument that the establishment of the contract should be considered as the past event as the seller would then not yet have performed under the contract and the contract would therefore be executory meaning that the rights and obligations cannot be separated - the liability to pay it thus not a (separate) liability.

30 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.

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

Table 2.1 Current requirements on when to recognise a liability for variable consideration that depends on the purchaser's future actions

Standard	Variable consideration in the form of:	When is a liability recognised?
IAS 19 *Employee Benefits*[31]		
Paragraph 71	Benefits from a defined benefit pension scheme.	When service is received.*
IAS 19 *Employee Benefits*		
Paragraphs 155 and 157	Long-term employee benefits (e.g., profit-sharing and bonus plans).	When service is received.*
IAS 19 *Employee Benefits*		
Paragraphs 11 and 19	Short-term employee benefits (profit sharing and bonus plans).	When service is received.*
IFRS 2 *Share-based Payment*		
Paragraph 7	Cash-settled share-based payments.	When an asset is received.*
IFRS 3 *Business Combinations*		
Paragraphs 39 and 7	Contingent consideration in a business combination.	When an 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 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.

31 In many cases, consideration to be paid to an employee would not be variable consideration that would depend on the purchaser's (the employer's) future actions.

2.32 In addition, there are other current requirements, for example, IAS 37 on contingent liabilities[32] 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.

2.33 IAS 37.17 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. 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 (IAS 37.19).

2.34 Also, as per the RRA ED, the variable consideration relates to changes in expected cash flows arising from uncertainty in the 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 paragraph 25 of the RRA ED, an entity should recognise all regulatory assets and all regulatory liabilities existing at the end of the reporting period.

2.35 As can be seen in Table 2.1, most of the current requirements reflect that a liability is recognised when the goods or services are received. However, most requirements do not distinguish whether the variability of payments is linked to the purchaser's future actions or not. One exception would be the most recent IFRS requirements on variable consideration under IFRS 16 where a liability is only recognised for variable consideration that depends on the purchaser's future actions when the actions triggering the variable consideration occur.

Possible alternatives based on the Conceptual Framework

2.36 Should the IASB develop requirements to clarify or develop requirements for the liability recognition issue, it may consider the principles set out in the Conceptual Framework for the recognition of a liability for variable consideration that depends on the purchaser's future activities. It is also worth noting that the IASB is exploring clarifying amendments to IAS 32 to address common accounting challenges that arise in practice under the Financial Instruments with Characteristics of Equity project and the analysis of liabilities recognition in this Discussion Paper may help.

2.37 Based on the above-discussed different interpretations of the liability definition criteria derived from the Conceptual Framework of 'there being an obligation' and 'existing as a result of past events', the following are possible alternatives 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 (Alternative 1); or

b) Recognising a liability when the purchaser would perform (or not perform[33]) the actions that would trigger the variable consideration (it is assumed that when this occurs, the purchaser will not have a practical ability to avoid the variable consideration) (Alternative 2).

2.38 These two possible alternatives 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 the variable payment.

32 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.

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

2.39 The **criterion relating to the practical ability to avoid the action applies to both Alternatives. However, the distinguishing factor between the two Alternatives is what is the past event. Alternative 1 considers the past event to be when the purchaser would obtain control of the good or service. While Alternative 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 (Alternative 1)

2.40 Under Alternative 1, the following two conditions need to be both met for a liability to be recognised:

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

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

2.41 In the case 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 any chocolate spread jars above 10 000 jars in the next five years, would be recognised when the purchaser entity receives the recipe and concludes that it does not have a practical ability to avoid the variable payment.

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

2.42 Under Alternative 2, a liability would be recognised only after the future actions (or inactions) of the purchaser that would trigger the variable payment have occurred.

2.43 Therefore, under Alternative 2, there is only one condition to be met in order to recognise a liability for variable consideration and this is the occurrence of the purchaser's actions that would trigger the variable payment. In such a situation, the purchaser would not have a practical ability to avoid the variable consideration because the action triggering the payment would have taken place.

2.44 In the example of the chocolate spread recipe, Entity A (purchaser) would only start recognising a liability (of CU 1) related to the variable consideration when it has sold 10 001 jars of chocolate spread.

2.45 Under Alternative 2, it would be necessary to clarify the notion of 'depends on the purchaser's actions'. However, it is beyond the scope of this Discussion Paper to provide such clarification.

2.46 Under Alternative 2 requirements, the timing of the liabilities recognised would depend on whether or not the variable consideration depends on the purchaser's future actions. To avoid similar interpretation challenges to those related to IAS 32.25, it would have to be specified what is considered to be an action of the purchaser (or what would be within the control for the purchaser). For example, there is a view that variable consideration that depends on entity-wide revenues would not be deemed to depend on a purchaser's future actions. On the other hand, if variable consideration depends on an asset or product-specific revenues, it would be deemed to depend on the purchaser's future actions and the appropriate accounting treatment is unclear. In addition, it could be argued that while the purchaser could decide whether it wants to sell a particular product its actions alone could not result in a given (high) threshold for the sales being reached.

2.47 In relation to the Conceptual Framework, the specification on what is meant by 'the purchaser's future actions' would need to reflect situations under which the purchaser has received an asset but has neither obtained economic benefits nor taken an action that will result in the purchaser having to transfer an economic resource that it would not otherwise have had to transfer (see paragraph 2.29 above).

2.48 When considering how to specify what depends on the purchaser's future actions (or when something is within the control of the purchaser), it might be relevant to consider the discussion on when an entity has a practical ability to avoid something. When a purchaser has a practical ability to avoid something could also indicate whether that something would depend on the purchaser's future actions. A discussion on the 'practical ability to avoid' criterion is provided below.

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

2.49 As noted above, there are differing interpretations of when an entity has no practical ability to avoid an activity that would trigger a variable payment[34] (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.

2.50 To apply Alternative 1, it would be necessary to develop further guidance on criteria for identifying when an entity has or does not have a practical ability to avoid taking the action that would trigger variable consideration[35]. Below are suggested possible criteria for assessing whether an entity has or does not have the practical ability to avoid a variable payment:

a) **An entity would cease its activities.** At one extreme, it could be said that an entity would not have a practical ability to avoid a variable payment if it would have to cease its activities to avoid the variable payment.

b) **Significant unfavourable economic impact on 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 an action/inaction would be 'significant', the entity-wide effect could be considered. That is, if the entity would have to change its business model or cease profitable sales, the adverse effect could be significant.

c) **Significant unfavourable economic impact in the context of the acquired asset.** A significant impact can also be considered relative to the cash flow generation capacity of an acquired asset rather than from an entity-wide perspective. For example, if an acquired asset could generate cash flows worth CU 10 without incurring variable payment and CU 15 by incurring a variable payment of CU 2, the economic consequences of avoiding the variable payment would be an opportunity cost/foregone gain of CU 3. This would be a significant impact relative to the cash flow generating capacity of the asset (CU 3 out of CU 10 or 30%) albeit that it may be insignificant relative to the entity-wide cash flows. Accordingly, because avoiding the variable payment would result in a significant unfavourable economic impact relative to the cash flow capacity of the acquired asset, it could be construed that the purchaser does not have the practical ability to avoid the variable payment.

d) **The asset would have to be used in a manner that would not reflect the initial economic purpose of acquiring the asset.** If an asset is acquired for use 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 in d) above but it also takes into account the intended economically beneficial purpose when an asset is acquired. In other words, an entity would not have the practical ability to avoid variable payments that are linked to the realisation of the initial intention of acquiring an asset.

   For example, a football club may want to acquire a particular player and in its budget for the acquisition, the football club management assumes that the player will play at least 20 matches in the first year. If the player will not play at least 20 matches, the club would not meet its objectives of acquiring the player. Accordingly, it is agreed that the football club will only pay the entire consideration for the player if the football player meets the objective of playing at least 20 matches.

   In this case, the club's failure to use the player for the initial economic purpose (i.e., to play at least 20 matches) would have an adverse economic impact. Therefore, under the criterion that would consider the initial economic purpose for acquiring an asset, it would be considered that the purchasing football club would have no practical ability to

34 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.

35 The Conceptual Framework also considers the practical ability to act in a manner inconsistent with customary practices, published policies or specific statements. The assessment of 'practical ability' in these cases would also be relevant for situations that are not related to variable consideration and is therefore a broader issue that is not considered in this Discussion Paper.

avoid making the football player play 20 matches and the liability for the variable consideration component would be recognised when the player is acquired.

In contrast, in situations where the variable payment occurs if the purchaser entity uses the acquired asset differently than was intended at acquisition, the entity would be deemed to have a practical ability to avoid variable payments, and a liability would not be recognised at the time of acquisition. For example, if an entity acquires a building to use as its headquarters under a contractual agreement that the entity would pay a fixed price for the property plus 5% of any profit made were it to sell the building within five years, the entity would be deemed to have a practical ability to avoid the variable payment. This is because the initial economic purpose of the entity acquiring the building was for ongoing use as its headquarters and not to profit from buying and reselling the building within five years.

e) **Marginal economically unfavourable consequences for the entity.** In contrast to criterion a) above, at the other extreme, an entity could be said not to have a practical ability to avoid variable payment, if there would be marginal unfavourable economic consequences should the entity not perform the activities that would trigger the variable payments. That is, the entity would experience minimal economic compulsion to pay the variable consideration.

2.51 A non-exhaustive description of the characteristics of useful information for the two Alternatives is discussed below.

Qualitative characteristics of useful information for the Alternatives

2.52 An assessment of the characteristics of useful financial reporting information for the Alternatives is done below and in Table 2.2. In addition, as noted in Chapter 1, this Discussion Paper assumes there will be accompanying disclosures for each Alternative for recognition and measurement requirements for liabilities for variable consideration. However, this Discussion Paper does not assess the incremental effects of disclosures. In other words, the assessment in Table 2.2 does not consider the additional contribution that disclosures would have on the characteristics of useful information. This assessment mainly focuses on the fundamental qualitative (and not enhancing) characteristics included in the Conceptual Framework:

a) *Relevance:*

(i) *Whether the Alternative would result in variable consideration being reflected in the initial measurement of the acquired asset.* As highlighted in Chapter 3, the recognised liability for variable consideration and the acquired asset are interlinked and not measured independently. Thus, when a liability for variable consideration is recognised, this liability is reflected in the measurement of the acquired asset. Consequently, if the entire consideration is variable, not recognising a liability would mean that a recognised acquired asset would correspondingly be measured at nil and there would be no amortisations/depreciation expenses recognised.

If the acquired asset contributes to the generation of cash flows before the trigger for the payment of variable consideration occurs, not recognising the variable consideration while recognising amortisation/depreciation expenses may not result in useful information to predict future profit margins.

Including the expected variable consideration in the cost of the acquired asset and thereafter getting it reflected in the depreciation/amortisation expenses enhances the predictive value of reported profit. This is the case even if the depreciation/amortisation expenses may not perfectly reflect the pattern of consumption of an asset (i.e., when depreciation/amortisation expenses may not perfectly match the asset's future economic benefits).

(ii) *Whether the Alternative could result in the same timing for the recognition of liabilities for variable payments irrespective of whether these variable payments depend on the purchaser's future actions.* IAS 32/IFRS 9 requirements would generally result in a liability for variable consideration that does not depend on the purchaser's future actions being recognised when the related asset is received. If IAS 32/IFRS 9 requirements can be assumed to provide relevant information for users to predict future cash flows when the variable payment does not depend on the purchaser's future action, it might be inferred that recognising a liability for variable payments that depends on the purchaser's future action, when the purchaser obtains control of the acquired asset, would similarly result in relevant information. If the purchaser has no practical ability to avoid variable payments when obtaining control of the acquired asset, an alternative under which a liability would be recognised for variable payments depending

on the purchaser's future actions when a good or service is received would result in the same timing for the recognition of liabilities for variable payments irrespective of whether these variable payments depend on the purchaser's future actions.

(iii) *Whether the Alternative could result in a counterintuitive accounting outcome.* Recognising an expense when the purchaser takes an economically beneficial action could be considered a counterintuitive accounting outcome. This could arise if a liability for variable consideration is recognised when the actions triggering the variable consideration take place, the liability is not reflected in the measurement of the acquired asset and when such actions are expected to provide a positive economic benefit for the purchaser. In effect, along with the recognition of a liability for variable payments, an expense is recognised (and the cost of the acquired asset is not updated) at the time the economically beneficial action that triggered the variable payment occurs. (See Chapter 3 for further analysis of whether the cost of the acquired asset is updated or not).

