Project	**IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*—Contingent pricing of property, plant and equipment and intangible assets**
Topic	**Scope and analysis of possible accounting treatments**

Introduction

1. The IFRS Interpretations Committee (the Interpretations Committee) received a request asking for guidance on how to account for contingent payments agreed for the separate purchases of property, plant and equipment (PPE) or intangible assets.
2. At its meeting in January 2011 the Interpretations Committee decided to take the issue onto its agenda.

Purpose of the paper

3. The objective of this paper is to:
   (a) provide a summary of discussions to date;
   (b) provide an analysis the possible accounting for the subsequent changes to the liability based on existing IFRS literature;
   (c) provide an update on the most recent decisions on the current Board projects on *Leases* and *Revenue Recognition*; and
   (d) ask for the Interpretations Committee's feedback on the analysis and possible effect of the Board's tentative decisions on this project.

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IFRS Interpretations Committee or the IASB. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

Background information

Meeting in March 2011

4. We partially reproduce below the March 2011 IFRIC Update for ease of reference:

> […] The Committee expressed concern over developing an interpretation based on too narrow a scope. The focus should be defining what the cost of the item purchased is.
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> The Committee noted that, where the obligation for the contingent price arises from a contractual agreement, the requirements in IAS 32/IAS 39/IFRS 9 *Financial Instruments* would apply. The contract would establish an obligation for the contingent price and IAS 32/IAS 39/IFRS 9 would lead to recognising a financial liability on the date of purchase of the asset for the fair value of the contingent payment. The definition of cost in IAS 16 similarly requires that the cost of the asset on the date of purchase should include the fair value of the consideration given (if a reliable estimate can be made), such as an obligation to pay a contingent price.
>
> The Committee noted that the initial accounting for contingent prices arising from the purchase of a single asset is consistent with the initial accounting for contingent consideration arising from a business combination under IFRS 3 (2008).
>
> The Committee also noted that the core issue is the accounting for the remeasurement of the liability and whether that remeasurement should be recognised in profit or loss, or included as an adjustment to the cost of the asset. The Committee noted that an initial analysis of IAS 39/IFRS 9 would suggest that the remeasurement should be recognised in profit or loss. However, the Committee expressed concern about whether this was a reasonable depiction of the transaction, noting that IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities* had addressed a similar issue in the context of decommissioning, restoration and similar liabilities and had required an adjustment to the cost of the asset.
>
> […]

5. At its meeting in March 2011, the Interpretations Committee directed the staff to:

   (a) present further analysis on how to account for subsequent changes to the liability; and

(b) to consider whether there are circumstances in which the remeasurement of the liability for the contingent price should be included in the cost of the asset.

Objective for this meeting

6. At this meeting, we plan not to elaborate further on the scope of the project outlined at the meeting in March 2011.
7. Instead, the objective at this meeting is to obtain feedback from the Interpretations Committee on the accounting for subsequent changes to the liability that reflects the contingent price.
8. The following analysis seeks to propose a basis for discussion taking into account current IFRS literature as well as the most recent tentative decisions from the Board's main projects on *Leases* and *Revenue Recognition*.

Staff's analysis

Analysis of existing IFRS literature

9. We have performed a comprehensive review of existing IFRS literature that provides guidance on the accounting for subsequent changes to an item of the statement of financial position.
10. We outline below our findings and our analysis of the drawbacks and advantages of each piece of literature in relation to contingent pricing for the purchase of an item of PPE or an intangible asset.
11. When applicable, we also draw out the interaction with the scope of this project and with the accounting for contingent pricing upon initial recognition.
12. We reproduce in Appendix A to this paper extracts of relevant IFRS literature in support of our analysis.

13. IFRIC 1 highlights the existence of different types of changes to the liability:

    (a) change in the estimated outflow of resources;

    (b) change in the current market-based discount rate (change in the time value of money and risks specific to the liability); and

    (c) increase that reflects the passage of time (also referred to as the unwinding of the discount).

14. We note that, when the related asset is measured using the cost model, in accordance with paragraph 5 of IFRIC 1 the changes described in (a) and (b) above are added to or deducted from the cost of the related asset in the current period. In contrast, paragraph 8 of IFRIC 1 requires that the periodic unwinding of the discount (item (c) above) to be recognised as a finance costs through profit or loss as it occurs.

15. The table below outlines the drawbacks and advantages if a similar accounting were to be applied to contingent pricing:

Advantages for applicability	Drawbacks for applicability
Provides for an alternative treatment to accounting for changes in profit or loss: under certain limits changes other than the unwinding of the discount in the liability are added to, or deducted from, the cost of the related asset	Applies to changes to a non-financial liability
	Interpretation in the specific context of IAS 37 not providing guidance for the accounting of changes => this leaves room for interpretation.

