Accounting for variable or contingent payments relating to the acquisition of property, plant and equipment.

Journal:	*Meditari Accountancy Research*
Manuscript ID	MEDAR-02-2016-0011
Manuscript Type:	Research Paper
Keywords:	Financial reporting, Qualitative research, Accounting theory

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Accounting for variable or contingent payments relating to the acquisition of property, plant and equipment.

Abstract

The accounting to be applied when dealing with contingent payments relating to the acquisition of property, plant and equipment has been identified by the IASB as a transaction that requires a solution. (IASB, 2011) The existing literature relating to property, plant and equipment is IAS 16; however it is silent on this transaction. A lack of guidance of this transaction results in inconsistencies in financial statements, as well as confusion by preparers as well as by users of the financial statements. This paper purports to explore and develop possible accounting options that may be applicable in accounting for this anomaly. The accounting options were developed by drawing from existing IFRS literature, and amongst others, the concepts of accountability, information usefulness, neoliberalism, and positivism. A questionnaire was conducted, and the results thereof were inconclusive, with no one option taking precedence over the other. This reflected that further research in the area is required as each scenario is unique, the accounting thereof will differ.

Keywords: Contingent payment, property, plant and equipment, useful information, neoliberalism, accountability

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1. Introduction

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One of the biggest challenges facing entities is striking a balance between preparing and presenting financial statements which encompass accountability and stewardship, together with providing useful information (IASB, 2010a). IFRS focuses on the provision of useful information as the core aspect of financial statements (IASB, 2010a). Accountability, however, cannot be set aside as it represents one of the root metaphors in accounting, and through the evolution of this craft, the provision of useful information may have taken precedence over the notions of accountability and stewardship. (Ravenscroft; Williams, 2009) This does not undermine the importance of reflecting accountability in the information that entities provide to their stakeholders.

With the advancement of technology and an abundance of information at users' fingerprints, greater responsibility is placed on entities to provide useful, faithfully represented and necessary information to its stakeholders. This responsibility is heightened due to the fact that many more people have access to the information, and possess a greater basic understanding of business, accounting and economics as compared to 50 years ago.

Accounting could be viewed as the core of an entity and its operations, whereby accounting influences the organisation in addition to the organisation influencing accounting (Hopwood, 1987). In other words, the accounting system is a flexible one which should be able to adapt to changes circumstances (Hopwood, 1987). In a contemporary setting, characterised by growing commercial complexity, entities may encounter transactions or events that are unusual or infrequent, which may be regarded as anomalies. In certain instances, no or a lack of guidance may be available relating to how one should account for this specific transaction or event, necessitating the use of professional judgement and existing accounting principles to develop an appropriate accounting policy (IASB, 2003).

The transaction this report aims to explore is when an entity acquires property, plant and equipment (PPE) where a part of the purchase consideration is payable on the satisfaction or realisation of one or more future events. Currently, International Accounting Standard 16 governs transactions relating to PPE, however, there is little guidance on the accounting for the contingent payments relating to the acquisition of property, plant and equipment. The IASB has undertaken a project to develop an accounting policy for this transaction and it is a current issue that has been identified by the IASB that is in need of a solution (IASB, 2011). This research paper finds this topic to be both an important one as it is a transaction that could potentially have a material effect on financial statements, and a solution is required to reduce the level of inconsistencies arising from accounting for this transaction in the financial statements of entities. This paper purports to answer the questions that have been set out by

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the IASB, aiming to explore possible accounting options, drawing from theories and historical events that have contributed to the dynamic nature of accounting standards.