For example, if a variable payment depends on whether a purchaser entity enters a particular profitable market, a liability for variable payment and a corresponding expense would be recognised when the purchaser would enter that market. This recognition of an expense when the entity has entered into a profitable market would be counterintuitive as it would fail to convey that the purchaser has undertaken an economically beneficial action.

b) *Faithful representation:*

(i) *Whether the Alternative would result in a liability being recognised that the purchaser has no practical ability to avoid.* For a liability to faithfully represent what it purports to represent, it is considered beneficial that obligations meeting the definition of a liability in the Conceptual Framework are recognised – and obligations that do not meet the definition are not. This means that the Alternative should result in the purchaser recognising a liability only when it has no practical ability to avoid the payment.

(ii) *Whether the Alternative could result in significant measurement uncertainty.* Significant measurement uncertainty can impair the faithful representation of a phenomenon. Accompanying disclosures may be helpful in those circumstances. However, for the assessments performed, additional disclosures that could be provided are not taken into account.

c) *Costs for preparers*, an assessment is made on how costly it will be for preparers of financial statements to generate the information required under each of the Alternatives.

Table 2.2 Assessing the characteristics of useful information of the Alternatives

Information characteristic[36]	Alternative 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**	Alternative 2 **Recognise a liability upon the purchaser's actions that would trigger the variable consideration**
Relevance	Variable consideration would be reflected in the initial measurement of the acquired asset unless the purchaser has a practical ability to avoid taking the action that would trigger the variable consideration.	Variable consideration would not be reflected in the initial measurement of the acquired asset.
	Could result in liabilities for variable consideration that depends on the purchaser's future actions being recognised at the same time as liabilities for variable consideration that does not depend on the purchaser's future actions This could occur if the purchaser has no practical ability to avoid variable payments when obtaining control of the acquired asset (see paragraph 2.52a)(ii)).	Would not result in liabilities for variable consideration that depends on the purchaser's future actions being recognised at the same time as liabilities for variable consideration that does not depend on the purchaser's future actions (see paragraph 2.52a)(ii)).
	Could result in a counterintuitive accounting outcome as explained in paragraph 2.52a)(iii) when the purchaser has a practical ability to avoid taking the action that would trigger the variable consideration.	Could result in a counterintuitive accounting outcome under some circumstances (i.e., when trigger actions are economically beneficial actions) as explained in paragraph 2.52a)(iii)
Faithful representation	Would result in a liability being recognised when the purchaser has no practical ability to avoid taking the action that would trigger the variable consideration.	Could result in no liability being recognised when the purchaser has no practical ability to avoid taking the action that would trigger the variable consideration.
	Would not result in a liability being recognised that the purchaser has a practical ability to avoid.	Would not result in a liability being recognised that the purchaser has a practical ability to avoid.
	Could result in significant measurement uncertainty as the variable consideration to be paid would have to be estimated.	Would not result in measurement uncertainty to the extent the amount to be paid is determined when the action that would trigger the variable consideration has been performed.
Costs for preparers	May be more costly than Alternative 2 as the entity would have to assess whether there is a practical ability to avoid the future activities that would trigger the variable payments. And, if it would have no practical ability to avoid those future activities, it would have to also estimate the liability and update this estimate.	Likely to be less costly than Alternative 1 as estimates would not have to be made and updated and there is no assessment on if the entity has a practical ability to avoid the variable payment.

36 As noted elsewhere, this Discussion Paper assumes the existence but does not propose requirements for accompanying disclosures. Accordingly, the information characteristics assessed in Table 2.2 do not consider the additional contribution of accompanying disclosures. In other words, Table 2.2 only reflects the effects on information characteristics of the alternatives for recognition and measurement requirements.

CHAPTER 3: MEASUREMENT OF THE 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.

This 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 alternatives that could be considered, should clearer requirements be introduced. The Chapter notes the different interpretations of 'cost' and inconsistent requirements on whether the cost of an acquired asset should be updated. The Conceptual Framework could also be interpreted in different ways on this matter.

Three possible alternatives for requirements on whether/when the changes in the estimate of variable consideration should be reflected in the cost of the acquired asset are proposed in this Chapter. These alternatives are derived from different interpretations of what 'cost' means in the Conceptual Framework and current requirements. In addition, an assessment of the qualitative characteristics of useful information for these three alternatives is presented. The three alternatives for requirements are:

- *Not to update changes in the estimate of variable consideration in the cost of the asset.*
- *Always update changes in the estimate of variable consideration in the cost of the asset.*
- *Update changes in the estimate of variable consideration in the cost of the asset under certain circumstances – several criteria are proposed.*

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 (i.e., the measurement of the acquired asset issue) has arisen in past discussions of the IFRS IC. The current divergence in practice was confirmed during EFRAG's interviews with the subject matter experts of major audit firms. These interviews indicated the following inconsistent practices in accounting for changes in variable consideration:

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

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

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

3.2 Furthermore, the IFRS IC has discussed variable payments for the purchases of PPE and intangible assets in the past in the context of payments that depend on an entity's future actions. 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 as a separate project covering variable payments. Appendix 3 has a more detailed summary of past IFRS IC discussions.

3.3 This Chapter first explains the reasons for the diversity in practice on the 'measurement of the acquired asset' issue. This is followed by an analysis of whether/when cost should be updated based on the interpretation of the guidance of cost in the Conceptual Framework and the interpretation of the requirements on 'cost' in IFRS Standards. Thereafter, current IFRS Standards and Interpretations are examined for their requirements on whether or not the cost of an acquired asset is updated to reflect changes in the estimate of variable consideration.

3.4 Subsequently, this Chapter describes possible alternative requirements for changes in estimates of variable consideration. It also includes an assessment of the qualitative characteristics of useful information for these alternatives.

WHAT ARE THE ISSUES?

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

3.6 Some refer to paragraph B5.4.6 of IFRS 9 with an interpretation that changes in an estimate of variable consideration should be recognised in profit or loss. Others analogously refer to IFRIC 1 which requires the cost of a related asset to be adjusted to reflect changes in a (decommissioning, restoration and similar) liability. These conflicting IFRS requirements have led to the current diversity in practice.

3.7 This Discussion Paper assumes that the acquired asset and the related liability are not measured independently, therefore the asset would have the same amount as the liability at initial recognition. Hence, the question arises whether the acquired asset, measured at cost should be updated subsequently to reflect changes in the measurement of a recognised liability for variable consideration (i.e., should the remeasurements of liabilities be recognised in profit or loss or be capitalised as part of the asset?

Illustrative example from Chapter 2

3.8 Referring to the illustrative chocolate spread example in Chapter 2 (paragraphs 2.6 to 2.8), 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.

3.9 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 estimates of future sales of the chocolate spread jars.

3.10 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 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?

SHOULD THE COST OF THE ACQUIRED ASSET BE UPDATED FOR CHANGES IN ESTIMATES OF THE LIABILITY FOR VARIABLE PAYMENT?

3.11 To assess whether and when the cost of the acquired asset should be updated, the following sections consist of a review of the Conceptual Framework guidance on measurement related to historical cost and the inferences about 'cost' from existing Standards. The purpose of this review is twofold. First, it illustrates the reasons underpinning the current divergence in practice on whether the cost of the acquired asset is updated for changes in estimates of a liability for

variable payment. Second, in developing the alternatives for requirements on the 'measurement of the acquired asset' issue, a natural starting point is the guidance in the Conceptual Framework and what 'cost' should mean.

Conceptual Framework guidance

3.12 The Conceptual Framework's guidance on measurement at historical cost would be the suitable starting reference point for developing alternatives for IFRS requirements on when/whether the cost of an acquired asset should be updated to reflect changes in estimates of variable consideration.

3.13 Paragraphs 6.4 and 6.5 of the Conceptual Framework state:

> 6.4 Historical cost measures provide monetary information about assets, liabilities and related income and expenses, using information derived, at least in part, from the price of the transaction or other event that gave rise to them. Unlike current value, historical cost does not reflect changes in values, except to the extent that those changes relate to impairment of an asset or a liability becoming onerous.
>
> 6.5 The historical cost of an asset when it is acquired or created is the value of the costs incurred in acquiring or creating the asset, comprising the consideration paid to acquire or create the asset plus transaction costs. The historical cost of a liability when it is incurred or taken on is the value of the consideration received to incur or take on the liability minus transaction costs.

3.14 Paragraph 6.7 of The Conceptual Framework 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.

3.15 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.

3.16 The guidance on whether the cost of an asset should be updated to reflect changes in liability for variable consideration could be interpreted differently as shown below.

3.17 One interpretation could be that the cost of an asset should not be updated beyond the time of acquisition/creation as cost should only be updated on the occurrence of the four circumstances in paragraph 6.7 of the Conceptual Framework. Consequently, cost would not be updated for changes in estimates of variable consideration. This interpretation is further supported by paragraph 6.4 of the Conceptual Framework which indicates that historical cost does not reflect changes in values except if it relates to asset impairment or if a liability becomes onerous. Also, the references to 'the price of the transaction' in paragraph 6.4 of the Conceptual Framework and to 'the historical cost of an asset when it is acquired' in paragraph 6.5 of the Conceptual Framework could support this interpretation.

3.18 On the other hand, paragraph 6.5 of the Conceptual Framework refers to the consideration paid to acquire an asset without stating any date on which to consider the amount of consideration paid. This could be interpreted to mean that cost should be updated to reflect what is eventually paid. It could be further interpreted that updating the cost would not reflect a change in the value of the asset – but simply what is paid for the asset. Accordingly, updating the cost of the acquired asset would not be inconsistent with paragraph 6.4 of the Conceptual Framework.

Inferences from the definition of 'cost' in existing IFRS requirements

3.19 In addition to the Conceptual Framework guidance, the definition of 'cost' in IAS 16, IAS 38 and IAS 40 *Investment Property* can be referred to while developing accounting requirements on whether cost should be updated to reflect the remeasurements of a liability for variable payment.

3.20 ‘Cost’ is defined in IAS 16.6, IAS 38.8 and IAS 40.5 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 under the specific requirements of other IFRSs, e.g., IFRS 2 *Share-based Payment*.

3.21 However, as elaborated below, there are different interpretations on whether this definition of cost supports updating the cost of the acquired asset or if it does not support such an update. The arguments underpinning these different interpretations only relate to the consideration paid by the purchaser in exchange for the acquisition of a particular asset and not to any additional costs incurred in making the acquired asset ready for its intended use.

Cost definition in IFRS requirements: Interpretation that cost should not be updated

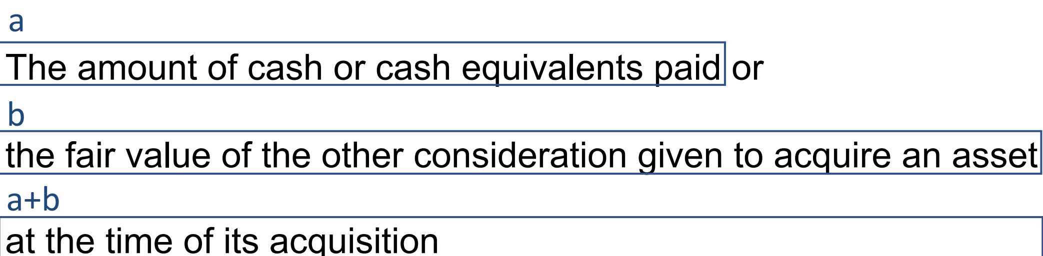
3.22 As elaborated below, three reasons why the cost definition in IFRS requirement could be interpreted to mean that the cost of an acquired asset should not be updated arise from a) a particular interpretation of the cost definition; b) requirements related to when an asset is ready for its intended use; c) the application of IFRS requirements for the related financial liability.

A particular interpretation of the cost definition

3.23 One interpretation of ‘cost’ could be that it consists of a) the amount of cash or cash equivalents paid at the time of the acquisition; or b) the fair value of the other consideration given to acquire an asset at the time of the acquisition as shown in Figure 3.1. In other words, ‘at the time of its acquisition’ relates to both ‘the amount of cash or cash equivalents paid’ and to ‘the fair value of the other consideration given to acquire an asset’.

3.24 Under this interpretation, variable consideration can only be included in the cost of an asset if deemed to be ‘other consideration given to acquire’ that asset. In that case, it would be measured at fair value at the time of its acquisition and this fair value would not be updated subsequently.

Figure 3.1 Interpretation of the definition of cost to mean that cost should not be updated



3.25 This interpretation could be supported by the fact that 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 (IAS 38.74 and IAS 16.30). Neither IAS 16 nor IAS 38 mentions that the measurement of an asset accounted for by the Standards should be adjusted by changes in the estimate related to variable consideration.

