

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

Discussion Paper on Variable Consideration Cover Note

Objective

- 1 The objective of this session is for EFRAG TEG to discuss the content of some of the parts of EFRAG's Discussion Paper ('the DP') on variable consideration. Further discussions of the content of the DP are foreseen for H2 of 2020.
- 2 Accordingly, although an outline of the entire DP has been provided for this session, **the questions for the session only relate to some of the sections of the outlined DP**. The outlined DP includes sections under development which are not yet ready for EFRAG TEG to consider and EFRAG TEG members can therefore either skip these sections or skim them. They have been included to provide a context for the sections to be discussed.

Project objectives

- 3 The EFRAG Board discussed an initial project plan at its meetings in September and October 2018. The following project aims were envisaged:
 - (a) identify the accounting issues around variable consideration;
 - (b) outline the information needs for users of financial statements in regard to variable considerations based on the objectives of general-purpose financial reporting in the IASB's *Conceptual Framework for Financial Reporting* and consultation with the EFRAG User Panel;
 - (c) summarise and compare the requirements in IFRS Standards and assess the rationale (or lack thereof) for any differences;
 - (d) develop accounting alternatives and illustrate their relevant strengths and limitations; and
 - (e) consider improvements in presentation and disclosure.
- 4 In December 2018, EFRAG User Panel members discussed variable consideration and members of the EFRAG User Panel generally supported a comprehensive and consistent approach to accounting for variable consideration.

Previous EFRAG TEG discussions

- 5 In March 2019, EFRAG TEG discussed the scope of the project and some practical cases. Members suggested clearly defining the issues, including what was meant by 'cost', the difference between 'variable' and 'contingent', and whether the measurement was related to the 'asset' or the 'contract'.
- 6 In its meeting in May 2019, EFRAG TEG discussed accounting issues related to variable consideration identified from interviews with experts at major audit firms, from discussions of the IFRS Interpretation Committee and from audit firms' accounting manuals and by comparing guidance included in existing IFRS

Standards. The issues related to the following areas were identified (see also paragraph 12 below): the unit of account, definition of a liability, recognition of a liability, initial measurement of a liability or equity instrument, subsequent measurement of a liability or equity instrument, definition and recognition of an asset, initial measurement of an asset at cost and subsequent measurement of assets at cost. In addition, it was noted that variable consideration could be included in contracts as a risk-sharing feature (and thus result in discussions about what contracts were about). At the meeting EFRAG TEG members identified additional situations under which variable consideration arises in practice. In addition, it was suggested that the effects of the change in the definition of a liability in the Conceptual Framework (the meaning of ‘practical ability to avoid’) was an issue that should be considered in the project. Furthermore, EFRAG TEG members identified additional accounting guidance to be considered.

- 7 At its meetings in September 2019 and November 2019, EFRAG TEG discussed the definition of variable consideration. EFRAG TEG suggested, based on the definition of contingent consideration in IFRS 3 *Business Combinations*, to define that a consideration is variable unless the amount or number of items and the qualities of these to be transferred in return for a fixed number or amount of other items is fixed.
- 8 The definition means that:
 - (a) An obligation to pay a fixed amount in any currency is considered to be fixed consideration;
 - (b) An obligation to pay an amount in the entity’s functional currency corresponding to a fixed amount in a foreign currency is variable consideration;
 - (c) An obligation to transfer a specific number or amount of a non-cash asset is considered fixed consideration;
 - (d) An obligation to transfer an amount in a currency equal to the value of a non-cash asset is considered variable consideration.
- 9 Some EFRAG TEG members, however, also thought that variable consideration include consideration in a foreign currency. It was therefore suggested to include a discussion in the DP on issues related to changes in the value of the consideration that would not meet the definition of variable consideration.
- 10 In addition, EFRAG TEG members considered contingent consideration to be a subset of variable consideration and suggested to defer discussion on the difference to a later stage.
- 11 At the November 2019 EFRAG TEG meeting, Andrew Lennard (*UK Financial Reporting Council*), presented the paper: *An Initial conceptual exploration including an analysis on variable and contingent consideration*. EFRAG TEG considered that the EFRAG DP should complement rather than compete with the UK FRC paper. A couple of the differences are: the UK FRC paper includes a discussion of the type of the asset required for variable and contingent consideration (the EFRAG DP does not include such a discussion). EFRAG’s DP considers other types of variable consideration other than consideration in cash (the UK FRC paper only considers variable consideration paid in cash).