PPE represents a major asset of a large number of industries, ranging from mining to retailing, forming a significant aspect of the entity's operations, and is both a qualitatively and quantitatively material line item in the financial statements of entities. PPE is an asset, however it does not only affect the asset section of the Statement of Financial Position. The accounting for property, plant and equipment affects profit and loss, in the form of depreciation, impairments and other write downs (IASB, 2014, paragraphs 43-63), it affects other comprehensive income if subsequently measured under the revaluation model in IAS 16 (IASB, 2014, paragraphs 31-42), it also affects the taxation charge in the Statement of Profit and Loss and Other Comprehensive Income, impacting both deferred and current tax as well as the deferred tax balance in the Statement of Financial Position (IASB, 2010, paragraph 58). The impact of this particular transaction relating to property, plant and equipment is pervasive to financial statements in its entirety, and not confined to a single line item. As a result, it influences many ratios that are used to analyse the entity's profitability, liquidity, solvency and earnings, upon which many investment and financing decisions are based. It is important that entities maintain a level of coherence and consistency when accounting for this transaction. This paper attempts to reduce the level of uncertainty around the way it is accounted for and is not exhaustive.

The rest of this paper is structured as follows: Section 2 is a literature review that comprises of subsections dealing with the provision of useful information, accountability as well as neoliberalism. This is followed by Section 3 which discusses the method used to collect data for the purpose of this research. Section 4 analyses the results of the data collected and section 5 concludes this paper.

2. Literature review

A lack of guidance on this transaction leads to management using its own assumptions to develop a methodology that can be followed to account for this transaction. This results in the accounting for this transaction varying from entity to entity. This results in inconsistencies between the financial statements of different entities which undermines comparability, which is an enhancing qualitative characteristic of useful information (IASB, 2010a, paragraphs QC20-QC25).

Accounting serves as a medium of communication between an entity and its stakeholders (Hopwood, 1987). It is a powerful tool that is used to capture the performance and financial position of an entity into financial statements and the notes that accompany them. This

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influences the entity's profitability and sustainability. Stakeholders may use the financial statements to base an investment or a financing decision, and is not something that can be taken lightly. The evolution of this craft has ensured that the accounting principles and concepts in place provides useful information to users of the financial statements and purports to faithfully represent the entity's financial performance and position (IASB, 2010a, paragraph OB2).

2.1 Theoretical framework

2.1.1 The provision of useful information

The provision of useful information has been identified as the dominant and primary objective of financial reporting (IASB, 2010a, paragraph OB2). Thus, it is essential that this goal is reached in the entities financial statements and other reports. The challenge lies in defining exactly what useful information is (Ravenscroft; Williams, 2009). *The Conceptual Framework* describes 'useful information' by using qualitative characteristics to provide guidance as to what attributes useful information possess. They are broken into two categories, fundamental qualitative characteristics and enhancing qualitative characteristics (IASB, 2010a). They are as follows:

Fundamental qualitative characteristics

Relevance

> "Relevant financial information is capable of making a difference in the decisions of users. Financial information is capable of making a difference in decisions if it has predictive value, confirmatory value or both." (IASB, 2010a, Paragraph QC6)

The concept of materiality falls under relevance. Information is regarded material if the omission or misstatement thereof, could influence decisions of users, materiality is entity specific aspect of relevance (IASB, 2010a, paragraph QC11).

Faithful Representation

> "To be a perfectly faithful representation, a depiction would have three characteristics. It would be complete, neutral and free from error" (IASB, 2010, Paragraph QC12)

Enhancing qualitative characteristics

These are characteristics that enhance the usefulness of information that is relevant and faithfully represented. These are as follows:

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> "Information about a reporting entity is more useful if it can be compared with similar information about other entities and with similar information about the same entity for another period or another date." (IASB, 2010, Paragraph QC20)

Verifiability

> "Verifiability means that different, knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation" (IASB, 2010, Paragraph QC26)

Timeliness

> "Timeliness means having information available to decision-makers in time to be capable of influencing their decisions." (IASB, 2010, Paragraph QC29)

Understandability

> "Classifying, characterising and presenting information clearly and concisely makes it understandable" (IASB, 2010, Paragraph QC30)

Although the above factors provide a framework to consider when providing information that is intended to be useful, useful information remains a subjective concept as what is considered useful by one party may not be considered useful to another (Ravenscroft; Williams, 2009). The general consensus is that if that information is capable of influencing the decision of the user, it is considered as useful.

