

Work Plan for Research Project

The objective of the session

- 1 Following the completion of the EFRAG Research agenda consultation, three topics have been tentatively identified as additions to the EFRAG Research agenda:
 - (a) Better Information on Intangible Assets;
 - (b) Crypto Assets; and
 - (c) Variable and Contingent Payments.
- 2 At its September meeting, the EFRAG Board decided to add all three topics to the Research agenda but asked for more details on the second and third project. The current paper addresses this request.
- 3 For each topic, the paper discusses the following:
 - (a) Why EFRAG is undertaking the project;
 - (b) Which parties will be involved in the project;
 - (c) Data collection and other evidence;
 - (d) Proposed timetable and output; and
 - (e) Proposed consultation process.

Variable and Contingent Payments

Why is EFRAG undertaking the project?

Description of the issue

- 4 In many transactions, the exchange price is not a fixed amount but can vary in relation to financial and non-financial factors. Recent IFRS Standards such as IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases* have developed specific requirements on the recognition and measurement of variable and contingent payments. However, the guidance across IFRS Standards is neither comprehensive nor consistent.
- 5 The IFRS Interpretation Committee debated a submission about initial recognition and subsequent measurement of variable payments on the acquisition of tangible and intangible assets. Eventually in March 2016 the Committee concluded that the issue was too broad to address within the confines of the existing IFRS and referred the issue to the IASB.
- 6 In the 2015 Agenda Consultation, the IASB suggested variable and contingent payments as a possible project. Eventually it was considered to add it to the research pipeline. The project may also look into risk-sharing features and participation agreements.

Scope of application

- 7 The objective of EFRAG's project should be to:
 - (a) Identify the accounting issues around variable and contingent payments;
 - (b) Outline what are the information needs for users of financial statements in regard to variable and contingent payments based on the objectives of general purpose financial reporting as stated in the IASB's revised *Conceptual Framework for Financial Reporting* and consultation with the EFRAG User Panel;
 - (c) Summarise and compare the guidance across different Standards and assess the rationale (or lack thereof) for difference in the requirements;
 - (d) Develop a number of accounting alternatives and illustrate the relevant strengths and limitations; and
 - (e) Consider improvements in presentation and disclosure.
- 8 One important aspect would be the scope definition. A fixed selling price per unit results in a total amount variable upon the number of units sold. This would not qualify for the scope of the project; however, the distinction may not always be clear.
- 9 Also, it may be useful to define a scope about only certain classes of transactions. For instance, variable and contingent employee benefits (long-term bonus, post-retirement benefits, share-based payments with vesting conditions) pose specific issues.
- 10 The outcome of the research project should be a discussion paper with a 120 days comment period.

Issues to be considered

- 11 The project would need to consider the following issues:
 - (a) When variable and contingent payments are initially recognised (and/or reflected in the measurement of related assets or liabilities). Variable and contingent payments may be reflected in the financial statements when:
 - (i) The underlying transaction is initially recognised;

New research topics – Work plan

- (ii) Their likelihood exceeds a defined recognition threshold; or
- (iii) They become due under the terms of the underlying transaction.

An early reflection would make users aware of their existence and provide information on the variability of future cash flows, but could lead to remeasurement and reversals, which users previously seem to have thought should be avoided in relation to revenue from contracts with customers.

- (b) How variable and contingent payments should be measured. If variable and contingent payments are reflected in financial statements before they become due, they need to be measured at an estimated amount. This could, for example be fair value, expected value or most likely outcome.
- (c) Whether, and if so, when variable and contingent payments should be re-measured. If variable and contingent payments are reflected in the financial statements before they become due, their estimated amount may change over time. While measurement at fair value may mean that the estimate is continuously updated, measurement at, for example, most likely outcome may require guidance on whether, and if so, when, the estimate should be updated and what factors the update should reflect. For example, IFRS 16 requires to re-assess the likelihood of exercising an option to extend only for changes in factors other than market prices.
- (d) How to account for re-assessments. Variable and contingent payments may be linked to the purchase of assets. If they are re-measured before the assets are derecognised or fully depreciated, it should be assessed if or when then re-measurement should affect the carrying amount of the asset or be charged to profit or loss.
- (e) Whether all variable and contingent payments should be accounted for similarly. Payments could vary or be conditional on different factors: performance or output of the asset, changes in market prices and other events. Some of these factors are under the control of the management and others are not. The project should investigate if these differences should give rise to different accounting. Different accounting could also arise if users are sensitive to some re-measurements (e.g. downward adjustments to revenue) but not to other re-measurements.