Requirements related to when an asset is ready for its intended use

3.26 It could be argued that it is inappropriate to true up variable consideration paid after an asset is ready for its intended use. This is because IAS 16.20, and IAS 38.30 state:

> 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[37].

37 As stated in Table 3.2, it may require judgement to determine when an asset is capable of operating in the manner intended by management. The term is not defined, and it is outside the scope of this Discussion Paper to propose guidance on this issue.

3.27 Thus, it can be argued that additional costs from changes in the estimate of variable consideration cannot be added to the carrying amount after the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the management.

The application of IFRS requirements for the related financial liability

3.28 Under IFRS 9, subsequent remeasurements of recognised financial liabilities after the revision of estimated contractual cash flows are recognised in profit or loss. This is interpreted to mean that changes in a liability for variable consideration cannot be reflected in the cost of the acquired asset.

Cost definition in IFRS requirements: Interpretation that cost should be updated

3.29 The reasons why the cost definition in IFRS requirement could be interpreted to mean that the cost of an acquired asset should be updated arise from a) a different interpretation of the cost definition from that stated in the above paragraph; b) analogous application of IFRIC 1 requirements; c) other arguments, including that the requirements on trade discounts show that cost should be updated and that it is not inappropriate to true up variable consideration paid after an asset is ready for its intended use[38].

A particular interpretation of the cost definition

3.30 The definition of cost in IAS 16.6, IAS 38.8 and IAS 40.5 could be interpreted to include in cost the amount of cash or cash equivalents that would actually be paid to the seller for the asset at any time.

3.31 Under this interpretation, the reference to 'the time of its acquisition' is only pertinent for 'the fair value of other consideration given to acquire the asset should be determined' (i.e., element b in Figure 3.2) and not applicable to 'the amount of cash or cash equivalents paid' (i.e., element a in Figure 3.2).

3.32 In effect, if variable consideration is paid in cash after an acquisition, it can be included in the cost of the acquired asset.

Figure 3.2 Interpretation of the definition of cost to mean that cost should be updated

a

The amount of cash or cash equivalents paid or

b

the fair value of the other consideration given to acquire an asset

at the time of its acquisition

3.33 This interpretation could be supported by the arguments that:

a) *Interpreting the definition of cost to mean that only cash paid at the time of acquisition would result in conflicts with other IFRS requirements.* An interpretation of the 'cost' definition as illustrated in Figure 3.1 (that is not updating cost), would mean that payments made in arrears would either:

(i) Not be reflected in the cost of an asset (as it is a payment in cash or cash equivalent and is not paid at the time of the acquisition); or

(ii) Would be measured at fair value at the date of the acquisition (because it is considered to be 'other consideration given' to acquire the asset).

38 An additional argument for adjusting cost is that it would be consistent with the latest thinking in the IASB's Exposure Draft on Accounting for Regulatory Assets and Regulatory Liabilities. Under the Exposure Draft, changes in expected cash flows relating to regulatory assets and regulatory liabilities are reflected in the cost of the asset or the liability. However, as the Exposure Draft states that an "entity shall measure regulatory assets and regulatory liabilities at historical cost, modified [emphasis added] for subsequent measurement by using updated estimates of the amount and timing of future cash flows, except that ..." the Exposure Draft could also be argued to imply that under a (historical) cost measurement, such updates should not take place. In addition, the application of the requirements included in the Exposure Draft would be limited to entities operating under specific circumstances and an Exposure Draft may not reflect the outcome of a final standard on the issue.

Both these alternatives would conflict with the requirements in IAS 16.23, IAS 38.32 and IAS 40.24 which require deferred payments to be included in the cost at its 'cash price equivalent' (i.e., payments made in arrears should be reflected in the 'cost' and measured at the 'cash price equivalent' – not at fair value[39]).

b) *Requirements in IAS 22 show that 'at the time of its acquisition' does not refer to the time of payment of cash'.* When the definition of cost was introduced, a similar (but not identical) requirement was introduced in IAS 22 *Business Combinations*[40]. IAS 22.22 required:

> An acquisition should be accounted for at its cost, being the amount of cash or cash equivalents paid or the fair value, at the date of exchange, of the other purchase consideration given by the acquirer in exchange for control over the net assets of the other enterprise, plus any costs directly attributable to the acquisition.

It appears in IAS 22.22 that the reference to 'the date of exchange' (in the definition of cost: 'at the time of its acquisition') only relates to the date at which the fair value of 'other purchase consideration' should be determined. To the extent the acquisition is paid in cash, the cost should thus reflect the amount paid (without any reference to any time at which this payment would need to have taken place before). IAS 22 thus specifically stated that adjustments to purchase consideration contingent on future events should result in the revision of the cost of the acquisition (with consequential effect on goodwill, or negative goodwill, as the case may be).

Analogous application of IFRIC 1 requirements

3.34 One of the main interpretations that cost should be updated is based on IFRIC 1 *Changes in Existing Decommissioning Restoration and Similar Liabilities* which requires the cost of a related asset to be adjusted to reflect changes in a (decommissioning, restoration and similar) liability. As per the Basis for Conclusions of IFRIC 1, the IFRIC had reached a consensus for this requirement. The IFRIC had considered three alternative approaches[41] (paragraph BC 8 of IFRIC 1). Considering the alternative approaches, the IFRIC considered it important that changes in the outflow of resources embodying economic benefits and in the discount rate should be treated in the same way given that matters such as inflation can affect both the outflow of economic benefits and the discount rate. Also, IFRIC did not agree with recognising changes in the estimated outflow of resources embodying economic benefits in profit or loss because would be inconsistent with the initial capitalisation of decommissioning costs under IAS 16.

Other arguments

3.35 Other arguments are provided as follows:

a) *The requirements for trade discounts show that cost should be updated to reflect changes in the price paid for an asset.* Not trueing up the cost conflicts with the guidance on rebates. IAS 16.16, IAS 38.27 and paragraph 11 of IAS 2 *Inventories* require entities to take trade discounts and rebates into account when determining the cost of an asset. In the case of volume rebates, it may only be known after the date of acquisition whether the rebate would apply – and cost would therefore only be updated after the acquisition date to reflect the amount actually paid for an asset.

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39 The cash price equivalent would take into account normal credit terms. To the extent payments would be made before the end of the normal credit period (e.g., 30 days), the cash price equivalent would correspond to the amount paid. Because of the time value of money, this amount could be different from the fair value of the promise to pay the amount (i.e., the fair value of the financial liability).

40 IAS 22 has been superseded by IFRS 3. Unlike IAS 22, IFRS 3 does not require an acquisition to be accounted for at its cost. Accordingly, the requirements in IFRS 3 have not been considered when providing alternative interpretations of the definition of 'cost'. The requirements in IFRS 3 IFRS 3.37 requires the consideration transferred in a business combination to be measured at fair value, which shall be calculated as the sum of the acquisition-date fair values of the assets transferred by the acquirer. In the submission to IFRIC resulting in the IFRIC project IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets – Accounting for contingent price for the purchase of single assets*, a view in favour of updating cost for changes in variable consideration was that this was required in IAS 22. The requirements in IAS 22 had established a practice for accounting for variable consideration under IAS 16 and IAS 38. Proponents of this view did not consider the different requirements in IFRS 3 (after the 2008 revision) would 'override' this practice as they considered the new requirements to be specific to business combinations only (see IFRS IC Staff Paper 10 for the January 2011 IFRIC meeting).

41 The three approaches considered by the IFRS IC are:

(a) capitalising only the effect of a change in the outflow of resources embodying economic benefits that relate to future periods, and recognising in current period profit or loss all of the effect of a change in the discount rate.

(b) recognising in current period profit or loss the effect of all changes in both the outflow of resources embodying economic benefits and the discount rate.

(c) treating changes in an estimated decommissioning, restoration and similar liability as revisions to the initial liability and the cost of the asset. Under this approach, amounts relating to the depreciation of the asset that would have been recognised to date would be reflected in current period profit or loss and amounts relating to future depreciation would be capitalised.

b) *It is not inappropriate to true up variable consideration paid after an asset is ready for its intended use.* Updating the cost would not conflict with the requirements in IAS 16.20 and IAS 38.30 (see paragraphs 3.26 - 3.27 above). This is because the variable consideration relates to the cost of acquiring an asset. The costs do therefore not relate to the period after the asset is in the location and condition necessary for it to be capable of operating in the manner intended by the management – even though the estimate of the cost is revised after this period.

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

3.36 Another reason for the 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.

3.37 The different current IFRS requirements are illustrated and further described in Appendices 1 and 2 and summarised in Table 3.1 below. As detailed, 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.

3.38 Table 3.1 shows that except for the treatment of rebates and trade discounts for standards such as IAS 2, IAS 16 and IAS 38, there is no general guidance on whether the cost should be updated. It also illustrates the inconsistency across current requirements. For example, if the liability for variable consideration, would be covered by IFRS 9, the requirements state 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.

Table 3.1 Current requirements on whether the cost of an asset should be updated to reflect changes in the related liability

Table 3.1 indicates whether the cost should be updated (✔) or not (✘).

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 / IFRIC 1 Paragraph 16 of IAS 16 Paragraph 24 of IFRS 16 Paragraph 5 of IFRIC 1	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.
IFRS 16 Paragraphs 24, 27, 29, 30, 39	Variable lease payments that depend on an index or rate or are in-substance fixed payments. Residual value guarantees 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	Variable consideration in the form of:	Cost of asset updated?	Treatment of variable consideration
Requirements on how to treat changes in the liability			
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 [42].	✘ Only applicable when there is a corresponding asset recognised	Changes in estimated outflow related to variable consideration are recognised in profit or loss.
IFRS 2 Paragraph 30	Cash-settled share-based payments.	✘ Only applicable when there is a corresponding asset recognised in exchange for share-based payments	Recognised in profit or loss.
IFRS 3 Paragraphs 38 and 40	Any variability of the 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. In practice, the initial estimate can be updated within 12 months of the acquisition date.

3.39 The proposed measurement requirements in the RRA ED 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[43] are reflected in the cost of the asset or the liability (paragraph 55 of the RRA ED). An entity would measure regulatory assets and regulatory liabilities on a modified historical cost basis reflecting updated estimates of future cash flows that will arise from those assets and liabilities (paragraph 29 of the RRA ED).

POSSIBLE ALTERNATIVES ON WHETHER TO UPDATE THE COST OF THE ACQUIRED ASSET TO REFLECT CHANGES IN THE ESTIMATE OF THE VARIABLE CONSIDERATION LIABILITY

3.40 The different interpretations of 'cost' in both the Conceptual Framework and current IFRS requirements described above and the reasons for the requirements (provided in the Basis for Conclusions) could inform different possible alternatives for requirements on whether to update the cost of the acquired asset to reflect changes in estimates of variable consideration.

3.41 Furthermore, in examining the alternatives for requirements, the linkage between the measurement of the acquired asset and the recognition/measurement of the liability for variable consideration was considered. In theory, the cost of an asset could be measured independently from the related liability. However, this would result in a day-1 gain or loss. Accordingly, this Discussion Paper presents alternatives underpinned by the assumption that the measurement at cost of an acquired asset is linked to the recognition/measurement of the related liability for variable consideration as follows:

a) If a liability for variable consideration that depends on the purchaser's future actions is recognised after the asset is acquired, the variable consideration cannot be reflected in the initial measurement of the acquired asset (i.e., such an acquired asset would be initially measured at nil).

42 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.

43 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.

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

3.42 In effect, there is a linkage between the issue of 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 of when/whether to update the measurement of cost to reflect the remeasurements of liabilities for variable consideration.

Alternative 1 – Not updating changes in the estimate of variable consideration in the cost of the asset

3.43 An alternative 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.

3.44 Arguments in favour of this approach are based on the interpretation of the Conceptual Framework guidance as stated in paragraph 3.17 above and the fact that the definition of 'cost', 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.

3.45 Requirements in current Standards could be used to support that cost is not updated subsequently. IAS 16.16 refers to the 'initial estimate' of the costs of dismantling and removing when it lists what the cost of an item of property, plant and equipment comprises.

3.46 In addition, IAS 16.30 and IAS 38.74 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 within the scope of these Standards should be adjusted by changes in the estimate related to variable consideration.

3.47 As mentioned above, there is a view that the requirements in IFRS 9 (paragraph B5.4.6) would mean that changes in the liability to pay variable consideration cannot be reflected in the cost of the acquired asset.

3.48 A possible measurement alternative 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 Alternative would therefore also reflect the current requirements on how to account for changes in estimates related to the liability in IFRS 2, IFRS 3, IFRS 9 and IFRS 16 (when the variability is neither in-substance fixed payments nor depends on an index or rate) (see Table 3.1).