2.1.2 Neoliberalism

Neoliberalism, another political factor, played an influential role in the conceptual shift in accounting. It transformed accounting function from evaluating past actions and their consequences to one of providing data to enable prediction as input to many economically rational decision models (Ravenscroft; Williams, 2009). As a result thereof, a gradual shift to fair value accounting occurred. The greed for creating huge profits is an important characteristic of the neo-liberal concept of capitalism and thus represents a foundation for the creation and the development of fair value accounting. The primary aim of fair value accounting is both the creation and placement of an unrealised gain or profit. It is general consensus that fair value does not represent a market place but rather a hypothetical market price established by various assessment methods and techniques (Stojlkovic, 2010).

Fair value can be a useful piece of information, but could lack accountability. Fair value represents a market related figure exclusive of entity specific factors, which does not necessarily indicate management's stewardship or use of the entity's assets. Fair value is to

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a degree, a subjective number. Although general valuation methods, techniques and models are used, there is still some degree of judgement and use of assumptions in determining a fair value. Determining fair value is a complex task and can be an expensive and time consuming process, which could result in management manipulating figures to avoid the expenditure and effort that must be incurred in calculating a fair value (Stojlkovic, 2010).

Fair value accounting has emerged and developed and is prominent in many accounting standards. The IASB has embraced the neoliberal shift to fair value accounting, as many standards now allow or require the measurement of assets and/or liabilities at fair value. Examples include IAS 40: Investment Property, where entities can choose to carry investment property at fair value (the fair value model) (IASB, 2003, paragraph 33), IAS 16: Property, plant and equipment has the revaluation model, where property plant and equipment is carried at fair value (IASB, 2014, paragraph 31), IFRS 9: Financial instruments has fair value models that can be applied to financial liabilities and assets (IASB, 2013) as well as IFRS 3: Business Combinations, where the acquirer shall measure the identifiable assets acquired and the liabilities assumed at their fair values on the acquisition date, with any resulting gains or losses presented in profit and loss, in addition to this the consideration transferred must also be measured at fair value (IASB, 2008, paragraphs 18; 37; 38). Another example of the neoliberal impact on account is the replacement of 'reliability' with 'faithful representation' (IASB, 2010a) as the trade-off between relevance and reliability was usually a reason not to use fair value measures, as they are perceived as often being relevant but unreliable (Zhang; Andrew, 2014).

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2.1.3 Accountability and the agency theory

Accounting has its origin in the need to give account to someone for a specific transaction. This notion was the dominant purpose of until a paradigm shift to providing useful information (Ravenscroft; Williams, 2009). Accountability is the responsibility or obligation owed to someone who has entrusted another with possessions to manage on their behalf.

> 'Accountability has clearly been the social and organizational backbone of accounting for centuries. Accounting, therefore, starts with the recording and reporting of activities and their consequences and ends with the discharging of accountability. This basically describes accounting, at least if we attempt to interpret the existing practice rationally. We may, therefore, say that accountability is what distinguishes accounting from other information systems in an organization or in society" (Ijiri, 1975, Page 32).

Accountability is fundamental to accounting for transactions and events that occur in an entity. Keeping a record of all resources generated and expended, emphasizing

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documentation and authorisation, makes sense in a regime of accountability. Giving an account to someone, the ability to hold someone accountable and the isolation of responsibility all leads back to accountability. Therefore, accountability remains a living law that is embedded in accounting and forms an integral part of an entity's financial statements and reports (Ravenscroft; Williams, 2009; Murphy et al, 2013).

Accountability is related to agency theory and in certain ways may be seen as a notion that mitigates risks inherent in the agency theory. Agency problems are a result of goal incongruence, in terms of which there is a conflict between the goals and interests of the agent, being management, and the principle, being the shareholders or the owners of a business. Agency theory re-establishes the importance of self-interest and incentives in organisational thinking (Eisenhardt, 1989). Incentive payments are usually performance-based. These incentives are calculated on profit which is an accounting number. It is human nature to be inclined to act in the best interests of yourself and to maximise your own benefit. As a result of this conflict of interest, management may manipulate accounting standards and adopt those which results in the best outcome for them. The standards and accounting policies that result in an increase in the profit figure and a decrease in expense is likely to be favoured by management (Watts; Zimmerman, 1978). Accountability reduces this risk by encouraging a more prudent approach, to reflect in financial reporting exactly how management has utilised the entities assets, and how that has resulted in either profit or losses for the entity (Ravenscroft; Williams, 2009). Disclosing qualitative information in the annual report of entities is another example of accountability. Accountability aims to promote trust and cooperation between the agent and principle which could narrow the gap created by the agency theory (Ravenscroft; Williams, 2009).

