In brief
A look at current financial reporting issues

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Variable payments for the separate acquisition of PPE and intangible assets

Issue

The IFRS Interpretations Committee (IC) has declined to address accounting for variable payments for the purchase of intangible assets and property, plant and equipment. The current diverse practice is expected to continue.

The issue has been the subject of discussions at the IC and at the IASB for several years. The IC finally concluded in March 2016 that the issue was too broad for it to address and published a formal decision not to add this issue to its agenda.

Impact

Variable payments occur in a number of industries; the purchaser makes an initial payment to acquire an asset and promises subsequent payments to the vendor. The additional payments may be triggered, for example, by the occurrence or non-occurrence of future events, the performance of the asset, the financial return earned by the purchaser or the existence and quantity of natural resources.

Many different industries are affected; pharmaceuticals, extractives, real estate and telecoms among others. There are two key accounting questions to consider:

1. Should a financial liability be recognised for variable payments on initial recognition of the related asset?
2. Are subsequent changes in the liability recognised in profit or loss or as adjustments to the cost of the asset?

There are two broad approaches applied in practice to accounting for variable payments. The effect on the balance sheet and the income statement could be material depending on the accounting approach selected.

Financial liability approach

The first approach is to apply a financial liability model, with the liability recognised at fair value at the date of recognition of the asset and subsequently remeasured through the income statement at every reporting date. The measurement of the liability is impacted by changes in the amount of payment, the likelihood of payment and the timing of payment. Significant income statement volatility may result as subsequent increases or reversals of the liability hit profit or loss.

Cost accumulation approach

The second approach is a cost accumulation model. A liability is recognised for estimated additional payments at the date of recognition of the asset. The liability is not remeasured until the change becomes highly probable or virtually certain. The adjustment to the liability is added to (or deducted from) the carrying amount of the related asset. This approach can expose assets to a greater risk of impairment as the cost accumulates.

Insight

Who is affected?

The issue is relevant for entities in a number of industries: pharmaceuticals, mining, oil and gas, telecommunications, entertainment and real estate among others.

Examples of arrangements with variable payment terms include: the purchase of a licence, purchase of a complex piece of equipment, acquisition of an in-process research and development project for a new drug and service concession agreements, among others.

What's next?

The IC decision means that the current diversity in practice is expected to continue.

A company should choose a measurement approach that is appropriate to the type of transactions it has and then apply that approach consistently to all similar transactions. The approach followed should be clearly disclosed and may in some circumstances rise to the level of a critical judgement under IAS 1.

If you have questions or require further information, please speak to your regular PwC contact.