3.49 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.

3.50 Applying this Alternative to the chocolate spread recipe example in paragraph 3.10:

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.

Alternative 2 – Always updating changes in the estimate of variable consideration in the cost of the asset

3.51 As mentioned in paragraph 3.18, it could be interpreted that the Conceptual Framework guidance would allow the reflection of changes in variable consideration in cost. The definition of cost in IFRS Standards is also being interpreted by some as the original estimate of an asset that should be updated to reflect all subsequent changes in an estimate related to variable consideration.

3.52 This is reflected in one of the interpretations of the definition of cost in paragraph 3.30 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.

3.53 In addition, an analogous reference could be made to IFRS 15, which deals with variable consideration from the party receiving variable consideration. IFRS 15.59 states that 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. 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[44] the cost of those goods and services.

3.54 The arguments provided in paragraph 3.29 above could similarly be used as arguments for this alternative.

3.55 An alternative 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[45]:

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.

Alternative 3 – Updating a change in the estimate of variable consideration in the cost of the asset under certain circumstances

3.57 A third alternative could be that under certain circumstances the cost is updated for changes in the estimate of variable consideration. For these circumstances, four criteria could be applied separately or in combination for when to update the cost of the asset for changes in estimates of variable consideration. The four criteria are as follows:

a) the variable consideration is included in the initial measurement of the cost of the asset;

b) the change in estimate of variable consideration takes place before the asset is ready for its intended use;

c) the variable consideration is positively associated with future benefits to be derived from the asset;

d) the variability is linked to the initial quality of the asset.

44 This assumption of analogous application of IFRS 15 reflects what could be an economically sensible interpretation of cost and it is made while being cognisant that IFRS requirements are not developed based on seeking symmetrical accounting between transacting counterparties.

45 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.

Update if estimates of variable consideration are included in the measurement of the asset's cost at initial recognition

3.58 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.

3.59 For example, IFRIC 1 requirements could be used by analogy to argue that estimates of the 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 the changes in estimates be included in the cost of the asset.

3.60 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 the current period statement of profit or loss would be inconsistent with the initial capitalisation of decommissioning costs under IAS 16.

Update if the change in estimates of variable consideration takes place before the asset is ready for its intended use

3.61 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.

3.62 IAS 16.16 requires that the 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.

3.63 A similar requirement is included in IAS 38.27.

3.64 Furthermore, IAS 16.20 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.

3.65 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.

3.66 For example, this alternative would mean that, if a purchaser entity has acquired the rights to sell a drug and a variable payment would have to be paid to the seller if the drug is approved, such a payment would 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 is approved and can be sold). On the other hand, any variable payment related to the sale of the drug after its approval would not be included in the cost/carrying value of the acquired rights.

Update the cost to the extent that variable payments are associated with future economic benefits to be derived from the asset

3.67 During the past IFRS IC discussions, the IFRS IC developed a possible alternative for when changes in variable consideration should be reflected in the cost of an asset. Under this alternative 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.

3.68 An example of applying this criterion could be if variable payments for the acquired asset are related to an increased production capacity of an asset. To the extent the additional payment is related to an additional asset being acquired, the consideration is not considered to be variable in the Discussion Paper (see paragraph 1.35). To the extent the additional payment is related to an additional asset being acquired, the consideration is not considered to be variable in this Discussion Paper (see paragraph 1.35).

Update the cost to the extent that variable consideration is linked to the initial quality of the asset

3.69 A final possible criterion is updating the cost of an asset for the changes in estimates of liabilities for variable consideration to the extent the variable consideration is linked to the initial quality of the acquired asset. The initial quality of the acquired asset could, for example, be the capability of the acquired asset doing what it is supposed to do.

3.70 If variable consideration is not linked to the quality of the asset (e.g., if it is instead linked to the usage of the asset), the changes in estimates of variable payments would be recognised in profit or loss.

3.71 This criterion could be applicable if there is uncertainty about the quality of the asset acquired in exchange for payment in variable consideration. Accordingly, if an asset of poor quality is acquired, the consideration to be paid and the cost of an asset ought to be low and vice versa. As such, the variable consideration might be deemed to be representative of the appropriate cost of the asset. And any changes in the estimate of variable consideration should therefore be reflected in the cost of the acquired asset.

3.72 Examples of variable consideration that would be linked to the initial quality of the acquired asset are a) if the purchaser would have to pay an additional amount if an acquired drug would be approved by the health authorities, and b) 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.

Qualitative characteristics of useful information for the Alternatives

3.73 The qualitative characteristics of useful information for the Alternatives on how to treat changes in an estimate of variable consideration are presented in Table 3.2 below. The list is not exhaustive. In addition, as noted in Chapter 1, this Discussion paper assumes there will be accompanying disclosures for each Alternative for recognition and measurement requirements for an asset acquired in exchange for variable consideration. However, this Discussion Paper does not assess the incremental effects of disclosures. In other words, the assessment in the table does not consider the additional contribution that disclosures would have on the characteristics of useful information.

3.74 The factors considered in the assessment of the qualitative characteristics of useful financial information included in Table 3.2 below are:

a) *Relevance:*

(i) To provide reported information that is relevant for financial-statements users' assessment of the amount, timing, and uncertainty of the future net cash inflows and their assessment of stewardship, the following factors are considered:

a. *Whether the Alternative reflects changes in variable consideration related to a particular period in that reporting period.* If variable consideration depends on factors relating to a particular period, the related income or expenses should be recognised in that period. In effect, under these circumstances, the change in a recognised liability for variable consideration should be recognised in profit or loss in the period it occurs instead of being reflected in the measurement of the acquired asset.

On the other hand, if the change in a liability for variable consideration is not related to a particular period, it should be reflected in the measurement of the acquired asset instead of being recognised in profit or loss. The latter treatment would create volatility in profit or loss without conveying relevant information.

b. *Whether the Alternative matches income or expenses related to variable consideration to future income generated by the acquired asset.* If variable consideration is related to future cash flows expected to be derived from the acquired asset, the recognition of the remeasurements of the recognised liability should be matched with the income generated by the acquired asset. This could be achieved by reflecting the changes in a recognised liability for variable consideration in the cost of the acquired asset and thereafter through subsequent-period amortisation and depreciation expenses. In this way, the change in the liability would be reflected in profit or loss as the future economic benefits embodied in the asset are consumed.

It is also worth noting that when amortisation/depreciation expenses reflect the consumption of the economic benefits embodied in an acquired asset whose cost has been updated for changes in estimates of variable consideration, the timing of recognition of these expenses may not perfectly match the timing of income generated by the acquired asset. Nevertheless, the pattern of recognition of the amortisation/depreciation expenses could still be a reasonable reflection of the pattern of consumption of the economic benefits of the asset.

(ii) *Whether the Alternative can result in counterintuitive information.* Recognising a gain (decrease in a liability for variable consideration) when there is a decline in expected future cash flows to be derived from the acquired asset and vice versa might be considered counterintuitive and could lessen the relevance of the information provided. As shown in Table 3.2, counterintuitive information could arise when a liability for variable consideration is recognised, if it varies positively with the expected future cash flows to be derived from the acquired asset, and if the changes in the liability are recognised in profit or loss instead of being reflected in the measurement of the acquired asset. In other words, it might be considered counterintuitive when increases/decreases in the expected future cash flows of an acquired asset occur during the reporting period that a loss/gain from remeasurements of liabilities for variable consideration is recognised.

b) *Faithful representation/verifiability/comparability.* For these information characteristics, it is considered whether each of the alternatives could result in significant subjective judgements on whether the cost of an asset should be updated. These subjective judgements could make it difficult to reach a consensus that a particular depiction is a faithful representation, and this could reduce the verifiability of the reported liabilities. In the same vein, comparability could be adversely affected to the extent similar economic transactions would be accounted for differently across entities.

c) *Costs for preparers*, an assessment is made on how costly it will be for preparers of financial statements to generate the information required under each Alternative.

Table 3.2 Assessment of the qualitative characteristics of useful information for the Alternatives

Information characteristic	Alternative 1	Alternative 2	Alternative 3: Updating cost under certain circumstances			
	Not updating cost of the asset	**Always updating cost of the asset**	**Criterion A** Updating the cost of the asset for variable consideration included in the initial measurement of the cost of the asset	**Criterion B**[46] Updating the cost of the asset until the asset is ready for its intended use	**Criterion C**[46] Updating the cost of the asset if the variable consideration is associated with future economic benefits to be derived from the asset	**Criterion D** Updating the cost of the asset to the extent the variability is linked to the initial quality of the asset
Relevance	Under what circumstances will changes in variable consideration that depends on factors relating to a particular period be recognised in that period?					
Relevance	Always	Never	When a liability for variable consideration is not included in the initial measurement of the cost of the asset	When the changes take place after the asset is ready for its intended use	Always	When the variable consideration is not linked to the initial quality of the acquired asset
Relevance	Under what circumstances will changes related to future cash flows expected to be derived from the acquired asset be matched with or reflected in the depreciation/ amortisation expenses recognised in subsequent periods after the cost of the acquired asset is updated for remeasurements of the liability for variable consideration?					
Relevance	Never	Always	When a liability for variable consideration is included in the initial measurement of the cost of the asset	When the changes take place before the asset is ready for its intended use	Always	When the variable consideration is linked to the initial quality of the acquired asset
Relevance	Could the Alternative result in counterintuitive information (i.e., recognising a gain/loss due to the decrease/increase in the estimate of a liability for variable payment when there is a decline/improvement in the expected future cash flows of an acquired asset) as explained in paragraph 3.74a)(ii)?					
Relevance	Yes	No	Yes, if a liability for variable consideration is not included in the initial measurement of the cost of the asset	Yes, when changes take place after the asset is ready for its intended use	No	Yes, if the variable consideration is not linked to the initial quality of the acquired asset
Faithful representation/ verifiability/ comparability	Would the Alternative require the use of significant judgement?					
Faithful representation/ verifiability/ comparability	No, all changes in variable consideration would be reflected in profit or loss	No, all changes in variable consideration would be reflected in the cost of the asset	Only to the extent what is covered in the initial estimate of variable consideration is uncertain	Determining when an asset is ready for its intended use could be subjective	It could be subjective to determine what is associated with future economic benefits to be derived from the asset. An example is provided in the footnote[47].	It could be subjective to assess whether changes in the variable consideration are linked to the initial quality of the asset or not.

46 Some consider that this is not a criterion, but it reflects the limitations that exist in current requirements.

47 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?

Information characteristic	Alternative 1	Alternative 2	Alternative 3: Updating cost under certain circumstances			
	Not updating cost of the asset	**Always updating cost of the asset**	**Criterion A** Updating the cost of the asset for variable consideration included in the initial measurement of the cost of the asset	**Criterion B[46]** Updating the cost of the asset until the asset is ready for its intended use	**Criterion C[46]** Updating the cost of the asset if the variable consideration is associated with future economic benefits to be derived from the asset	**Criterion D** Updating the cost of the asset to the extent the variability is linked to the initial quality of the asset
Costs for preparers	Recognising changes in estimates in profit or loss may be less costly than updating the cost of an asset. This is because an entity would not need to continuously link obligations with the asset.	Alternative 2 may be more costly to apply than Alternative 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.	Criterion A would be more costly to apply than Alternative 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.	Applying Criterion B would likely be more costly than Alternative 1 before the asset is ready for its intended use and thereafter there ought to be no difference with Alternative 1.	Criterion C may be more complex to apply for preparers compared to Alternative 1 as it would require judgement related to whether some (all) changes in estimates of variable consideration should either be reflected in the cost of the acquired asset or recognised in profit or loss. Also, similar to Alternative 2, the link between liabilities and acquired assets needs to be established.	Criterion D may be more complex to apply for preparers compared to Alternative 1 as it would require judgement related to whether some (all) changes in estimates of variable consideration should either be reflected in the cost of the acquired asset or recognised in profit or loss. Also, similar to Alternative 2, the link between liabilities and acquired assets needs to be established.