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2.1.4. The relationship between accounting and the organisation and its needs

Accounting represents dynamic phenomenon. It is not only a set of rules; it adapts and reacts to changes in economic, social, environmental and political factors (Ravenscroft; Williams, 2009). Accounting has continued to evolve into an integral part of an entity, without which could result in ineffective and inefficient operations and business processes.

Generally, accounting is perceived to be a craft that simply records and captures all of the transactions and events that occur in an entity. It is a function that is independent of the core operation of the entity. Accounting has, however revolutionised into something that influences the organisation just as much as the organisation may influence accounting. Accounting is implicated in many facets of an organisation including processes of direction,

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planning, decision making, coordination, control and the management of motivation. Accounting can have a positive impact on the efficiency and effectiveness of the organisation (Hopwood, 1987).

The needs and requirements of the organisation is a way in which accounting can be viewed and understood. Users of the financial reports and statements generated by an organisation consist of users that are both internal and external to the organisation. Therefore, the pressure to fulfil the needs of all users of the financial reports changed accounting from an organisationally isolated viewpoint to one that takes the needs of all affected parties into consideration. Organisational needs which encompass social, political and economic factors and tensions, depending on the specific objectives and circumstances of an entity, have influenced developments in accounting system in response to this. It should also be noted that accounting affects the organisation in multiple ways and could potentially improve the way in which it functions, by employing specific accounting changes and policies. And by doing so, accounting brought about a possibility and opportunity for its own transformation. As the organisation, the market and environment in which it operated got more complex and dynamic, the accounting system had to be adapted to correctly reflect the events that transpire as a result thereof (Hopwood, 1987). The transaction this paper deals with has brought about the need to amend the IAS 16, the existing standard dealing with PPE. This is discussed in the next subsection.

2.1.5. IAS 16

Transactions relating to PPE fall under IAS 16. This standard is currently silent relating to the accounting for contingent payments relating to the acquisition of PPE, however, the principles present in IAS 16 can be applied to this transaction, to assist one in deciding how to account for this transaction.

IAS 16 splits the cost of PPE into two categories, namely initial costs and subsequent costs. Initial costs are costs that are incurred at acquisition of the asset and subsequent costs are incurred after acquisition. It further states that an item of PPE that meets the recognition criteria must be measured at its cost. The elements of cost include the purchase price of the asset, including import duties and non-refundable taxes and after trade discounts and rebates, any costs that are directly attributable to bringing the asset to the condition and location necessary for it to be capable of operating in the manner intended by management and the initial estimate of dismantling, removal and restoration costs, as a result of the entity's obligation to do so (IASB, 2014, paragraphs 11-17).

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All of the above have been taken into account in developing possible accounting options for the accounting of contingent payments relating to the acquisition of PPE which is presented in a later section in this paper.

2.2. The accounting for variable or contingent payments relating to the acquisition of property, plant and equipment

Although IAS 16 is silent with regards to this transaction, there are a few standards that have similar transactions on which guidance is provided. One of the main issues is to identify whether the conditional payment would form part of the initial cost or the subsequent cost of the asset. There has been a conflict of views by the IASB in determining if the contingent payment forms part of the initial cost of the asset. On the one hand, some believe that the contingent payment should form part of the cost of the asset, even though the event triggering the payment occurs after initial recognition, provided that a reasonable estimate of the payment can be made on date of initial recognition (IASB, 2011).