16. This interpretation was issued in the context of a lack of guidance in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* with respect to

the debit entry when accounting for a non-financial liability, both upon initial recognition and at the end of each reporting period when the liability is reassessed.

17. We note that contingent price are financial liabilities and that there is no such lack of guidance in IAS 39 / IFRS 9 with respect to subsequent remeasurement.

18. We note that IFRIC 1 provides guidance for changes to the liability when the related asset is accounted for using the revaluation model. We believe that this could be a basis for including assets measured using the revaluation model within the scope of this project. However, we also believe that further analysis should be performed as to the consequences for assets measured using the revaluation model.

IFRS 3 Business Combinations

19. We note that paragraph 58 of IFRS 3 requires different accounting for changes in the fair value of contingent consideration that are 'measurement period adjustments'. Those changes should be recognised as part of the consideration transferred at the date of acquisition. Accordingly, those changes are recognised as part of goodwill.

20. We note that the accounting described above is irrespective of the fact that the contingent consideration is a financial instrument. In addition, this accounting prevails over the general requirements in IAS 39 and IFRS 9 to recognise subsequent changes to financial liabilities in profit or loss.

21. In contrast, we note that changes that are not 'measurement period adjustments' are recognised in profit or loss which is consistent with the general requirements for financial instruments.

22. Paragraphs 45 to 49 of IFRS 3 provide guidance as to what the measurement period is and as to how to determine those changes to the fair value of the contingent consideration that are measurement period adjustments.

23. The measurement period is the period in which the contingent consideration transferred may be adjusted to 'reflect new information obtained about facts and

circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date'.

24. We draw a parallel between the measurement period described in IFRS 3 and the period during which 'directly attributable costs' are considered elements of the cost of the asset purchased upon recognition as set out in paragraph 16(b) of IAS 16 and paragraph 27(b) of IAS 38. For single assets, we think that period expands between the date of purchase and the date the asset is ready for its intended use.

25. IFRS 3 characterises those measurement period adjustments as:

    (a) reflecting new information on facts and circumstances that existed as of the acquisition date; and

    (b) having an effect on the measurement of identifiable assets and liabilities recognised at that date.

26. We acknowledge that there is a judgement call as to whether changes to contingent consideration are measurement period adjustments. As to the characterisation of changes that are measurement period adjustments versus those that are not, we note that paragraph 58 of IFRS 3 specifically excludes those changes that result from meeting an earnings target, from reaching a specified share price or from reaching a milestone on a research and development project.

27. In relation to contingent prices for the purchase of single assets, we note that in practice, subsequent changes often result from achieving milestones before the asset can be commercialised or from the buyer hitting a sales target. We also observe that the period before a single asset is ready for its intended use is different from the measurement period in IFRS 3. We believe that the objective in IFRS 3 is to fine tune the fair value of the total consideration transferred on the date of acquisition, with an effect on goodwill, a non amortisable item. In contrast, in IAS 16 or IAS 38, the objective is to capture in the original cost of the asset any directly attributable cost to get to a basis for depreciation once the asset is capable of generating cash inflows. We observe that this is a broader focus than

just a consideration of those directly attributable costs reflecting facts and circumstances that existed as at the date of purchase.

28. In addition, we note that for business combinations it may be difficult to distinguish those changes that might result from events and circumstances related in part to a pre-combination period from those changes that relate to the post-combination period (see BC357 of IFRS 3). In contrast, we believe that, for the purchase of single assets, the distinction pre/post-purchase should be made possible in practice in most, if not all, cases.

29. The table below outlines the drawbacks and advantages if a similar accounting were to be applied to contingent pricing:

Advantages for applicability	Drawbacks for applicability
Guidance applies to financial instruments	The bases for measuring the related asset upon recognition are different between IFRS 3 (subsequent changes may affect goodwill) and IAS 16/IAS 38 (directly attributable cost may be an element of the cost).
Provides a precedent and a basis to depart from the requirements in IAS 39 and IFRS 9 as to the accounting for subsequent changes to the financial liability under certain circumstances.	

30. We draw the Interpretations Committee's attention to the fact that applying a measurement period adjustment type of accounting to the contingent price for the purchase of a single asset may raise consistency concerns in that variations to an element of cost of an asset may be accounted for in two different ways: adjustment to the cost and recognition in profit or loss. In its paragraph 49, IFRS 3 also requires restatement of comparatives when a measurement period adjustment is made which may include making changes in depreciation or amortisation. In contrast, under the cost model, in accordance with paragraph 55 of IAS 16 and

paragraph 97 of IAS 38, amortisation begins only once the asset is ready for its intended use.