CHAPTER 4: GENERAL IFRS REQUIREMENTS AND STANDARD-SETTING IMPLICATIONS

The first part and primary focus of the Discussion Paper (Chapters 2 and 3) has provided alternatives/principles for requirements for the liability recognition and measurement of the acquired asset issues where there is diversity in practice *due to differences and difficulties with the interpretation of existing IFRS requirements. The alternatives proposed in the first part of the Discussion Paper can aid narrow-scope amendments to IFRS requirements related to variable consideration transactions or be considered if the IASB decides to add a variable consideration project to its technical agenda at a future date.*

The second part of the Discussion Paper consisting of this Chapter (and Appendix 2) complements the earlier two chapters by reviewing the general IFRS requirements for accounting variable consideration to inform possible standard-setting responses. *Specifically, this Chapter (and Appendix 2) assess the consistency (or lack thereof) of the general requirements for accounting for variable consideration to inform 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. Alternatively, whether the IASB should address the gaps and inconsistencies on a Standard-by-Standard basis (e.g., amending IAS 16 and IAS 38) as suggested by some respondents to the IASB Third Agenda Consultation.*

The Chapter presents the advantages and disadvantages of the possible standard-setting responses including cost-benefit considerations, timeliness and anticipated impacts on the usefulness of reported information (e.g., on comparability). In addition to the alternatives for requirements presented in Chapters 2 and 3, the possible standard-setting responses (i.e., either to develop a unified set of principles or a Standard-by-Standard amendment) could be applied to address the liability recognition and measurement of acquired asset issues. Moreover, this Chapter reviews matters of note on the requirements for transactions that are outside the scope of Chapters 2 and 3 (e.g., accounting requirements for non-financial liabilities for variable payments) that would also need to be considered if a standard-setting project occurred.

The analysis in this Chapter 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 IFRS Standards except in a few cases where conceptual reasons, cost-benefit considerations, or the objective of achieving consistency across some Standards is cited. Hence, differences could also arise because Standards were developed at different points in time or under different prevailing circumstances. These could also reflect that different IFRS Standards and Interpretations have been developed taking account of the specificities of different transaction types.*
- *There is incremental complexity in accounting for variable consideration transactions paid through the transfer of a non-financial asset including by performing a service and the related non-financial liabilities. Nonetheless, the alternatives for requirements for the recognition of liabilities and measurement of acquired assets outlined in Chapters 2 and 3 could be applicable for these transactions.*

INTRODUCTION

4.1 The first part of the Discussion Paper (Chapters 2 and 3) addresses areas known to have diversity in practice in accounting for variable consideration. The analysis and alternatives presented in the first part of the Discussion Paper can either aid narrow-scope amendments to IFRS requirements related to variable consideration transactions with a component or be considered should the IASB decide to add a variable consideration project to its technical agenda at a future date.

4.2 The second part of the Discussion Paper consisting of this Chapter (and Appendix 2) complements the first part by analysing the general requirements for accounting for variable consideration (i.e., requirements applicable to the variable transactions in Chapters 2 and 3 and those that are not) to further inform possible future standard-setting responses.

4.3 This Chapter consists of the following sections:

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

b) Assessment of 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) Matters of note on accounting requirements for transactions outside the scope of Chapters 2 and 3; and

d) Conclusion and standard-setting implications.

ASSESSMENT OF THE CONSISTENCY OF RECOGNITION AND MEASUREMENT REQUIREMENTS FOR LIABILITIES FOR VARIABLE CONSIDERATION

4.4 As noted, this Chapter (and Appendix 2) review the general IFRS recognition and measurement requirements for liabilities for variable consideration encompassing both the transactions discussed in Chapter 2 (i.e., variable consideration to be paid in cash or another financial instrument and where the variable consideration depends on the purchaser's future actions) and transactions outside the scope of Chapter 2 (e.g. where variable consideration is paid by the transfer of a non-financial asset and/or where variable consideration does not depend on the purchaser's future actions). The purpose of this analysis is not to broaden the scope and primary focus of the Discussion Paper addressed in Chapters 2 and 3 but to assess the consistency (or lack thereof) of applicable IFRS requirements for liabilities for variable consideration in a manner that can inform possible future standard-setting responses. For instance, identifying the inconsistencies of current requirements can inform the development of a unified set of principles if this was to occur in the future.

4.5 As highlighted in Chapter 2, the applicable IFRS requirements for liabilities for variable consideration are:

a) IAS 19 when respectively applied for short-term and long-term employee benefits, and 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 fixed payments, variable lease payments that depend on an index or rate, and residual value guarantees. IFRS 16 also has guidance for the remaining variable payments (e.g., when variable payments depend on future performance or usage of an asset);

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.

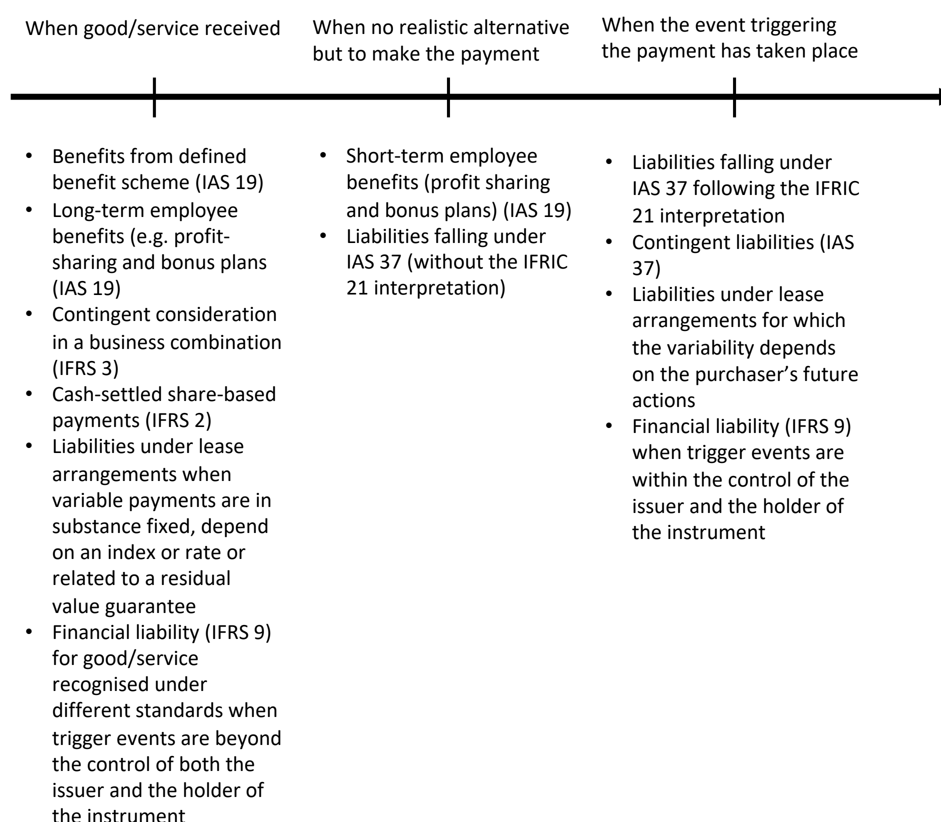
4.6 Appendix 2 has details of the recognition and measurement requirements of the above Standards except for IAS 32/ IFRS 9, whose details are included in Chapters 2 and 3.

4.7 Also included in Appendix 2 are the recognition and measurement requirements of Standards that can be applied analogous (i.e., IFRS 15 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

4.8 Figure 4.1 summarises the differing recognition requirements across Standards showing variation in existing IFRS Standards on the recognition of variable consideration.

Figure 4.1 Summary of the differing recognition requirements across Standards



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

4.10 Only IFRS 16 differentiates the recognition requirements for when the variable payment depends on the purchaser's future actions (i.e., liability recognised when the payment trigger occurs) from the requirements of when it does not (i.e., liability recognised when purchaser acquires control of right-of-use asset). However, these requirements can result in some grey areas. For example, whenever variable payments do not depend on the purchaser's future actions and are also not based on an index or rate (e.g., an airport retailer whose variable rentals depend on the volume of passenger traffic flowing through the airport lounges).

4.11 *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.

4.12 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 (i.e., the "highly probable that a significant reversal will not occur" constraint).

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

a) Some liabilities are measured at fair value under IFRS 13 *Fair Value Measurement* (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

4.14 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 BC55).
IFRS 2	To be consistent with the requirements in IAS 19 (paragraph BC245).
IFRS 3	An acquirer's agreement to make contingent payment is the obligation event in a business combination transaction (paragraph BC346).
IFRS 16	Residual value guarantees and variable lease payments that are either in-substance fixed payments or depend on an index or rate are included in the lease liability in the initial measurement at the commencement of the lease for the following reasons: IFRS 16.BC164 notes that variable lease payments that are in-substance fixed lease payments are payments that, despite their variability, are unavoidable and, thus, are economically indistinguishable from fixed lease payments. IFRS 16. BC165 notes the IASB decided to include variable lease payments that depend on an index or a rate in the measurement of lease liabilities because they are unavoidable and do not depend on any future activity of the lessee. Any uncertainty relates to the measurement of that liability and not to its existence. IFRS 16.BC170 notes that residual value guarantees are similar to variable lease payments that depend on an index or rate.
Requirements under which a liability is not recognised when a good or service is received	
IAS 37	No reasons are found in the Basis for Conclusions for the requirements in IAS 37.
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 BC17).
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 BC169).

ASSESSMENT OF CONSISTENCY IN REQUIREMENTS FOR INCLUSION OF VARIABLE CONSIDERATION IN THE MEASUREMENT OF ACQUIRED ASSETS

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

4.16 As can be seen in Appendix 3, the IFRS IC has mainly addressed issues related to the measurement of acquired PPE, intangible assets, right-of-use leased assets, and service concession arrangements where the operator has to make variable payments to the grantor in exchange for an intangible asset. 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 include inventories, investments and financial assets, investment properties, and biological assets.

4.17 Appendix 2 details the IFRS recognition and measurement requirements (or mostly lack thereof) for the 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 *Separate Financial Statements*, IAS 41 *Agriculture*, IFRS 6 *Exploration for and Evaluation of Mineral Resources*, 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, except for trade receivables, at fair value and their subsequent measurement at either amortised cost or fair value.

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

4.19 Similar to the 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 for updating the initial measurement of acquired assets.

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

4.20 The reasons for the current IFRS requirements and the IASB Exposure Draft proposed guidance for regulatory assets and regulatory liabilities are summarised in Table 4.2 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 the acquired assets

<table>
<tr><th>Current and possible future requirements</th><th>Reasons in the Basis for Conclusions</th></tr>
<tr><td colspan="2">Reasons provided for updating the cost of the acquired asset for changes in estimates of variable consideration</td></tr>
<tr><td>IAS 16 / IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities
(There is a view that these are generally not variable consideration components as defined in this Discussion Paper but it could be if it is an obligation to the seller of the PPE that arose at acquisition)</td><td>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 BC15 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 BC11).</td></tr>
<tr><td>IFRS 16</td><td>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 and residual value guarantees), the IASB 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 BC192).</td></tr>
<tr><td>Regulatory Assets and Regulatory Liabilities IASB Exposure Draft</td><td>The IASB selected modified historical cost as the measurement basis because in the IASB’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).</td></tr>
<tr><td colspan="2">Reasons provided for not updating the cost of the acquired assets for changes in estimates of variable consideration</td></tr>
<tr><td>IFRS 3</td><td>The IASB 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 BC357).</td></tr>
<tr><td colspan="2">No reasons provided</td></tr>
<tr><td>IAS 2/ IAS 16 / IAS 38
Variable consideration only relates to rebates and trade discounts under IAS 2/ IAS 16 /IAS 38</td><td>No reasons are included in the Basis for Conclusions.</td></tr>
<tr><td>IFRS 9</td><td>No reasons are included in the Basis for Conclusions.</td></tr>
</table>

MATTERS OF NOTE ON ACCOUNTING REQUIREMENTS FOR TRANSACTIONS OUTSIDE THE SCOPE OF CHAPTERS 2 AND 3

4.24 Chapters 2 and 3 present alternatives for requirements related to the two issues where there is a current diversity in practice with a focus on variable consideration paid in cash or another financial instrument. These alternatives can inform future targeted narrow-scope amendments or any standard-setting project on variable consideration.

4.25 However, the scope of a possible future standard-setting project may have to also cover transactions that are not considered in Chapters 2 and 3 including variable consideration paid through the transfer of non-financial assets, for business combinations under IFRS 3, and the acquisition of multiple-element assets (e.g., each part of an item of PPE

with a cost that is significant relative to the total cost of the item and is depreciated separately in accordance with IAS 16.43, or a tangible asset with associated rights (intangible assets)). For this reason, this Chapter also presents aspects of note that may arise for the requirements for these transactions that are outside the scope of Chapters 2 and 3. Along with the alternatives proposed in Chapters 2 and 3, solutions to these aspects could be considered in a future possible standard-setting project.

Variable consideration paid through the transfer of a non-financial asset

4.26 As mentioned in Chapter 1 in the discussion of the scope, variable payments made through the transfer of a non-financial asset (including by performing a service) are not the primary focus of this Discussion Paper. EFRAG is not aware of any related questions to the IFRS IC but this could simply be a reflection of these transactions not being currently pervasive.