On the other hand, IAS 16 refers to 'costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management' (IASB, 2014, paragraph 16). This could be seen as a cut-off date for costs forming part of the initial cost of the asset. As the asset can be operated in the manner intended by management, and no obligation exists at acquisition date for the contingent payment as the triggering event has not occurred, the contingent payment should not form part of the initial cost of the asset. In addition to this, payments for a realisation of a future event are representative of the value of the date of the future event as opposed to its cost at time of acquisition (IASB, 2011). Emphasizing this argument is the fact that depreciation commences once the asset is ready for its intended use and therefore costs incurred beyond this date should not be an element of the initial cost of an asset (IASB, 2014, paragraph 55).

Principles confined within current IFRSs can be used to interpret to what extent a conditional payment after the assets recognition date is an element of the assets cost. A contingent payment can be variable, based on future sales, volumes or another factor subject to change, or the payment can be fixed (IASB, 2011).

As mentioned above, contingent payments can be based on a number of variable factors. These include performance and usage of the asset, performance of the entity acquiring the

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asset; the payment can be based on an index or upon obtaining a regulatory approval (IASB, 2011). A contingent payment dependant on the future performance or usage of the asset is difficult to link to the initial cost of the asset. As this is determined during the operating phase of the asset, it is unlikely that it is related to the initial purchase of the asset, but rather representative of changes in the value of the asset during operation. A contingent payment based on indices can fall into two broad categories, indices directly linked to the asset or indices entirely disconnected from the asset acquired. If the index has a direct link to the asset purchased, it can be argued that the contingent payment has an effect on the cost of the asset on acquisition date. If it can be proved that the contingent price is a financial instrument, it should be accounted for under IFRS 9 and excluded from the cost of the asset at acquisition. Contingent prices disconnected from the asset should not form part of the initial cost of the asset as it is not 'directly attributable' to the asset (IASB, 2011).

It is also important to determine if an obligation to make a contingent payment exists at acquisition date. The nature of a contingent payment is one of dependence. The payment is contingent upon the satisfaction or realisation of one or more future events or conditions. At initial recognition, there is no certainty as to whether the future events or conditions will be realised or satisfied. In this instance there is no obligation on the date of purchase for the buyer. In certain circumstances, the date of payment is fixed, and the monetary amount is contingent upon future events, in this instance, an obligation exists as a payment will be made, the uncertainty arises around the amount. Contingent payments of a contractual nature may create an obligation on acquisition date (IASB, 2011).

Accounting principles in existing IFRS literature can be used to develop an accounting policy to account for this transaction. Analogies to IFRSs that have similar concepts have been identified and are presented below (IASB, 2003).

IFRS 3: Business Combinations

The principles relating to a contingent consideration in IFRS 3 state:

> "The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration. The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree" (IASB, 2008, Paragraph 39)

It further goes on to state that:

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> "The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial liability or as equity on the basis of the definitions of an equity instrument and a financial liability" (IASB, 2008, Paragraph 40)

IFRS 3 also provides guidance on subsequent measurement of the contingent consideration which is presented in paragraph 58 of IFRS 3.

Applying IFRS 3 by analogy to the accounting for contingent or variable payments for the acquisition of PPE would result in the capitalisation of the fair value of the contingent consideration at the date of purchase of the asset and subsequent changes in the fair value of the contingent payment presented in profit and loss (IASB, 2008, paragraphs 39 and 58). If the contingent payment is on conditions similar to a contingent consideration that is payable in a business combination, it would be questionable to apply principles different to those in IFRS 3, solely on the basis of whether the asset was acquired as part of a business combination or independently. The support of this analogy will enhance consistency and comparability across IFRSs, as it makes reference to existing literature (IASB, 2008; IASB, 2011). As a result, the following accounting policy was included in the final survey instrument:

<u>**Option 1**</u>

Capitalise the fair value of the future variable or contingent payment(s) as part of the initial cost of property, plant and equipment with the corresponding amount recognised as a provision. If the provision is settled at a future date when the contingencies are met, the provision shall be reversed. If the condition is not met and it is no longer probable that an outflow of benefits would be required to settle an obligation, the provision shall be derecognised with a corresponding gain in profit or loss.

