# Realization of Variable Consideration

## Extract, IFRS® Discussion Group Report on the Meeting – June 20, 2019

IFRS 15 *Revenue from Contracts with Customers* requires an entity to estimate variable consideration when determining the transaction price. The estimated variable consideration should only be included in the transaction price to the extent that it is highly probable that there will not be a subsequent significant reversal. Furthermore, at the end of each reporting period, the entity should update the estimated transaction price (including updating its assessment of whether an estimate of variable consideration is constrained) to represent faithfully the circumstances present at the end of the reporting period and the changes in circumstances during the reporting period.

New information related to variable consideration may arise between the end of the reporting period and the date when the financial statements are authorized for issue. The Group is asked to consider whether this information is considered to provide evidence of conditions that existed at the end of the reporting period (i.e., an adjusting event). Paragraph 8 of IAS 10 *Events after the Reporting Period* requires the entity to recognize the amounts in its financial statements reflecting the adjusting events after the reporting period.

### *Fact Pattern*

- Entity A enters into a contract with Customer Z on November 30, 2018, to deliver 100 widgets on December 31, 2018 (which is when the performance obligation is satisfied). The transaction price is $1,000 per widget and there are no other performance obligations in the contract. Entity A has a 30-day return policy. Payment is due on January 31, 2019.
- Entity A has a December year-end and financial statements will be authorized for issue March 31, 2019.
- Historical returns have been 3-5 percent of total widget sales for each respective month.
- In considering the requirements for constraining the estimate of variable consideration, based on historical returns and circumstances present at December 31, Entity A concluded that it is highly probable that a significant reversal in the revenue recognized for Customer Z will not occur if a transaction price of $95,000 is used, applying estimated returns of 5 percent.
- Customer Z returned two widgets (or 2 percent) on January 30, 2019.

### ***Issue: Is the return of two widgets subsequent to the reporting date an adjusting event under IAS 10?***

### *View A – Yes, the return of two widgets subsequent to the reporting date is an adjusting event under IAS 10*

Proponents of this view note when the uncertainty associated with the variable consideration was resolved in the subsequent event period, it provided evidence of conditions that existed at the end of the reporting period. Therefore, Entity A should adjust the estimate of variable consideration recognized in its financial statements.

*View B – No, the return of two widgets subsequent to the reporting date is not an adjusting event under IAS 10*

Proponents of this view note that the variability was resolved as a result of conditions that arose after the reporting period and did not represent circumstances present at the reporting date. Entity A should not adjust the estimate of variable consideration recognized in its financial statements.

In this scenario, Entity A would not adjust the estimate of variable consideration recognized in its financial statements. The financial statements should reflect the uncertainty related to the variable consideration that existed on December 31.

*The Group's Discussion*

Most Group members supported View B. These members considered the management's process to estimate variable consideration to be rigorous. Absent any abnormal circumstances of the return that can raise questions about the accuracy of the management's estimate, the year-end estimation does not need to be adjusted. One Group member commented the development in data analytics can improve forecast accuracy and reduce likelihood of differences between estimates and actual results occurring in the future.

Some Group members supported View A. One Group member noted that if the uncertainties associated with the variable consideration were resolved subsequent to the reporting date, then revenue should be adjusted to reflect the certainty. A few Group members discussed examples in IAS 10, IAS 2 *Inventories*, and IFRS 9 *Financial Instruments* and considered the judgement involved in determining whether subsequent changes in value will need to be reflected in estimates at the year-end. For example, one Group member thought of analogizing to the example in paragraph 9(a) of IAS 10 in considering whether to adjust the estimate based on the updated information.

Other Group members focused on the nature of the intervening events that caused the difference between actual and estimated returns. If the intervening event does not relate to circumstances that existed at the reporting date, then the variable consideration should not be adjusted. Otherwise, the estimate may need to be adjusted.

Overall, the Group's discussion raises awareness about the considerations to determine whether information subsequent to the reporting date should result in an adjustment to estimated variable consideration. No further action was recommended to the AcSB.

(For a full understanding of the discussions and views expressed, listen to the audio clip).