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Discussion Paper on Variable Consideration Cover Note

Objective

- 1 The objective of this session is to decide on the general structure of EFRAG's Discussion Paper on variable consideration ('the DP').
- 2 If EFRAG TEG decides to keep the current structure - reflected in the outlined DP presented in Agenda Paper 06-03 for today's session- the EFRAG Secretariat would also like EFRAG TEG's comments on the questions prepared for the 3 June 2020 EFRAG TEG meeting, which, due to time constraints, were not discussed at that meeting (see questions in paragraphs 23-32).
- 3 If EFRAG TEG decides on another structure, the EFRAG Secretariat would like to receive EFRAG TEG's directions on the following (see questions in paragraphs 33-34):
 - (a) How the current sections should be amended to fit the new structure.
 - (b) Whether some of the current sections should be removed.
 - (c) Whether additional sections should be added to the DP.
- 4 The EFRAG Secretariat has outlined the content of some of the sections of the DP in Agenda Paper 06-03 (**unchanged from the 3 June EFRAG TEG meeting**).
- 5 In the appendix of this paper are included the sections that are unchanged compared to the cover note provided at the 3 June 2020 TEG Meeting (*agenda paper 08-01 provided at the 3 June 2020 TEG Meeting*).

Scope and definition of variable consideration

- 6 From the perspective of the buyer, the issues with variable consideration arise when an entity has acquired an asset, but the purchase price (consideration to be made) in return for that asset depends on events or circumstances in the future.
- 7 The DP considers a consideration to be variable, unless the agreed consideration (in an amount of any currency or a number of/an amount of other items – including services - of a specified quality) to be transferred in return for good or services, is fixed (a fixed amount). Variable consideration includes consideration that is contingent on future events. The DP will examine events that are considered to be within and outside the control of the acquiring (receiving) entity.
- 8 The definition means that the following considerations to be provided in return for a specified item would be considered to be fixed:
 - (a) A fixed amount of a foreign currency;
 - (b) A fixed number of own equity instruments;
 - (c) A fixed quantity of a specified item (goods or services).

- 9 On the other hand, the following considerations to be provided in return for a specified item would be considered as variable:
 - (a) An amount in any currency that would vary depending on factors both within and outside the control of the receiving entity;
 - (b) An amount in any currency corresponding to the market value of the receiving entity's own equity instruments; and
 - (c) An amount in any currency corresponding to the market value of a given item (good or service).
- 10 The assessment of whether consideration is variable or not should be done for each asset the entity acquires. This means that:
 - (a) The fact that an entity decides to purchase two items and accordingly must pay an amount twice as high as if it only bought one item, is not considered variable and contingent consideration.
 - (b) If an entity has acquired a right to use one copy machine for two years and the consideration it will have to pay depends on the number of copies it makes, the consideration for the *right-to-use* is variable. However, if an entity has access to a copy machine, for which no *right-to-use* should be recognised in its statement of financial position, a fixed price, it will have to pay for *each copy* it makes is not variable or contingent consideration.
 - (c) If an entity has to transfer a consideration which consists of both a fixed amount and a variable amount and it is assessed that the entity receives something additional (e.g. an additional right) from the variable amount, only the part of the transfer that relates to the variable amount is within the scope of the DP.
- 11 The existence of variable consideration may result in questions about the nature of the asset an entity has acquired (for example whether in substance an entity has acquired a single asset or more than one asset). However, this discussion is outside the scope of the DP.
- 12 At this stage, the DP focuses on variable consideration from the perspective of the buyer. Whether the DP ought to address the accounting from the perspective of the seller will be discussed with EFRAG TEG at a future meeting.
- 13 At a forthcoming meeting, EFRAG TEG will discuss how to clarify what is meant by variable consideration in the context of the DP. This is briefly discussed in paragraphs 14 - 16 below.

Definition of variable consideration

- 14 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.
- 15 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.
- 16 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.

IASB proposed amendments to IFRIC 16 regarding variable consideration

- 17 At its April 2020 meeting, the IASB tentatively decided to propose narrow-scope amendments to IFRS 16 *Leases* to specify how a seller-lessee would apply the subsequent measurement requirements in IFRS 16 to a lease liability that arises in a sale and leaseback transaction with variable lease payments (not based on an index or rate). The IASB proposals will address how a seller-lessee would account for a sale and leaseback transaction with variable payments, both at the date of the transaction and subsequently throughout the lease term
- 18 The IASB thinking in development these proposed amendments will be considered in developing the accounting alternatives for variable consideration in this DP.

Structure of the DP

- 19 At its 3 June 2020 meeting, some EFRAG TEG members thought that the structure of the DP should be based on how an asset acquired for variable consideration should be measured.
- 20 Agenda Paper 06-02 has been prepared to provide EFRAG TEG with a basis for a discussion on the structure of the DP (see questions for EFRAG TEG in this regard are included in paragraphs 21-22).

Questions for EFRAG TEG

- 21 Does EFRAG TEG have other suggestions to structure the DP than those mentioned in Agenda Paper 06-02 (the current structure based on a preparer's thought process, focus on the measurement of the asset and focus on performance) that they consider could be useful? If so, please explain.
- 22 Which structure of the DP does EFRAG TEG support? Please explain your answer.

If EFRAG TEG supports the current structure:

Questions related to Chapter 4 'The cost and recognition issue' (Agenda Paper 06-03)

- 23 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?
- 24 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 06-03)

- 25 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?
- 26 Is EFRAG TEG aware of other non-IFRS literature/requirements that could be helpful in developing the issue further?

Questions related to Chapter 6 'Asset measurement update issue' (Agenda Paper 06-03)

- 27 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.
- 28 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 *should not* 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?

Questions related to Chapter 7 'The value change issue' (in Agenda Paper 06-03)

- 29 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?
- 30 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?
- 31 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?
- 32 Does EFRAG TEG have any other comments on chapter 7 'value change issue'?

If EFRAG TEG wants another structure of the DP:

- 33 Would the following sections still be relevant to include in the DP and if so, should the content the sections be different than what is reflected in the outlined DP (Agenda Paper 06-03) (it is assumed that the order of the sections should be different):
- (a) Determining the unit of account;
 - (b) Recognising a liability;
 - (c) The cost and recognition issue;
 - (d) The inconsistent measurement issue; and
 - (e) The asset measurement update issue.
- 34 Should additional issues other than those listed in paragraph 33 be considered in the DP?

Agenda Papers

- 35 In addition to this cover note, the following agenda papers have been provided for this session:
- (a) *Agenda Paper 06-02 Decision tree and impact on the structure of the DP on variable consideration.*
 - (b) *Agenda Paper 06-03 Outlined Discussion Paper on Variable Consideration.*

Appendix

- 36 This appendix includes the sections that are unchanged compared to the cover note provided at the 3 June 2020 TEG Meeting (*agenda paper 08-01 provided at the 3 June 2020 TEG Meeting*)

Project objectives

- 37 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.
- 38 In December 2018, the EFRAG User Panel discussed variable consideration and Panel members generally supported a comprehensive and consistent approach to accounting for variable consideration.

Discussion Paper - Issues

- 39 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

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

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.

40 Based on the objective of the project as stated in paragraph 37 and the identified issues, the EFRAG Secretariat had structured an outlined DP presented at the 3 June 2020 EFRAG TEG meeting (agenda paper 06-03) 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						
Differences in guidance						
Users' information needs						
Accounting alternatives proposals						
Presentation and disclosure proposals						