The issue with the application of this analogy is the fundamental difference in acquiring an asset as compared to acquiring a business. Acquiring a business is in essence acquiring two elements, namely inputs and processes, in comparison to purchasing an asset which does not possess processes. Therefore, a contingent payment that forms part of the initial cost of an asset can be directly linked to an asset that is purchased separately. In contrast to this, it may be more difficult to link the contingent consideration to an asset acquired as a result of the business combination, as it may relate to other aspects of the business and cannot be

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allocated on a reasonable or consistent basis to separate components of the business (IASB, 2008; IASB, 2011).

IFRIC 1: Changes in existing decommissioning, restoration and similar liabilities

IFRIC 1 deals with changes in liabilities that have been capitalised as part of the cost of the asset (IASB, 2004). This relates to contingent payments as it may provide guidance relating to the subsequent measurement of the contingent payment once it has been included in the initial cost of the asset. Similarities between decommissioning or restoration liabilities and contingent payments, include the need for estimation of the amount at initial recognition and the fact that conditions need to be met in both instances (the entity must use the asset for a particular period and has the obligation to dismantle, remove or restore the site on which the asset is located). The contra to this journal would be accounted for in accordance with IAS 37: Provisions, Contingent Liabilities and Contingent Assets (IASB, 2014, paragraph 18).

If one were to apply IFRIC 1 to the accounting for contingent payments relating to the acquisition of PPE, it would result in the capitalisation of the initial estimate of the contingent payment as part of the initial cost of the asset, with subsequent changes to this liability, to the extent that they do not reflect the passage of time, be adjusted against the cost of the asset or against any balance of revaluation surplus, depending on whether the asset is carried on the cost model or revaluation model respectively (IASB, 2014; IASB, 2004, paragraphs 4-6). As a result, the following accounting policy was included in the final survey instrument:

Option 2

Capitalise the fair value of the future variable or contingent payment(s) as part of the initial cost of property, plant and equipment with the corresponding amount recognised as a provision. If the provision is settled at a future date when the contingencies are met, the provision shall be reversed. If the conditions are not met and it is no longer probable that an outflow of benefits would be required to settle the obligation, the provision shall be derecognised and a corresponding adjustment is posted to property, plant and equipment. Depreciation, useful life and any residual value should be adjusted accordingly.

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Using the above discussion, four possible accounting options have been developed. These have been presented below followed by a brief justification.

Option 1: Capitalise the fair value of the future variable or contingent payment(s) as part of the initial cost of property, plant and equipment with the corresponding amount recognised as a provision. If the provision is settled at a future date when the contingencies are met, the provision shall be reversed. If the condition is not met and it is no longer probable that an outflow of benefits would be required to settle an obligation, the provision shall be derecognised with a corresponding gain in profit or loss.

Option 2: Capitalise the fair value of the future variable or contingent payment(s) as part of the initial cost of property, plant and equipment with the corresponding amount recognised as a provision. If the provision is settled at a future date when the contingencies are met, the provision shall be reversed. If the conditions are not met and it is no longer probable that an outflow of benefits would be required to settle the obligation, the provision shall be derecognised and a corresponding adjustment is posted to property, plant and equipment. Depreciation, useful life and any residual value should be adjusted accordingly.

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As discussed earlier, it may be possible for a contingent payment to be considered an element of the initial cost of the asset. The other leg of the journal according to the above two options is to recognise a provision. A provision is defined as a liability of uncertain timing or amount (IASB, 2001, paragraph 10). Depending on the specifics of the transaction, either the timing or the amount may be fixed, in which instance recognising a provision would be appropriate. The pre requisite to recognising a provision is meeting the definition and recognition criteria of a liability in *The Conceptual Framework*:

> "A liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits" (IASB, 2010a, Paragraph 4.4)

As discussed earlier, an obligation may exist at the date of purchase, in instances where a payment is certain but the amount or timing thereof is uncertain, or if the payment is of a contractual nature. The past event would be the actual acquisition of the asset and the payment amounts to the outflow of resources embodying economic benefits. The definition criteria of a liability are met; however, before a liability can be recognised, the recognition criteria must be recognised. The recognition criteria states that:

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> "A liability is recognised in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably" (IASB, 2010a, Paragraph 4.46)

The probability of the payment must be analysed with reference to the specific situation. Estimating the payment will require the use of judgement and inherently will include some level of uncertainty; however using generally accepted valuation techniques and methods could reduce the uncertainty to an acceptably low level, and would provide a reliable estimate of the liability.