Discussion Paper

- 12 In previous EFRAG TEG discussions, the following six high-level issues related to variable consideration have been identified:

- (a) *The unit of account issue:* If/when variable consideration is considered as a separate unit of account for recognition purposes¹ in a (possible) obligation to transfer a variable and fixed consideration.
- (b) *The definition issue:* whether/when variable consideration would meet the (new) definition of a liability and be recognised in the statement of financial position.
- (c) *The cost issue:* How/whether variable consideration should be included in the measurement at ‘cost’ of the related asset.
- (d) *The inconsistent measurement issue:* Requirements in IFRS Standards relating to recognition, initial measurement and subsequent measurement of a liability to transfer a variable contribution are different. This means that:
 - (i) To the extent the transaction resulted in the recognition of an asset and this asset is measured independently of the liability for variable consideration, any difference between the measurement of the liability and the asset would have to be reported in profit or loss (or OCI). For example, if an asset is measured under the cost model under IAS 16 *Property, Plant and Equipment* and the liability for variable consideration is measured at fair value under IFRS 9 *Financial Instruments*. A difference will arise if cost and fair value are different.
 - (ii) To the extent the related asset is measured based on the measurement of the liability, assets with similar economic characteristics could be measured differently depending on which IFRS Standard the consideration/the liability would be covered by. For example, if for Transaction A an asset is measured at cost because the liability for variable consideration is measured at cost, and for Transaction B the asset is measured at fair value variable consideration liability is measured at fair value.
- (e) *The asset measurement update issue:* How/whether subsequent changes in the amount of variable consideration should be reflected in the measurement of the acquired assets. Currently some IFRS Standards (and Interpretations) provide guidance on this issue. However, the guidance is inconsistent and may not be intended to be applied by analogy for other areas.
- (f) *The value change issue:* Whether/how to account for value changes of the consideration to be transferred, when there is a time lag between the agreement of what to transfer and the transfer. In the following this is referred to as ‘the value change issue’. For example, if it is agreed to transfer one kilo of gold in 30 days, the price of the gold would likely change during those 30 days.

13 Based on the objective of the project as stated in paragraph 3 and the identified issues, the EFRAG Secretariat has structured the DP in accordance with the table below, with the necessary amendments following from the specific issues.

	Determining the unit of account	Recognising a liability	The inconsistent measurement issue	The cost issue	The asset measurement update issue	The value change issue
Description of issue						

¹ The unit of account could be different for, for example, recognition and measurement.

Differences in guidance						
Users' information needs						
Accounting alternatives proposals						
Presentation and disclosure proposals						

- 14 The EFRAG Secretariat has started outlining the content of some of the sections of the DP which has been made available as Agenda Paper 08-02 and has the questions in the box below for EFRAG TEG. **These questions only relate to some of the sections of the DP.** The DP includes sections that are still under development and therefore not ready for EFRAG TEG to consider. These sections have, however, been included in the outlined DP to provide a context for the questions.

Questions for EFRAG TEG

Questions related to Chapter 2 'Determining the unit of account' (in Agenda Paper 08-02)

- 15 The first section of Chapter 2 describes the issue. Do EFRAG TEG members assess that it would be possible for EFRAG's constituents to understand the issue based on the description provided?
- 16 The second section of Chapter 2 describes the unit of account in IFRS Standards that are considered relevant. Do EFRAG TEG members think that some relevant guidance is missing from the section? Do EFRAG TEG members have other comments to the section?
- 17 For the sections 'Users' information needs' and 'Accounting alternatives', the outlined DP shortly describes the expected content of those sections. Do EFRAG TEG members have any initial comments on the expected content?

Questions related to Chapter 4 'The cost and recognition issue' (Agenda Paper 08-02)

- 18 Does EFRAG TEG consider that the issue on 'cost and recognition' in Chapter 3 is correctly and clearly described? If you disagree, please explain what you propose and why?
- 19 Does EFRAG TEG consider that the IFRS requirements included in this Chapter are relevant for the issue being discussed? If not, which changes or other IFRS requirements do you consider to be relevant for 'cost and recognition' issue?

Questions related to Chapter 5 'Inconsistent measurement issue' (Agenda Paper 08-02)

- 20 Does EFRAG TEG consider that the issue is correctly and clearly described in Chapter 5? If you disagree, please explain what you propose and why?

- | | |
|----|---|
| 21 | Is EFRAG TEG aware of other non-IFRS literature/requirements that could be helpful in developing the issue further?
<u>Questions related to Chapter 6 'Asset measurement update issue' (Agenda Paper 08-02)</u> |
| 22 | Does EFRAG TEG consider that the issue is correctly and clearly described in Chapter 6? If you disagree, please explain what you propose and why. |
| 23 | Does EFRAG TEG consider that it would be useful to develop some guidance to help assess/determine in which cases subsequent changes to variable consideration <i>should not</i> be reflected in the measurement of the cost of an asset? If so, do you have preliminary suggestions on which factors should be considered in this regard?
<u>Questions related to Chapter 7 'The value change issue' (in Agenda Paper 08-02)</u> |
| 24 | The first section of Chapter 7 describes the issue. Does EFRAG TEG assess that it would be possible for EFRAG's constituents to understand the issue based on the description provided? |
| 25 | Does EFRAG TEG assesses that any relevant guidance identified by the EFRAG Secretariat in the second section of chapter 7 'Difference in guidance' is missing? |
| 26 | In chapter 7, sections 'Users' information needs', 'Accounting alternatives' and 'Presentation and disclosure proposals' include a very short summary on what it is expected to be developed and assessed in these sections. Do EFRAG TEG members have any initial comments on the expected content? |
| 27 | Does EFRAG TEG have any other comments on chapter 7 'value change issue'? |

Agenda Papers

- 28 In addition to this cover note, agenda paper 08-02 'Outlined Discussion Paper on Variable Consideration' has been provided for this session.