Which parties will be involved in the project

- 12 The EFRAG Secretariat does not consider it beneficial to set up a special working group for the project. The EFRAG Secretariat assesses that there would not be a group of specialists in variable and contingent payments the project could benefit from assembling. EFRAG TEG will be involved in the discussions and the EFRAG User Panel will be consulted on specific issues (e.g. on whether all contingent and variable payments should be accounted for similarly).

Involvement of other parties

- 13 National Standard Setters are invited to participate in the project as partners. The EFRAG Secretariat also aims to establish a formal or informal exchange of information with National Standard Setters working on similar projects and with the IASB.

Data collection and other evidence

Data collection

- 14 While variable and contingent payments are frequently used in many industries, it seems difficult to obtain aggregated quantitative information. It is unlikely that databases containing financial statements information include information on variable payments that could be used to determine the frequency and magnitude of these payments. Some data could, however, be available on the use of contingent payments in lease arrangements.
- 15 It is similarly unlikely that there is much academic literature available that could provide insights on how variable and contingent payments are best accounted for. However, there will be some studies that, for example, could provide some general indications on when recognising items in the financial statements may be most useful.

Other evidence

- 16 Evidence could be collected by:
 - (a) Inviting constituents to submit real-life examples of variable and contingent payments;
 - (b) Consulting the EFRAG User Panel;
 - (c) Public consultations;
 - (d) Reviewing a sample of financial statements; and
 - (e) Speaking to the technical departments of large accounting firms about common types of variable and contingent payments.
- 17 As the purpose of the project is to facilitate a discussion on the topic rather than suggesting a solution to the issue, collection of evidence suggested in (a), (d) and (e) above may be limited to obtain reasonable assurance that commonly found variable and contingent payments are covered.

Relevant literature and references

- 18 The IFRS Interpretation Committee has already considered variable and contingent payment issues, and the papers prepared in that regard should be consulted.
- 19 In addition, the IASB staff has previously prepared a paper on arguments in favour and against different methods to account for uncertainty (i.e. whether and when the most likely outcome or expected value would provide the most useful information).
- 20 The IASB has a project on Variable and Contingent Payments on their Research pipeline. The IASB staff will start work on it by bringing a paper to the IASB Board on scoping the project in Q4 2018.
- 21 The EFRAG Secretariat has already reached out to the IASB staff for an initial exchange of views.
- 22 In addition to this, the following material will be consulted:
 - (a) Work performed on the role of measurement uncertainty in the context of the revised IASB *Conceptual Framework for Financial Reporting*;
 - (b) Academic journals;
 - (c) Accounting textbooks;
 - (d) Accounting manuals of large firms;
 - (e) Accounting standards;
 - (f) Accounting literature inside and outside Europe.

New research topics – Work plan

Proposed timetable and output

23 Although some initial work on the topic would be done as soon as the work plan has been approved, the EFRAG Secretariat will focus on first finalising EFRAG’s project on accounting for certain types of pension plans before accelerating the progress on a project on variable and contingent payments. Significant resources will therefore not be allocated to the project until Q1 2019. However, as the project does not require meetings of specialised working groups or advisory panels and as the collection of evidence is limited, it is expected that a discussion paper can be published in early 2020.

