IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase

Extract, IFRS Discussion Group Report on Meeting – May 31, 2016

The Group discussed the issue, "IFRS 3, IAS 16 and IAS 37: Contingent Consideration in an Asset Purchase" at its meeting on September 11, 2014.

The issue was whether the contingent consideration payable in an asset purchase when the assets do not constitute a business should be:

- measured at fair value and recorded as part of the cost of purchase (View A);
- measured and recorded at some other point (for example, when the conditions associated with the contingency are met) (View B); or
- measured in accordance with an accounting policy choice because IFRS guidance in unclear (View C).

At that time, the Group expressed diverse views on this issue. Many Group members thought the accounting is dependent on the fact pattern and that no view could be discounted outright. The Group noted that the IFRS Interpretations Committee discussed the accounting for variable payments for asset purchases in 2013 and recommended that the IASB undertake a narrow-scope project to address the issue. The IASB decided it would reconsider the issue after the proposals in the IASB's Exposure Draft, "Leases" had been redeliberated. Therefore, the Group recommended that the AcSB monitor the IASB's consideration of this issue in relation to its Leases project.

Subsequent to the Group's discussion, the IFRS Interpretations Committee revisited this issue at its September 2015 and November 2015 meetings. The IFRS Interpretations Committee considered two possible views with respect to initial recognition of variable payments:

- Apply the leasing principles. This application would include variable payments based on an index or rate in the initial measurement of a liability for acquisition of an asset and exclude all other variable payments, such as those dependent on the future activity of the purchaser. This view shared some similarities to View B that the Group discussed at its September 2014 meeting.
- Apply the business combination principles. This application would result in the purchase-date fair value of all variable payments being recognized as part of the consideration transferred in exchange for the asset(s). This view is similar to View A discussed by the Group at its September 2014 meeting.

In the March 2016 agenda decision, the IFRS Interpretations Committee noted that it could not reach a consensus on whether the variable payments that depend on the purchaser's future activity should be recognized as a liability on the purchase date of the asset or only when that activity is performed. The IFRS Interpretations Committee was also unable to reach a consensus on how the purchaser measures a liability for such variable payments. In addition, during the IASB's deliberations on its Leases project, the Board did not conclude whether these variable payments meet the definition of a liability. As a result, it is not clear whether an analogy to the principles of the Leases project could be made. The IFRS Interpretations Committee concluded that the IASB should address the accounting for variable payments comprehensively.

The Group's Discussion

Group members discussed whether the deliberations of the IFRS Interpretations Committee subsequent to September 2014 would change their previous views on the accounting for contingent consideration in an asset purchase.

Some Group members noted that views on this issue have not changed in practice and international deliberations furthered the possibility of an accounting policy choice (View C). However, the Group noted that before reaching this conclusion, preparers should carefully examine whether the facts and circumstances of an entity's situation are similar to the fact pattern discussed by the IFRS Interpretations Committee. Preparers should also consider whether the arrangement is in the scope of other standards that could require the recognition of a liability (for example, IAS 39 *Financial Instruments: Recognition and Measurement* or IFRS 9 *Financial Instruments*).

One Group member observed that there is tension between the recognition and measurement concepts, and that it is important to determine first whether there is something to recognize. Another Group member noted that the IFRS Interpretations Committee discussion focused more on determining whether there is a financial liability and moved away from analogizing to the principles in IFRS 3 *Business Combinations*. A question was raised on where the debit entry would be recorded if an entity chooses not to recognize the contingent consideration in an asset purchase but subsequently pays for it. One Group member suggested that a future agenda item could be to discuss various scenarios involving a contingent consideration payable.

Overall, the Group's discussion raises awareness about this item. No further action was recommended to the AcSB.

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