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## **Decision tree and impact on the structure of the DP on variable consideration Issues Paper**

### **Objective**

- 1 At its June 2020 meeting some EFRAG TEG members thought that it could be useful to structure EFRAG's discussion paper on variable consideration ('the DP') starting from the question on whether variable consideration should be included in the cost price of an asset.<sup>1</sup>
- 2 This paper illustrates some of the consequences of such an approach and sets out alternative approaches.
- 3 The purpose of the paper is to provide EFRAG TEG with a basis for deciding on the general structure of the DP. The current structure of the DP is presented in agenda paper 06-03.

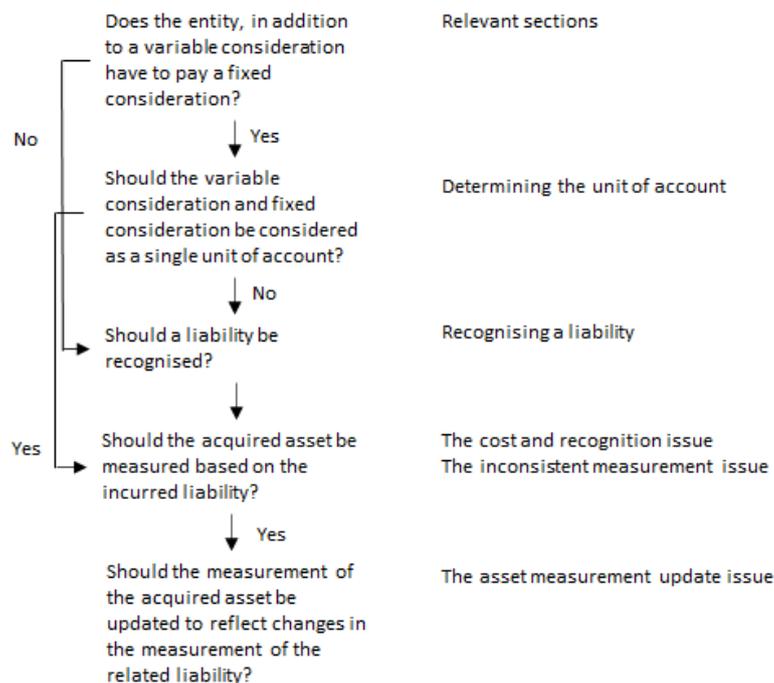
### **Current structure of the DP**

- 4 The current structure of the DP is based on the structure applied by the IFRS Interpretations Committee when discussing how to account for variable payments for the purchases of PPE and intangible assets outside of a business combination.
- 5 As with the alternative structures, the current structure applies to the case under which an entity (the buyer) has acquired (and received) an asset, but the amount the entity will have to pay depends on future circumstances or events. At this stage, this paper focuses on the perspective of the buyer.
- 6 The current structure is meant to reflect the thought process a preparer would have to go through, to determine how to account for the variable consideration. From the perspective of a buyer, it is considered that the first thing to determine is whether the buyer has a liability in relation to variable consideration. If the buyer has a liability, the next question is how to measure this liability (including updating the measurement following changes in (the estimation of) the variable consideration. If the buyer has a liability in relation to the variable consideration, another issue is how this liability (and changes in this) should be reflected in the measurement (initial cost and subsequent measurement) of the asset (to be) received in exchange for the consideration (or in the statement of comprehensive income).
- 7 The current structure considers whether a buyer has a liability in relation to the variable consideration by first discussing whether an obligation to pay a variable consideration should be considered to be a separate unit of account and if so, whether this would meet the definition of a liability in the *Conceptual Framework*.

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<sup>1</sup> At this stage, the scope of the DP excludes business combinations that are accounted for under IFRS 3 *Business Combinations*, however, the guidance included in IFRS 3 will be considered in the DP.