24 The various steps in the project are:

| Step | Start | End | Description |
|------|-------|------|--|
| 1 | Q1 | Q2 | <p>The first step in the project will be to collect information about:</p> <ul style="list-style-type: none"> Where variable and contingent considerations exist. For example, but not limited to, acquisition of businesses, tangible assets, intangible assets and provisions. Which factors influence variable consideration, and what contingent consideration is contingent on: For example, but not limited to: the performance (of an asset or entity), usage (of an asset), condition (of an asset or provision) and macroeconomic circumstances. How existing IFRS Standards (e.g. IAS 32 <i>Financial Instruments: Presentation</i>, IFRS 3 <i>Business Combinations</i>, IFRS 15 <i>Revenue from Contracts with Customers</i> and IFRS 16 <i>Leases</i>) require variable and contingent consideration to be accounted for. <p>The EFRAG Secretariat will collect information on these three issues, describe them in a consultation document and ask whether constituents consider the description to be (almost) complete.</p> |
| | 2019 | 2019 | |
| 2 | Q2 | Q3 | <p>As a second step, EFRAG TEG will have an initial discussion about the rationale (if any) for the differences in existing IFRS Standards for the accounting for variable and contingent consideration. Based on this discussion – and considering the information collected in the first part of the project, EFRAG TEG may decide to focus the second part of the project on particular areas where it assesses that improvements could be made in relation to recognition and measurement for variable and contingent consideration.</p> |
| | 2019 | 2019 | |
| 3 | Q3 | Q1 | <p>Subject to any decisions of EFRAG TEG on the scope of the second part of the project, the EFRAG Secretariat will prepare alternatives to how recognition and measurement requirements could be in relation to variable and contingent consideration (see paragraphs 11(a) - 11(e) above). These alternatives will be discussed with EFRAG TEG. The purpose is not to find the “best solution” but to describe different options to be included in a discussion paper. Following the discussions, EFRAG will issue a discussion paper.</p> |
| | 2019 | 2020 | |

New research topics – Work plan

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|---|------------|------------|---|
| 4 | Q3 2020 | Q3 2020 | EFRAG will issue a feedback statement on the comments received in response to the discussion paper. |
|---|------------|------------|---|

Proposed consultation process

- 25 In addition to collecting input from constituents through the replies to the discussion paper, the EFRAG Secretariat suggests presenting the discussion paper at international fora such as CFSS and ASAF.

| Q1 2019 | Q2 2019 | Q3 2019 | Q4 2019 | Q1 2020 | Q2 2020 |
|------------|---------------------------------------|---|--|--------------------|------------|
| | Consultation on information collected | | | | |
| | | Discussion of issues and scope with EFRAG TEG | | | |
| | | | Drafting discussion paper and approval | | |
| | | | | Target publication | |

Crypto Assets

Why is EFRAG undertaking the project?

Description of the issue

- 26 A cryptocurrency is a virtual or digital currency and refers to a form of exchange that does not exist in physical form. It is not linked to any physical currency, does not have a central repository nor is it typically backed by any government or central bank. It is generally held for capital appreciation or in limited cases (and in some jurisdictions) as a means for exchange.
- 27 The accounting treatment of cryptocurrencies under IFRS Standards is unclear. They may not qualify as financial assets, as they neither represent a right to receive cash or other financial instruments, nor a contract to exchange assets. They may qualify as intangible assets, but they are not legally protected and have no useful life. It is also debatable that the measurement requirements in IAS 38 would provide relevant information – and the impairment issue would need to be addressed.
- 28 Cryptocurrencies make it easier to transfer funds between two parties in a transaction and are typically based on the blockchain technology. They are initially 'mined' but could subsequently be bought, exchanged, awarded, or granted. Mining cryptocurrencies is a specialised activity and the accounting for such activities warrant further research. There are a number of potential options to account for them and diversity has already emerged in practice under different GAAP's and potentially under IFRS.
- 29 Cryptocurrencies including initial coin offerings (ICO's) are undergoing rapid growth and developments, although they are also subject to extreme price volatility. ICO's are gaining increasing attention from investors, businesses and regulators, and are popular because of the ease with which they can be used to obtain public funding with less complexity and greater speed than traditional methods.