4.27 Nonetheless, variable consideration transactions that are paid through the transfer of a non-financial asset including services 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. Thus, there could be transactions where an asset is acquired in exchange for variable consideration to be paid in a non-financial asset such as a crypto-asset (i.e., the quantity of crypto-asset to be paid can vary depending on a predetermined factor). It is worth noting that 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 either an intangible asset or inventory if held in the ordinary course of business under IFRS requirements).

4.28 Illustratively, a 2021 Journal of Accountancy article[48] (Murphy, M.L. 2021) 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 tokens by the purchaser to others) meaning the purchaser has variable payments to the seller.

4.29 Below is an analysis of aspects of note for transactions where variable payments are made through the transfer of a non-financial asset or by the performance of a service. Specifically, around identifying the variable consideration component and gaps in the related IFRS requirements.

Identifying the variable consideration component

4.30 As stated in Chapter 1, this Discussion Paper's definition of variable consideration refers to a change in the quantity (and not change in unit price/value) of the asset or service to be transferred in exchange for an acquired asset. One of the accounting issues would be determining what is variable consideration in monetary equivalent terms when a payment is made through the transfer of a non-financial asset including services. This issue does not exist for functional currency cash-settled transactions. For example, unlike consideration that is to be paid in cash 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.

4.31 Thus, it has to be assessed whether the variable consideration paid in a non-financial asset or by performing a service is equivalent to variable consideration if the payment was settled in cash in the functional currency. And that the components of variability attributable to changes in unit price/value are not accounted for as variable consideration. This issue is also discussed in Chapter 1 and is described as 'changes in the value of consideration' (see paragraphs 1.13 and 1.14). It is noted that the 'changes in value of consideration' issue would also arise for some financial instruments in the scope of Chapter 2. For instance, for variable payments through the transfer of foreign currency, equity, and bonds. In effect, the 'changes in the value of consideration' issue would be at play for all payments that are not made in cash in the purchaser's functional currency.

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

4.32 However, it is easier to determine the 'equivalent variable consideration if the payment was settled in cash in the functional currency'[49] for financial assets including (foreign currency, equity, and bonds) than it is to do so for units of non-financial assets. This is because entities can often readily determine the fair value of foreign currency, equity, and bonds as these asset classes typically (albeit not always) have observable active markets. But it is much more challenging to reliably and readily determine the fair value of units of non-financial assets as these do not have observable, active markets. Therefore, for the latter, it is relatively very challenging to determine the 'equivalent variable consideration if the payment was settled in cash in the functional currency'.

4.33 In summary, **the 'changes in the value of consideration' issue applies to all forms of variable payments except for cash paid in the functional currency, and it introduces complexity as noted in Chapter 1. There is additional complexity on this issue for variable payments made through the transfer of a non-financial asset. This is due to the difficulties in reliably and readily determining the appropriate fair value of each additional unit** of the non-financial asset being transferred so as to assess the 'equivalent variable consideration if the payment was settled in cash in the functional currency'. As mentioned in Chapter 1, due to the associated complexity, this issue has been excluded from the scope of the Discussion Paper's primary focus. However, this issue would likely have to be considered in any possible future standard-setting project.

Non-financial liability recognition requirements

4.34 Chapter 2 highlighted the issue[50] that has led to diversity in practice in accounting for financial liabilities for variable payments that depend on the purchaser's future actions (the liability recognition issue). Similarly, as discussed below, this issue could arise non-financial liabilities for variable payments that depend on the purchaser's future action due to the lacking or only implicit related IFRS requirements.

4.35 Unlike IAS 32 which at least has explicit requirements for the recognition of financial liabilities for variable payments that do not depend on the entity's future actions, there are no explicit IFRS requirements for non-financial liabilities for variable payments irrespective of whether these variable payments depend on a purchaser's future actions. This situation could exacerbate the overall challenge of accounting for these items.

4.36 As noted earlier, IFRS 16 has explicit requirements for variable payments that either depend or do not depend on the entity's future actions. Hence, it is implicit that IFRS 16 would be applicable when the variable payments that are within the scope of the Standard are made through the transfer of a non-financial asset and, where as a result, there are non-financial liabilities for variable payments.

4.37 It is also implicit that non-financial liabilities for variable payments could be within the scope of other transaction-specific applicable Standards (i.e., IAS 19 and IFRS 3) or within the scope of IAS 37 (including IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*) (i.e., for obligations to restore or dismantle assets at a future date) if they do not fall in the scope of other applicable Standards.

4.38 However, all these applicable Standards do not explicitly provide differentiated requirements for financial and non-financial liabilities for variable payments. Furthermore, unlike IFRS 16 requirements, other applicable Standards (IAS 19, IAS 37 and IFRS 3) do not distinguish between whether or not the recognition of a liability depends on a purchaser's future actions. It could be that these other Standards were developed under the assumption[51] that the recognition of a liability should not depend on whether the variability of payments depends on a purchaser's future actions. Nevertheless, as highlighted in Chapter 2, the main challenge in practice is in determining the timing of recognising liabilities for variable payments that depend on a purchaser's future actions.

49 Determining the equivalent variable consideration if the payment was settled in cash in the functional currency for variable payments made through the transfer of non-cash assets/services, requires knowledge of the fair value of a unit of the non-cash asset/service being transferred at the time of asset acquisition, and at the time of changes in the estimates of quantity of non-cash asset/service. The changes in quantity deemed to be variable consideration should be adjusted for the changes in unit price of the non-cash asset/service.

50 As described in Chapter 2, the diversity in practice in the recognition of the financial liability for variable payments made in cash or another financial instrument that depend on the purchaser's future actions arises due to the different interpretations of the IAS 32 requirements.

51 This could be an implicit assumption made by the IASB at the time of developing the respective Standards. The reasons for not having differentiated requirements for liabilities that depend on a purchaser's (entity's) future actions across these other Standards are not stated in the Basis for Conclusions.

4.39 Of note, in March 2017, the IFRS IC had discussions in relation to accounting for a liability representing the obligation of an entity to deliver gold in exchange for an asset or the right to receive gold (i.e., for commodity loans). IFRS IC concluded that it was not clear what Standard (if any) would cover an obligation to deliver a fixed amount of gold, therefore an accounting policy choice[52] (i.e., IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*) could be applied. However, the fact pattern of the commodity loans question related to a fixed commitment and the IFRS IC did not provide a view on the appropriate accounting treatment if it had been a variable commitment.

4.40 **In the absence of explicit IFRS requirements for the recognition of non-financial liabilities for variable payments, the two alternatives proposed in Chapter 2 for financial liabilities that are derived from the Conceptual Framework definition of a liability and its accompanying guidance could also guide the possible development of requirements for the recognition of non-financial liabilities for variable payments.**

Measurement of the acquired asset - remeasurements of non-financial liabilities for variable payments

4.41 Chapter 3 discusses the different interpretations[53] and diversity in practice on whether the remeasurements of a liability for variable payments should be included in the cost of the acquired asset (i.e., the measurement of the acquired asset issue). Because of the interlinkage between and the need for consistency in the discussion of liability recognition and asset measurement, Chapter 3 focuses on the remeasurements of financial liabilities that are under the scope of IAS 32/ IFRS 9.

4.42 Nonetheless, as noted in the description of scope in Chapter 1 – paragraph 1.22, this issue could also arise for the remeasurements of non-financial liabilities for variable payments.

IFRS requirements for measurement of assets

4.43 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. IAS 16.24 and IAS 38.45 respectively address the measurement of non-monetary exchanges in the initial measurement of PPE and intangible assets in the event of an exchange[54] of PPE and intangible assets for non-monetary asset(s). However, these particular requirements do not explicitly address whether to include variable consideration in the initial and subsequent measurement of acquired assets.

4.44 Only IFRS 16 provides explicit requirements for the inclusion of variable payments in the definition of cost/initial measurement of acquired right-of-use assets. But these requirements do not explicitly refer to remeasurements of non-financial liabilities.

4.45 A financial asset could also be acquired in exchange for transferring a non-financial asset. As noted in Chapter 1, IFRS 9 requires the initial measurement of financial assets at fair value and subsequent measurement at either amortised cost or fair value. Accordingly, the measurement of the acquire asset issue which arises for assets measured at cost is not relevant to situations in which the purchaser acquires a financial asset that would be initially measured at fair value (except for trade receivables). Hence, the measurement of the acquired asset issue does not apply to acquired financial assets regardless of the form of variable payments.

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52 IFRIC Update, March 2017, https://www.ifrs.org/content/dam/ifrs/news/updates/ifrs-ic/2017/ifric-update-march-2017.pdf

53 As noted in Chapter 3, this issue arises due to conflicting IFRS requirements and interpretations of the definition of cost. Specifically, IFRS 9 would require the remeasurement of the financial liability to be recognised in profit or loss. However, IAS 16, IAS 38 and IFRIC 1 requirements would support updating the cost of an acquired asset for the remeasurements of the financial liability.

54 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.

4.46 **In summary, there are no explicit requirements for the remeasurements of non-financial liabilities for variable payments and whether these should be included in the cost of the acquired asset. Hence, the three alternatives proposed in Chapter 3 that are derived from the definition of cost in the Conceptual Framework and the existing IFRS requirements could also guide the possible development of requirements for the remeasurements of non-financial liabilities for variable payments.**

Incremental complexity - measurement

4.47 As enumerated in the 2019 IVSC *IVS 220 Non-Financial Liabilities* Exposure Draft[55], the measurement/valuation of non-financial liabilities is more challenging than it is for financial liabilities for variable payments.

4.48 The challenges of determining the value of non-financial liabilities arise from their highly illiquid markets (i.e., due to the unique nature, limited transaction volume, and fulfilment requirements of non-financial liabilities). There are other factors[56] that distinguish non-financial liabilities from financial liabilities making it harder to value the former.

4.49 These measurement challenges would extend to the update of the cost of acquired assets for changes in estimates in variable consideration (i.e., remeasurements of the non-financial liabilities for variable payments).

Accounting for business combinations under IFRS 3

4.50 As noted in Chapter 1, notwithstanding that IFRS 3 has related requirements, variable consideration in exchange for the acquisition of a business is outside the scope of this Discussion Paper due to the complexity arising from the allocation of liabilities remeasurement to goodwill, acquired assets and assumed liabilities (i.e., excluded for simplicity). Nonetheless, whether the alternatives for liabilities recognition and acquired asset measurement requirements presented in Chapters 2 and 3 are applicable toward variable consideration in exchange for business acquisition, can be evaluated further during a possible future standard-setting project on variable consideration.

Multiple-element acquired assets, step acquisitions and hybrid payments

4.51 As noted in Chapter 1, the Discussion Paper's scope neither includes the acquisition of multiple-element assets (e.g., each part of an item of PPE with a cost that is significant relative to the total cost of the item and is depreciated separately or acquisition of tangible assets with rights) nor does it include step or staggered-acquisitions of different portions of an asset. As mentioned, it can be challenging to distinguish between transactions for variable consideration and those involving step acquisitions.

4.52 If multiple-element acquired assets were included in the scope of a possible future standard-setting project, it would be necessary to develop requirements for determining the allocation of the variable consideration to different asset components during the initial and subsequent measurement. Such an allocation would be necessary because the individual elements of the multiple-element asset may have different patterns of consumption of economic benefits. Also, the question of whether to subsequently update the cost of the recognised acquired asset is not relevant for the changes in estimates of the variable consideration attributable to unrecognised embedded rights.

4.53 The scope of the Discussion Paper also does not include hybrid forms of variable consideration (i.e., contractual arrangements where the variable payment consists of a combination of the transfer of financial assets with non-financial assets). A possible future standard-setting project would need to consider the bifurcation requirements necessary to determine the respective financial liabilities and non-financial liabilities arising from such hybrid variable payments as well as any other associated complexities (e.g., the 'change in value of consideration' issue that is discussed in Chapter 1 and paragraph 4.33).

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

56 For instance, non-financial liabilities typically do not have a corresponding and offsetting asset recognised by the counterparty, whereas financial liabilities typically do. As such it is harder to find comparative values whilst valuing non-financial liabilities

4.54 In summary, a possible future standard-setting project on variable consideration would likely have to consider the noted complexities that could arise from multiple-element contractual arrangements (multiple-element acquired assets, and hybrid forms of variable consideration).

CONCLUSION AND STANDARD-SETTING IMPLICATIONS

Overall assessment of the consistency of requirements

4.55 The review of IFRS requirements in Chapters 2 and 3 related to the 'liability recognition' and 'measurement of the acquired asset' issues as well as the review of general IFRS requirements for variable consideration in this Chapter and Appendix 2 have shown the inconsistencies and absence of explicit requirements. This finding supports the need for the development of a unified set of principles.