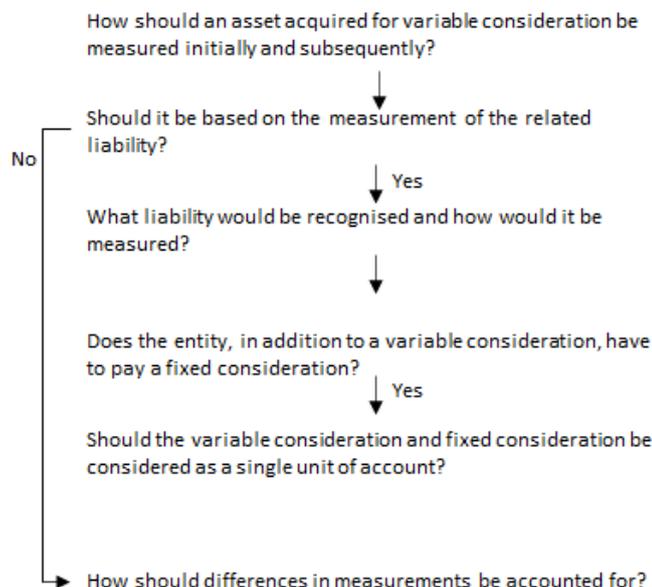
8 The current structure is implicitly based on the following “decision tree”:



- 9 The current structure implicitly assumes that variable consideration can only be reflected in the measurement (initial cost and subsequent measurement) of an asset if a liability for the amount has been recognised.
- 10 As the DP is developed further, implications on the measurement of the asset, in cases where a liability for variable consideration is not recognised (because it is expensed), could also be considered.
- 11 The paragraphs below discuss two alternatives to the decision tree in paragraph 8:
- (a) Focus on the measurement of the asset.
  - (b) Focus on performance.

**Focus on the measurement of the asset**

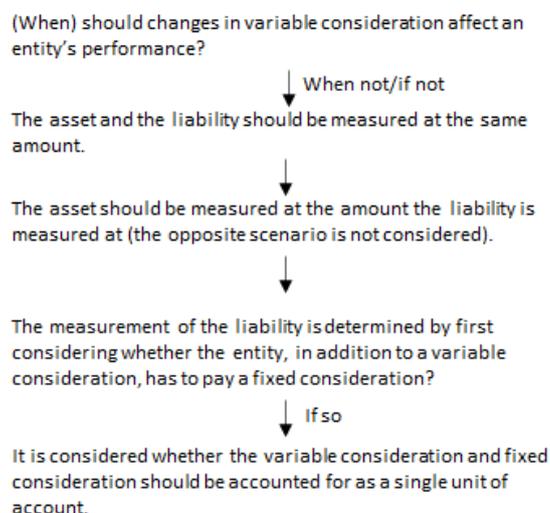
- 12 As an alternative approach to the current structure, the focus of the DP could be on how to measure an asset acquired for variable consideration (in part or in full).



- 13 Under this approach, it could be argued that the main question of the DP would be how to provide a useful measurement of assets acquired for variable consideration (in part or in full).
- 14 The choice of a measurement basis of the asset would have some consequences which might affect profit or loss (or OCI). If the measurement of the asset would not be based on the measurement of the liability, one would need to determine how to account for any differences between the two. If the measurement of the asset would be based on the measurement of the related liability, then the questions on how to account for the liability under the current structure (including the unit of account) would also be relevant.

**Focus on performance**

- 15 The focus of the DP could also be on performance, that is whether/when it would result in useful information to reflect a change in variable consideration in comprehensive income.



*Structure of discussion paper on variable consideration - Issues Paper*

- 16 If/when a change in variable consideration should not have an immediate<sup>2</sup> effect on comprehensive income, changes in the measurement of the liability to pay the variable consideration should be offset by a similar change in the measurement of the related asset.
- 17 Again, this would require consideration of how of how to account for the liability for variable consideration under the current structure (including the unit of account) and the measurement of the asset. It is therefore assessed that the sections currently included in the DP would also be relevant to consider under a structure focusing on the effect on performance of variable consideration. However, the order of the sections would be different compared to the current structure.

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<sup>2</sup> Variable consideration will subsequently affect comprehensive income. If variable consideration is reflected in the carrying amount of an asset, the amount will affect comprehensive income as the asset is amortised, depreciated and/or impaired.