New research topics – Work plan

- 30 The Canadian Securities Exchange (CSE) announced in February 2018 the launch of a securities clearing and settlement platform based on the Ethereum Blockchain that allows companies to raise capital with security tokens. Some established exchanges have launched bitcoin futures.
- 31 Some European countries have discussed initiatives to facilitate the blockchain technology. However, there is also a view that global cryptocurrency regulation is necessary. Some claim that cryptocurrencies appear as a threat to the long-term financial stability.
- 32 The objective of the project would be to assess whether the current IFRS Standards could be used to account for digital assets or whether a new accounting model should be developed to cater for the specific characteristics of this type of virtual currency.
- 33 Another aspect could be to assess whether the measurement basis should be the same for all digital assets held or whether different bases may be justified based on the business model or purpose and based whether an active market exists.
- 34 A third aspect could be to investigate the accounting implications, including disclosure, of specific activities linked to digital assets such as held by an entity on its own behalf versus on behalf of others, mining and Initial Coin Offerings.

Scope of application

- 35 The previous paragraphs refer indistinctly to cryptocurrencies, crypto assets or digital assets. However, these terms have a different meaning, and different types of digital assets are held for different purposes.
- 36 The EFRAG Secretariat suggest that the focus of the project should be on cryptocurrencies (the most popular being Bitcoin and Ethereum) that are generally meant to be a medium of exchange; and tokens, which are designed to support a more specific use of the distributed ledger technology.

Interaction with IASB activities

- 37 In July 2018, the IASB discussed whether to add a project on cryptocurrencies to its work plan or research pipeline. The Board decided it did not have sufficient information to reach a conclusion and is now consulting the IFRS Interpretations Committee on holdings of cryptocurrencies and ICOs. Possible ways forward include the development of a specific Standard, the inclusion of crypto currencies in the scope of an existing Standard or delaying activity and consult constituents in the context of the next Agenda consultation.

Which parties will be involved in the project

Involvement of EFRAG Working Groups

- 38 The EFRAG Secretariat expects to involve in the discussion of the issues the EFRAG User Panel and the Financial Instruments Working Group.

Setting up an Advisory Panel

- 39 The EFRAG Secretariat suggests setting up an Advisory Panel. We consider that a reasonable understanding of the legal and regulatory aspects as well as the technical features of the different assets is needed to develop relevant accounting guidance. Panel members should include preparers, users, accountants, lawyers, IT specialists and market experts. It would also be helpful to reach out to regulators.

New research topics – Work plan

Involvement of other parties

- 40 Based on the replies to the Research agenda consultation, there is considerable interest among European Standard Setters for research on this topic. The EFRAG Secretariat understands that some of them are considering developing guidance in their local GAAP. We suggest reaching out to CFSS members and invite them to cooperate with EFRAG on the project. We could also offer them to take part in the Advisory Panel.

Data collection and other evidence

Data collection

- 41 The EFRAG Secretariat does not consider that collecting accounting data, such as the amount of crypto currencies held by European entities, would be helpful in developing possible solutions. Other information such as the volume of exchanges of crypto currencies should be available from existing publications. Therefore, we do not plan any data collection activity.

Relevant literature and references

- 42 The EFRAG Secretariat does not suggest outsourcing an academic literature review. The topic is relatively new, and it is unlikely that there are significant studies on the financial reporting for cryptocurrencies or digital assets.
- 43 The EFRAG Secretariat has started to collect the relevant material from Standard Setters. Appendix 1 provides a short summary of the accounting and reporting guidance issued in different countries. Other countries like France are currently working on the topic.
- 44 Additionally, accounting firms have issued publications to provide possible guidance on the reporting of cryptocurrencies and digital assets.

Proposed timetable and output

- 45 The EFRAG Secretariat expects that the Research should take approximately 12-15 months to complete. The expected output of the Research will be a Discussion Paper.