4.56 As shown in Tables 4.1 and 4.2 above; there are usually no reasons provided in the Basis for Conclusions for the IFRS requirements for the recognition of liabilities for variable consideration and measurement of acquired assets. Nonetheless, there are a few cases where reasons are provided including conceptual reasons (e.g., the inclusion of variable lease payments that depend on an index or rate in the lease liability measurement), cost-benefit considerations (that was provided for the IFRS 16 exclusion of variable lease payments that depend on future performance or usage of an asset from the lease liability measurement), and 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).

4.57 Moreover, differences in requirements could arise because these Standards were developed at different points in time, and under different prevailing economic circumstances. It also reflects that different IFRS Standards and Interpretations have been developed taking account of the specificities of different transaction types.

4.58 As noted, except for IFRS 16, many of the applicable Standards do not have explicit requirements related to the inclusion of variable consideration in the acquired asset. This situation may lead to preparers applying an accounting policy choice and/or different Standards by analogy resulting in diversity in practice as extensively discussed in Chapter 3. Similarly, except for IFRS 16, other liabilities Standards do not have differentiated recognition and measurement for liabilities that depend on the entity's future actions.

Outcome of IASB Third Agenda Consultation

4.59 The IASB *Request for Information:* Third Agenda Consultation (the 'RFI') sought views on whether variable and contingent consideration could be included in the IASB 2022-2026 workplan. Paragraph B 80 notes that examples of transactions that may feature variable or contingent consideration include business combinations, leases, sales of goods and renderings of services, purchases and sales of tangible and intangible assets and service concession arrangements. It also notes that stakeholders reported diversity in practice in the accounting for such transactions, particularly for those transactions for which the applicable IFRS Standards provide limited specific requirements.

4.60 Paragraph B81 of the RFI highlighted the liability recognition and measurement of the acquired asset issues that are the primary focus of this Discussion Paper as being areas that were addressed by IFRS IC in the past. It is also noted that in the March and July 2016 IFRS IC discussions, it was decided that a) the accounting for 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; and b) how an operator accounts for variable payments that it makes to a grantor when the intangible asset model in IFRIC 12 applies- were too broad for the IFRS IC to address within the confines of IFRS Standards.

4.61 In paragraph B82 of the RFI, the IASB indicated it could either a) as a medium-sized project, amend IAS 16, IAS 38 and IFRIC 12 due to their limited requirements on variable and contingent consideration or b) develop a consistent approach

to reporting variable and contingent consideration across all Standards. However, constituents' feedback[57] to the RFI shows that only some respondents considered variable and contingent consideration as a high priority for inclusion in the IASB agenda. Consequently, the IASB in the decision of its 2022-2026 workplan made in April 2022 removed this project from its research pipeline and it is unlikely that the topic will be undertaken by the IASB in the near term.

4.62 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 that could inform the IASB's future 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, others supporting the development of a consistent set of principles, and some suggesting the following steps to be undertaken by the IASB in any of the following ways:

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

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

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

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

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

Possible standard-setting responses

4.63 Chapters 2 and 3 have proposed possible alternatives for recognition and measurement requirements to address the liability recognition and measurement of the acquired asset issues. These alternatives are underpinned by existing requirements and the Conceptual Framework guidance and can contribute to the targeted amendments of IFRS requirements where most difficulties arise.

4.64 Beyond the mentioned proposed alternatives, some respondents to the RFI supported the development of a unified set of principles. The need for such principles is supported by the noted inconsistencies in the requirements for variable consideration across IFRS Standards. Accordingly, the advantages and disadvantages of developing a unified set of principles are provided below.

4.65 In addition, as indicated in the RFI and the views expressed by some respondents to the RFI as summarised in paragraphs 4.61 and 4.62, a Standard-by-Standard amendment (e.g., amending IAS 16, IAS 38 and IFRIC 12 or the amendment of a combination of standards) could be appropriate. Therefore, the advantages and disadvantages of a Standard-by-Standard amendment are also provided below.

4.66 Finally, as pinpointed in the analysis in paragraphs 4.24 to 4.54 on aspects of note on the requirements for transactions outside the scope of Chapters 2 and 3, there are additional complexities for these transactions that should be taken into account in any standard-setting response including if a unified set of principles for aligning IFRS requirements were developed, or a Standard-by-Standard amendment was undertaken by the IASB in the future.

57 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

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

4.67 The IASB has a project on targeted amendments of requirements for provisions under IAS 37 for liabilities and the assessment of the differences/consistency of current requirements and thereafter developing a unified set of principles can inform the IASB's thinking around the IAS 37 amendments and any other related narrow/targeted scope amendments.

4.68 A unified set of principles can contribute to the development of guidance that will ensure the relevance, comparability, consistency, and faithful representation in reporting of variable consideration transactions.

4.69 Unified principles could help address the two issues ('liability recognition' and 'measurement of the acquired asset') and could also address notions that need further enhancement such as the definition of cost. This Discussion Paper is seeking constituents' views on the definition of cost and the feedback received could inform the development of these unified principles.

4.70 Developing a unified set of principles 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 the need for interpretations due to a lack of clear guidance. A unified set of principles could also be applicable for other transactions that are not in the scope of Chapters 2 and 3 (e.g., when the liability for variable consideration would not be covered by IAS 32/IFRS 9 and when multiple assets are acquired).

4.71 The development of suitable approaches could be framed as principles that can be applied differently depending on the specific characteristics of transactions 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 for variable consideration

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

4.73 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.

4.74 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. Tailoring the requirements may also help provide more useful information for specific transactions. A one-size-fits-all approach, despite its simplicity, is unlikely to provide useful information in all circumstances.

4.75 As noted, the variable consideration was not identified as a high-priority topic during the consultation on the RFI for the IASB 2022-2026 workplan. Hence, the formulation of a "conceptually correct" unified set of principles may have limited utility.

Advantages of a Standard-by-Standard review

4.76 As discussed in the 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).

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

4.78 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

4.79 A Standard-by-Standard review may take a lot longer to provide solutions that address both the liability recognition issue and measurement of the acquired asset issues.

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

APPENDIX 1: DIAGRAMMATIC OVERVIEW OF CURRENT REQUIREMENTS

Appendix 1 provides a diagrammatic overview of current requirements (or lack thereof) for liabilities recognition and remeasurements. It illustrates the application of these requirements to a selection of examples of common types of variable consideration transactions. This overview of requirements mapped to the illustrative examples further illustrates where there are lacking, different and inconsistent requirements as discussed in Chapters 2, 3 and 4 (and Appendix 2). It illustrates but is not limited to the requirements for examples of transactions within the scope of Chapters 2 and 3.

OBJECTIVE

A1.1 The diagrams below (Figures A 1.1 to A 1.4) show the requirements for liabilities recognition and remeasurements that are related to the most common types of variable consideration. The diagrams show the requirements related to:

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 (■).

ILLUSTRATIVE EXAMPLES COVERED

A1.2 To illustrate how the IFRS requirements for liabilities recognition and remeasurements (IAS32/IFRS 9, IFRS 2, IAS 19, IFRS 16 and IFRS 3) would be applied to different examples of variable consideration transactions, the below examples are mapped to the diagrams of IFRS requirements (Figures A 1.1 to A 1.4):

a) 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 **Figure A1.2 IAS 32/ IFRS 9 Diagram**)[58].

b) A good or service acquired in exchange for cash-settled share-based payment. For example, an entity acquires a specialised piece of PPE and promises payment in cash that will correspond to the value of five of the entity's ordinary shares in five years. (See **IFRS 2 in Figure A 1.1 Main Diagram**).

c) A business acquired in exchange for variable consideration to be paid in cash. For example, if an acquirer will have to pay an additional CU 10 million for a business should the turnover of the business in the first year following the acquisition exceed CU 20 million. (See **IFRS 3 in Figure A 1.1 Main Diagram**).

d) 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 **Figure A 1.3 IAS 19 Diagram**).

e) A right-of-use asset for 10 years is acquired. Each year an amount is paid which is adjusted by the Consumer price index (CPI). (See **IFRS 16 in Figure A 1.1 Main Diagram**).

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

f) A good or service that is acquired in exchange for a variable number of non-financial assets for which IAS 37 would apply in relation to the liability or if it is in exchange for the purchaser assuming 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 **Figure A 1.4 IAS 37 Diagram**).

Illustration of current guidance

Meaning of the symbols in Figures A1.1-A1.4

'?' ▶ there are no clear requirements on the subject.

'A' ▶ changes in the estimate of the liability are reflected in the cost of an asset.

'PL' ▶ changes in the estimate of the liability are recognised in profit or loss (hence not reflected in the cost of the acquired asset).

'R' ▶ a liability for variable consideration is generally recognised when the acquired goods or services have been received.

'N' ▶ a liability for variable consideration is generally not recognised when the goods or services are received.