As proved above, it is possible to satisfy both the definition and recognition criteria of a liability as well as the definition of a provision, and therefore Option 1 and 2 is applicable. Fair value has been used as the measurement due to the conceptual shift to fair value accounting as a result of neoliberalism and is consistent with the flavour in existing IFRSs (Ravenscroft; Williams, 2009; Stojlkovic, 2010). Fair value may also provide the best estimate of the amount payable and could be argued to provide the most useful information to users of the financial statements. This amount must be restimated at each reporting period, and any changes accounted for in profit and loss (IASB, 2011).

The difference in the two options exists if no contingent payment is made. Option 1 proposes that the provision shall be derecognised, with the contra recognised in profit and loss, whilst Option 2 suggests that the contra of the derecognition of the provision be made as an adjustment to PPE. Option 1 would usually create an unrealised gain in profit which could be favoured by entities as it would inflate profits and overstate PPE as the contingent payment would remain a part of the cost of the asset (Watts, Zimmerman, 1978). In addition to this, the fact that a payment has not been made does not necessarily result in an increase in economic benefits that can be measured reliably, which is in contravention of the definition of income in the conceptual framework (IASB, 2010a). The increase in profits by the contingent payment has a positive connotation to it that communicates a good level of stewardship by management of the entity's assets, which may not always be reality. This is reflective of the positivist theory of accounting (Watts; Zimmerman, 1978). Option 2 will result in a decrease in PPE, which is skewed in favour of the notion of accountability as PPE would not be overstated by the contingent consideration. It is arguable that the treatment proposed by Option 2 better represents faithfully the economic substance of the transaction as compared to Option 1 (IASB, 2010a).

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Option 3: Disclose a contingent liability or contingent asset in relation to the variable or contingent payment in the financial statements only. Do not recognise the amount

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as part of the initial cost of property, plant and equipment. If the payment is made or received at a future date, recognise the payment as an expense or gain in profit and loss.

Option 4: Disclose a contingent liability or contingent asset in relation to the variable or contingent payment in the financial statements only. Do not recognise the amount as part of the initial cost of property, plant and equipment. If the payment is made or received at a future date, a corresponding adjustment should be made to the property, plant and equipment. Depreciation, useful life and any residual value should be adjusted for accordingly.

Option 3 and 4 take somewhat of a more prudent approach in comparison to Option 1 and 2. A contingent liability as per IAS 37 is defined as:

> "A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity or,
>
> A present obligation that arises from the past events but is not recognised because it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation or the amount of the obligation cannot be measured with sufficient reliability." (IASB, 2001, Paragraph 10)

A contingent asset is defined as:

> "A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity" (IASB, 2001, Paragraph 10)

It is vital to note the fundamental difference between a provision and a contingent liability. A provision is recognised in the financial statements whilst a contingent liability is only disclosed in the financial statements. A contingent payment can be applied to the definition of a contingent liability or a contingent asset rather easily. A contingent payment is dependent on the occurrence or non-occurrence of one or more future events and it may be difficult to estimate the cost of the contingent payment or to assess the probability of the payment being made due to the inherent level of uncertainty and subjectivity. The agency theory is relevant here as management may want to recognise the contingent payment as part of the cost of the asset, which provides the opportunity to possibly recognise an unrealised gain in profit or loss as described by Option 1. This could result in higher performance bonuses for management, but may not truly represent the economics of the transaction (Watts; Zimmerman, 1978; Eisenhardt, 1989).

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Once again, the difference in the Option 3 and Option 4 exists in subsequent accounting, after the future event/s has occurred. Option 3 proposes that the payment be recognised as an expense or gain in profit or loss while option 4 suggests that the payment should result in a consequent increase or decrease to the cost of the item of property, plant and equipment.