Proposed consultation process

- 46 The EFRAG Secretariat considers that most of the input will be from the Advisory Panel participants, the EFRAG Working Groups and the respondents to the Discussion Paper.

| October | November | December | January | February | March |
|-----------------------------|----------|----------|-------------------------------------|----------|-------|
| 2018 | | | 2019 | | |
| Advisory Panel appointed | | | | | |
| Review of relevant material | | | | | |
| | | | Analysis of different crypto assets | | |

Appendix 1

| Country | Scope | Accounting classification | Valuation |
|---|---|---|---|
| <p>Japan – Issued by the Accounting Standards Board of Japan (ASBJ)</p> <p>Crypto currencies issued by the entity itself, including Initial Coin Offerings (ICOs) as well as mining of virtual currencies are <i>excluded</i> from the scope. The ASBJ are currently undertaking further research in this area</p> | <p>Crypto currencies (held by an entity on its own behalf)</p> | <p>“No category of assets” would be appropriate. Crypto currencies should therefore be presented as an independent category of assets</p> | <p>(a) Initial measurement at cost;</p> <p>(b) Subsequent measurement when active market¹ exists – FVPL; and</p> <p>(c) Subsequent measurement when active market does not exist at cost. However, if the estimate disposal value is lower than the cost, the difference should be recognised as a loss and should not be reversed in subsequent periods</p> |
| | <p>Crypto currencies (held by a dealer on behalf of its customers)</p> | | <p>(a) The company should recognise an asset and at the same a liability for the obligation to return the crypto currency to the customers. The initial and subsequent measurement above applies</p> |
| <p>Lithuania – Issued by the Lithuanian Authority of Accounting, Audit, Property Valuation and Insolvency.</p> | <p>Extensive guidance on crypto currencies, different types of tokens and accounting for both holders and issuers</p> | <p>Holders of crypto currencies and tokens generally recognise a financial asset. Payment tokens that are not circulated during an ICO and remain property of the promoter are registered in a memorandum account and recognised only when the active markets of token stabilises</p> | <p>In general, financial assets are carried at either FVPL (if an active market exists) or cost less impairment. Sellers of tokens shall recognise a liability for the obligation to the purchaser (which may or may not be equal to the consideration received). Subsequent measurement of the liability follows the applicable Standard</p> |
| <p>Belarus – issued by Government</p> <p><i>EFRAG Board meeting 18 October 2018</i></p> | <p>Crypto currencies</p> | <p>Inventories</p> <p><i>Paper 08.01, Page 9 of 11</i></p> | <p>(a) Initially measurement at cost; and</p> <p>(b) Subsequent measurement at fair</p> |

¹ An active market is defined as a market in which transactions for the virtual currency take place with sufficient frequency and volume to provide pricing information on an ongoing basis. This definition is consistent with the definition of ‘active markets of token stabilises’.

| | Tokens | Investments | value (established in the expected selling price) |
|---|---|----------------------------|--|
| Canada – issued by CPA Canada as non-authoritative guidance for IFRS preparers | Crypto currencies | Intangible assets (IAS 38) | (a) Initially measurement at cost; (b) Subsequent measurement when active market exists – either at cost or fair value with revaluation model; and (c) Subsequent measurement when active market does not exist - cost less impairment |
| | Crypto currencies (held for sale in the normal course of business) | Inventories (IAS 2) | (a) Initially measurement at cost; and (b) Subsequent measurement – lower of cost or net realisable value |
| The Netherlands – issued by the Dutch Accounting Standards Board | Crypto currencies (held for use in production) | Intangible fixed assets | (a) Initially measurement at cost; and (b) Subsequent measurement at cost or fair value |
| | Crypto currencies (held for trading in the normal course of business or production) | Inventories | (a) Initially measurement at cost; and (b) Subsequent measurement at acquisition cost |
| | Crypto currencies (held for capital appreciation or earning revenues) | Other investments | (a) Initially measurement at cost; and (b) Subsequent measurement at cost or FVPL or first through other comprehensive income (OCI) with |

| | | | |
|---|---|---------------------------------|---|
| | | | recycling in PL |
| Switzerland – based on application of Swiss GAAP to guidelines issued by the Swiss Financial Market Supervisor | Crypto currencies for which an active market exists (regular trading) | Securities | (a) Initially measurement at cost; (b) Subsequent measurement when active market exists – at fair value or price published by the Swiss Federal Tax Authorities every year-end. It is possible to adjust values for future price fluctuations; (c) Subsequent measurement when active market does not exist – cost less amortisation and impairment |
| | Crypto currencies (regular trading, mining or using in production) | Inventories or intangible asset | |