Figure A1.1 Main Diagram

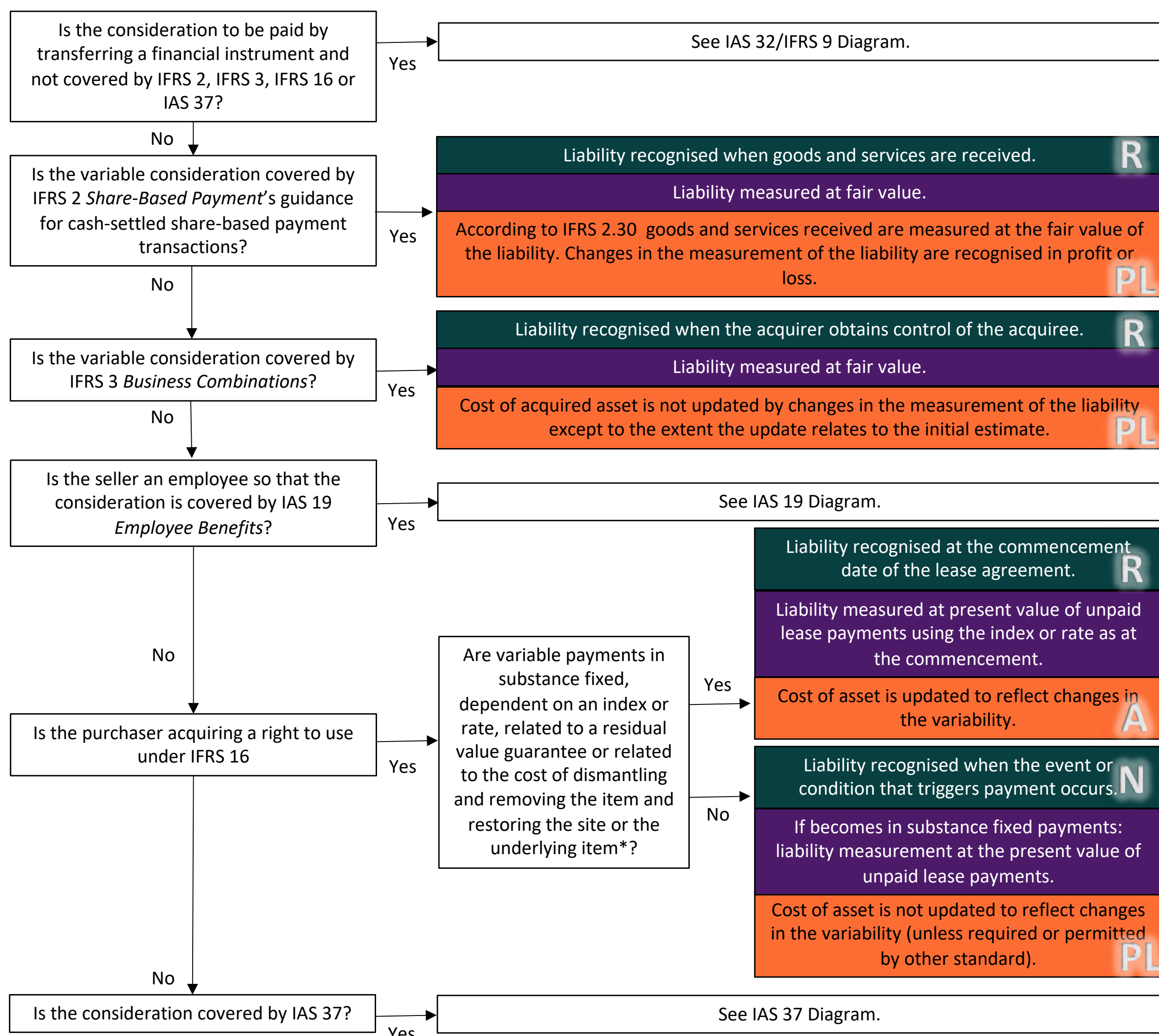


Figure A1.2 IAS 32/IFRS 9 Diagram

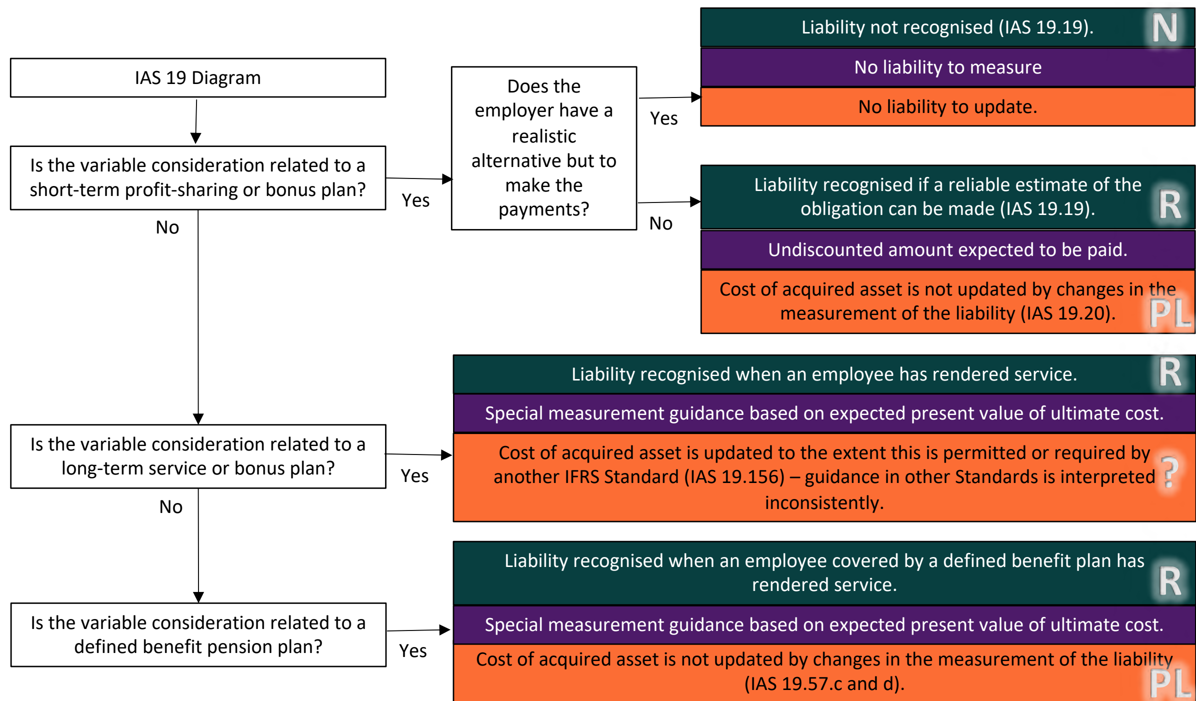


Figure A1.3 IAS 19 Diagram

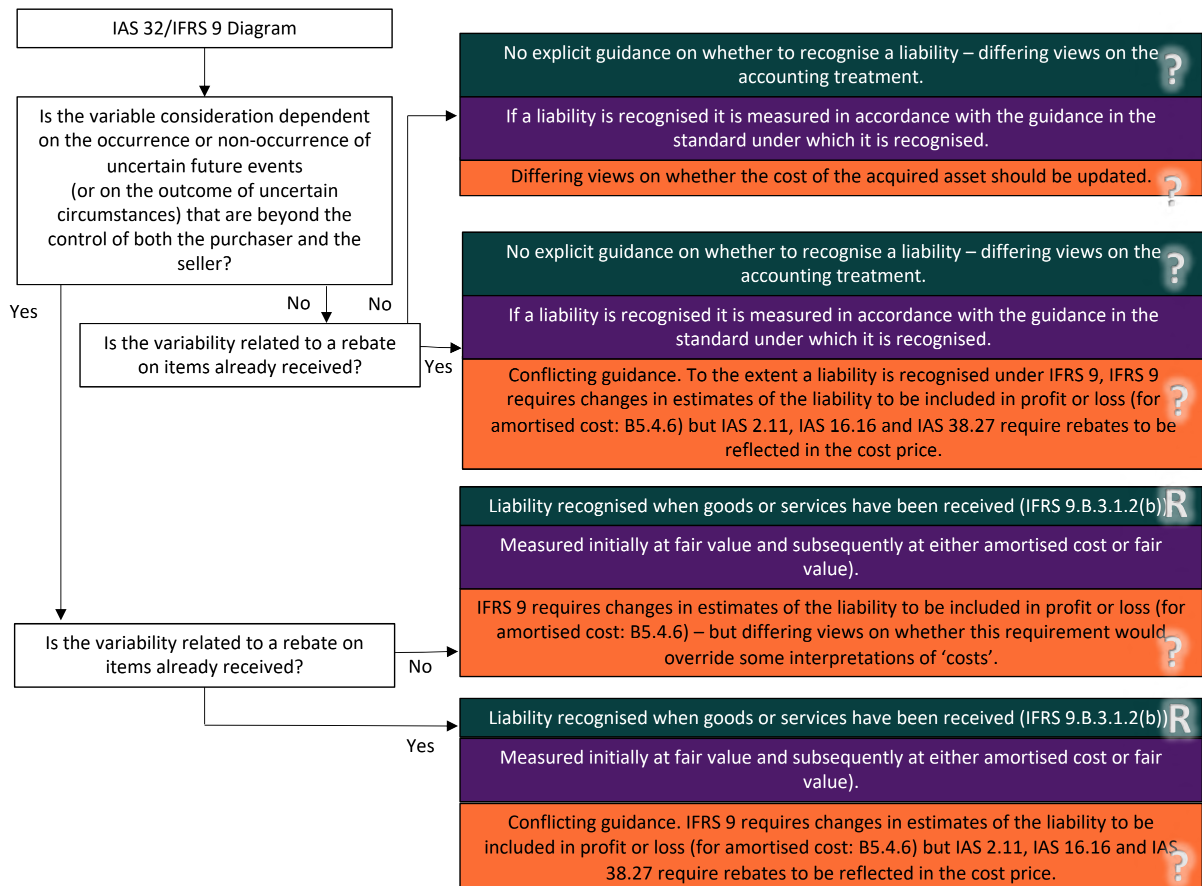
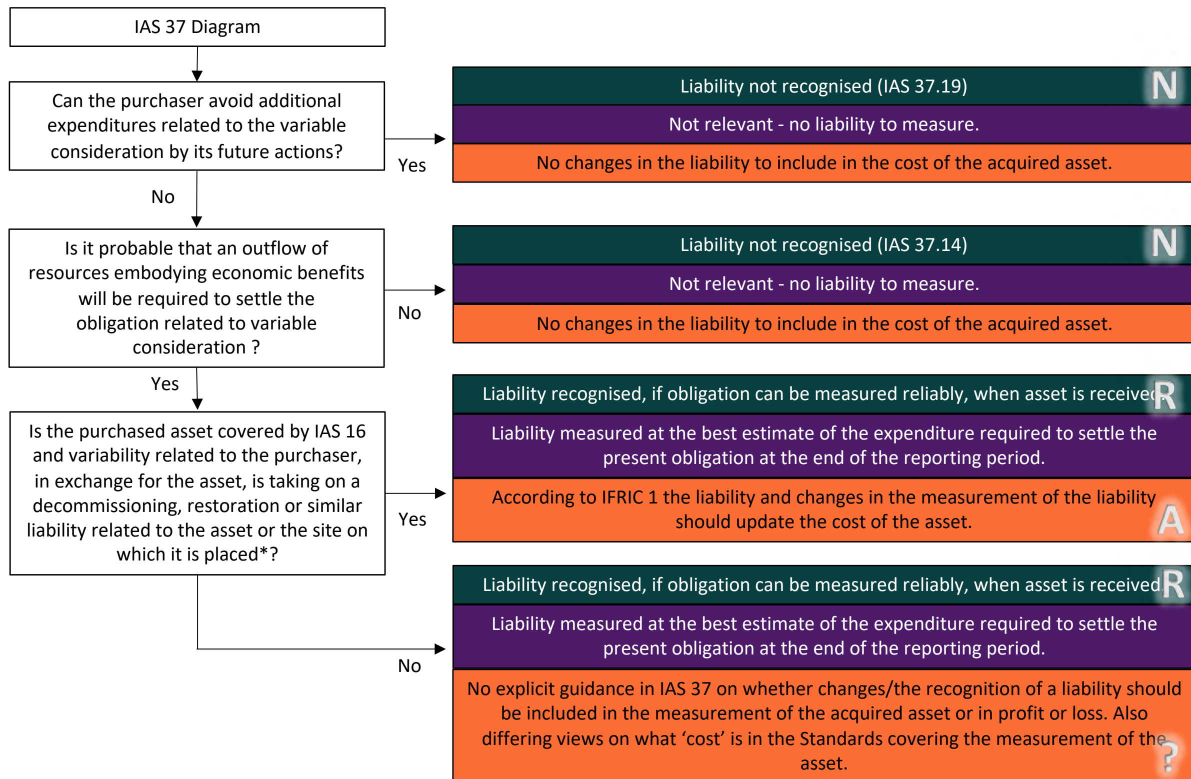


Figure A1.4 IAS 37 Diagram



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

APPENDIX 2: DETAILS OF GENERAL IFRS 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 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 either as:

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

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

Defined benefit plans

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, 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 arise 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 at 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 is 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 the acquisition date. Such changes are measurement period adjustments under IFRS 3.45-59. The acquirer can update provisional amounts recognised at the 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 the 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) is the present value of expected future payments.

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[59] whilst determining transaction price for the purposes of recognising revenue by seller entities can also 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.

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 entity 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 entity should 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 in sub-paragraph b) above, the liability of variable consideration should be measured at either the expected value or most likely amount depending on which method the purchaser entity expects to better predict the amount of consideration it will have to pay.

59 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.

d) The purchaser shall update the estimated variable consideration (including updating its assessment of whether an estimate of variable consideration is constrained as stated in sub-paragraph 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 approach could be introduced, it might not be 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 stated in paragraph A2.30 b) above was included in IFRS 15 because users of financial statements that were consulted when the Standard was developed indicated that the most relevant measure for revenue recognition in a reporting period would be one that will not result in a significant reversal of recognised amounts in a subsequent period. This is because an amount that does not reverse in the future helps users of financial statements to better predict the future revenues of an entity. However, it is questionable whether users would have the same view as they had for revenue recognition as a requirement to constrain the measurement of the liability could result in a general understatement of the reported amount. Moreover, the IFRS IC has in the past examined[60] and concluded that a complete mirroring approach would not be appropriate for the recognition of liabilities for variable consideration.

A2.32 Except for the constraint, it could be considered appropriate to 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 reduce future rates charged to customers) might be analogously applicable for the recognition and measurement of liabilities for variable consideration and the cost of the acquired asset.

A2.34 The 2021 IASB Exposure Draft *Regulatory Assets and Regulatory Liabilities* proposed 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 proposed 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.

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.

60 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

REQUIREMENTS FOR VARIABLE CONSIDERATION IN THE MEASUREMENT OF ACQUIRED ASSETS

IAS 16

A2.36 IAS 16 neither address whether variable consideration is included in the 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 the 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 a right-of-use asset includes the amount of the initial measurement of the lease liability at the commencement date. As noted in paragraph A2.24 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 the cost of a 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 Discussion Paper, 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 the 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 their scope.

APPENDIX 3: SUMMARY OF PAST IFRS INTERPRETATIONS COMMITTEE ISSUES

ISSUES RELATING TO LIABILITY RECOGNITION

Variable payments for asset purchases[61] (IAS 16 and IAS 38)

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 under the IAS 32/IAS 39 *Financial Instruments: Recognition and Measurement*/IFRS 9 requirements.

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[62].

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.

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.

61 Source: IFRS IC March 2016 Agenda Decision and March 2016 IFRS IC Staff paper

62 Source: November 2015 IFRS IC Staff paper

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[63]

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.

A3.8 In 2015, the IFRS IC Staff[64] 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[65].

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. The IFRS IC had been aware of this linkage even prior to 2016. 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).

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.

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63 Source : July 2016 IFRS IC Staff paper and July 2016 IFRS IC Agenda Decision

64 Source : November 2015 IFRS IC Staff paper 02A

65 Source : November 2015 IFRS Update

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:

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

d) 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 to this issue.

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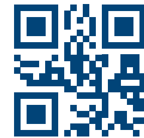

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