Update of latest Board's discussions on the Leases and Revenue Recognition projects

Revenue recognition - Uncertain consideration

31. We reproduce below the IASB Update on the Board's discussions at the main meeting in April 2011:

> The Boards discussed how an entity would determine the transaction price and recognise revenue when the customer promises an amount of consideration that is uncertain. The Boards tentatively decided that:
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> 1. An entity's objective when determining the transaction price is to estimate the total amount of consideration to which the entity will be entitled under the contract.
>
> 2. To meet that objective, an entity should estimate either of the following amounts depending on which is most predictive of the amount of consideration to which the entity will be entitled:
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> a. the probability-weighted amount, or
>
> b. the most likely amount.
>
> 3. An entity should recognise revenue at the amount allocated to a satisfied performance obligation unless the entity is not reasonably assured to be entitled to that amount. That would be the case in each of the following circumstances:
>
> a. the customer could avoid paying an additional amount of consideration without breaching the contract (for example, a sales-based royalty).
>
> b. the entity has no experience with similar types of contracts (or no other persuasive evidence).
>
> c. the entity has experience, but that experience is not predictive of the outcome of the contract based on an evaluation of the factors proposed in the Exposure Draft (for example, susceptibility to factors outside the influence of the entity, the amount of time until the uncertainty is resolved, the extent of the entity's experience, and the number and variability of possible consideration amounts).

32. We understand from the Board's decisions that for uncertain transaction prices (sales-based royalties, etc) the obligation is performed on the date of purchase and as such revenue is recognised at that date. Consequently, and by symmetry, we

believe it is consistent to assert that a liability should be recognised at that date in the buyer's financial statements. We note that the Board accepts that measurement for the uncertain portion of the transaction price could be nil at that date.

33. However, the revenue project does not provide insight as to the accounting for subsequent changes.

Leases - Variable lease-payments

34. We reproduce below the IASB Update on the Board's discussions at the main meeting in April 2011:

> **Lease payments that meet a high threshold**
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> The boards tentatively decided that the measurement of the lessee's liability and the lessor's receivable should not include variable lease payments that meet a high threshold.
>
> **Lease payments for which the variability lacks economic substance**
>
> The boards tentatively decided that the measurement of the lessee's liability and the lessor's receivable should include lease payments that are in-substance fixed lease payments but are structured as variable lease payments in form
>
> **Lease payments that depend on an index or a rate**
>
> The boards will discuss lease payments that depend on an index or a rate, including reassessment, at a future meeting. In addition, the boards directed the staff to consider appropriate disclosures for variable lease payments for future discussions. Accounting for changes to the asset should be redeliberated by the Board later in May.

35. We note that the tentative decisions to date on the Leases project as to the measurement of the liability are consistent with the Revenue Recognition project. The liability should be recognised on the date of purchase, but its measurement may not include all types of variable lease payments.

Summary of findings

Existing IFRS literature

36. The analysis above shows that there are circumstances in current IFRS literature under which changes to a financial liability are recognised as an adjustment to the cost of a related asset rather than recognised in profit or loss.

37. We note that similarly to the measurement period in IFRS 3, IAS 16 and IAS 38 set a period during which the cost of the asset may be increased by directly attributable costs.

38. At this stage, we ask for feedback from the Interpretations Committee as to whether it believes that the accounting for measurement period adjustments in IFRS 3 could be a sound basis for setting the accounting for some subsequent changes to a liability for a contingent price for the purchase of a single asset.

Effects of the recent Board's decisions

39. The recent Board's decisions confirm the existence of the liability that reflects the contingent price on the date of purchase irrespective of whether the buyer has control or not over the realisation of the triggering event.

40. We also note that decisions to date envisage a practical expedient for the measurement of the liability on the date of purchase in cases where it is difficult in practice to determine a reliable amount for the portion of the price that is uncertain on the date of purchase.

41. We are aware that the Board will reach further tentative decisions on the Leases project as to the accounting for subsequent changes to the amount of the asset for variable payments. We will keep the Interpretations Committee informed of the results of those discussions at the next Committee meeting in July 2011.

Staff's recommendation

42. We recommend that the Interpretations Committee should take no action as for now and should wait until the Board has concluded before developing clarification wording, if needed.

Questions to the Interpretations Committee

Questions—Feedback from the Interpretations Committee
(1) Does the Interpretations Committee believe that the accounting for measurement period adjustments in IFRS 3 could provide a sound basis for the accounting of subsequent changes to some contingent price for the purchase of a single asset?
(2) If so, does the Committee have inputs for the staff as to how to characterise those changes in the contingent price that should adjust the cost of the asset?
(3) Does the Interpretations Committee agree with the staff's recommendation to wait until the Board has concluded on other projects before developing clarification wording, if needed?

Appendix A—Selection of relevant IFRS literature

Excerpts from IFRIC 1 *Changes in Existing Decommissioning, Restoration and Similar Liabilities*

Issue

3 This Interpretation addresses how the effect of the following events that change the measurement of an existing decommissioning, restoration or similar liability should be accounted for:

(a) a change in the estimated outflow of resources embodying economic benefits (eg cash flows) required to settle the obligation;

(b) a change in the current market-based discount rate as defined in paragraph 47 of IAS 37 (this includes changes in the time value of money and the risks specific to the liability); and

(c) an increase that reflects the passage of time (also referred to as the unwinding of the discount).

Consensus

4 Changes in the measurement of an existing decommissioning, restoration and similar liability that result from changes in the estimated timing or amount of the outflow of resources embodying economic benefits required to settle the obligation, or a change in the discount rate, shall be accounted for in accordance with paragraphs 5–7 below.

5 If the related asset is measured using the cost model:

(a) subject to (b), changes in the liability shall be added to, or deducted from, the cost of the related asset in the current period.

(b) the amount deducted from the cost of the asset shall not exceed its carrying amount. If a decrease in the liability exceeds the carrying amount of the asset, the excess shall be recognised immediately in profit or loss.

(c) if the adjustment results in an addition to the cost of an asset, the entity shall consider whether this is an indication that the new carrying amount of the asset may not be fully recoverable. If it is such an indication, the entity shall test the asset for impairment by estimating its recoverable amount, and shall account for any impairment loss, in accordance with IAS 36

IASB Staff paper
Appendix A

Excerpts from IFRS 3 *Business Combinations*

Measurement period

45 If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer shall report in its financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, the acquirer shall retrospectively adjust the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date and, if known, would have affected the measurement of the amounts recognised as of that date. During the measurement period, the acquirer shall also recognise additional assets or liabilities if new information is obtained about facts and circumstances that existed as of the acquisition date and, if known, would have resulted in the recognition of those assets and liabilities as of that date. The measurement period ends as soon as the acquirer receives the information it was seeking about facts and circumstances that existed as of the acquisition date or learns that more information is not obtainable. However, the measurement period shall not exceed one year from the acquisition date.

46 The measurement period is the period after the acquisition date during which the acquirer may adjust the provisional amounts recognised for a business combination. The measurement period provides the acquirer with a reasonable time to obtain the information necessary to identify and measure the following as of the acquisition date in accordance with the requirementsof this IFRS:

(a) the identifiable assets acquired, liabilities assumed and any non-controlling interest in the acquiree;

(b) the consideration transferred for the acquiree (or the other amount used in measuring goodwill);

(c) in a business combination achieved in stages, the equity interest in the acquiree previously held by the acquirer; and

(d) the resulting goodwill or gain on a bargain purchase.

47 The acquirer shall consider all pertinent factors in determining whether information obtained after the acquisition date should result in an adjustment to the provisional amounts recognised or whether that information results from events that occurred after the acquisition date. Pertinent factors include the date when additional information is obtained and whether the acquirer can identify a reason for a change to provisional amounts. Information that is obtained shortly after the acquisition date is more likely to reflect circumstances that existed at the acquisition date than is information obtained several months later. For example, unless an intervening event that changed its fair value can be identified, the sale of an asset to a third party shortly after the acquisition date

for an amount that differs significantly from its provisional fair value determined at that date is likely to indicate an error in the provisional amount.

48 The acquirer recognises an increase (decrease) in the provisional amount recognised for an identifiable asset (liability) by means of a decrease (increase) in goodwill. However, new information obtained during the measurement period may sometimes result in an adjustment to the provisional amount of more than one asset or liability. For example, the acquirer might have assumed a liability to pay damages related to an accident in one of the acquiree's facilities, part or all of which are covered by the acquiree's liability insurance policy. If the acquirer obtains new information during the measurement period about the acquisition-date fair value of that liability, the adjustment to goodwill resulting from a change to the provisional amount recognised for the liability would be offset (in whole or in part) by a corresponding adjustment to goodwill resulting from a change to the provisional amount recognised for the claim receivable from the insurer.

49 During the measurement period, the acquirer shall recognise adjustments to the provisional amounts as if the accounting for the business combination had been completed at the acquisition date. Thus, the acquirer shall revise comparative information for prior periods presented in financial statements as needed, including making any change in depreciation, amortisation or other income effects recognised in completing the initial accounting.

Contingent consideration

58 Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 45–49. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:

(a) Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.

(b) Contingent consideration classified as an asset or a liability that:

(i) is a financial instrument and is within the scope of IFRS 9 or IAS 39 shall be measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income in accordance with IFRS 9.

(ii) is not within the scope of IFRS 9 shall be accounted for in accordance with IAS 37 or other IFRSs as appropriate.