Both gain and expense are defined terms in *The Conceptual Framework*. A contingent payment made or received would meet the definition of expense and income respectively and it would therefore be appropriate to apply Option 3. Option 4 implies that the contingent payment made is a subsequent cost that qualifies for recognition of an asset. In order for this to be compliant with IAS 16, the payment must meet the definition and recognition criteria of an asset in the conceptual framework. The definition and recognition criteria of an asset are as follows:

Definition of an asset

> "An asset is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity" (IASB, 2010, Paragraph 4.4)

Recognition criteria of an asset

> "An asset is recognised in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be reliably measured" (IASB, 2010, Paragraph 4.44)

The main issue is determining if the benefits flowing to the entity are enhanced or depleted a result of the contingent payment being made or received. Making a contingent payment may not necessarily increase the operating capacity of the asset but instead maintain the current capacity of the asset or allow management continued usage of the asset. The contingent payment may simply be part of the purchase consideration, due to contractual, cash flow or other reasons, of the asset with no impact on the usage or performance of the actual asset. In this scenario, capitalising the payment to PPE reflects an increase in assets, which is not useful information as in essence no addition has been made to PPE. In the case where a contingent payment is receivable, Option 4 suggests that the credit goes to PPE. This may not be appropriate as the economic benefits embedded in the asset remain unchanged. In these instances, Option 4 is not representative of the substance of the transaction.

In a change of circumstance, where the contingent payment may result in additional usage of the asset or a modification to the asset that will improve its performance, capitalising the payment to the asset is appropriate, and thus Option 4 may be applicable.

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Option 3 and Option 4 better reflect accountability as the satisfaction of conditions upon which the contingent payment is payable, could be in some instances, within the control of management. Disclosing a contingent liability or contingent asset makes users of the financial statements aware of the transaction and the subsequent accounting treatment communicates to users the outcome of the transaction as a result of the manner in which management has operated and managed the asset and any other relating resources. This simultaneously achieves the provision of useful information indicating that accountability and useful information is linked in its ultimate purpose (Ravenscroft; Williams, 2009).

It is noted that the contingent payment may meet the definition of a financial asset or a financial liability, in which instance IFRS 9 is applicable, however, this is scoped out of this paper.

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3. Method

This paper uses the same approach as that adopted by Van Staden and; Van der Merwe, 2012). It uses a quantitative approach relying on a questionnaire as the data collection instrument.

The questionnaire consists of a total of 14 questions. The first 6 questions are general questions focusing on the notions of useful information and accountability, including which amounts are reflective of useful information and accountability and which of those are most important to users of the financial statements. The remaining 8 questions are developed around each accounting option formulated in Section 2.2.1. Two questions are asked on each policy, which once again focuses on which one reflects the highest level of accountability and stewardship and provided the most useful information. The questions are multiple choices and a matrix structure is utilised where participants rank the appropriateness of the statement given from ‘strongly disagree’ to ‘strongly agree’. This structure is designed in this manner as it is considered to be the most efficient way to collect the data required for this paper, and it presents the data in a manner that is relatively simple to analyse (Adapted from Van Staden and Van der Merwe, 2012).

The target population consists of trainee accountants. It is reasonable to assume that these participants have sufficient technical knowledge of the accounting standards utilised in developing the questionnaire, to understand and interpret both the questions and the purpose of the questionnaire. Nevertheless, the use of a single group of users who are not responsible for the preparation of financial statements is an inherent limitation of this study.

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The questionnaire was posted on the QuestionPro website, which serves as an online survey website. The link of this site was provided to respondents. The participation of this survey is both voluntary and anonymous.

A total of 52 participants completed the survey online, which is considered to be adequate response for the purposes of this paper. Non-responses can be attributed to a lack of interest by the potential participant in this topic or to a lack of time due to academic work-load. The answers to each question is converted into percentages and made available for analysis by the online software. These percentages provide the opportunity to analyse the appropriateness of each of the options developed as within the context of the questions asked in the questionnaire.

Data analysis takes the form of descriptive statistics as opposed to inferential statistics. This decision is as a result of both the structure of the questionnaire as well as the purpose and scope of this paper as it comprises preliminary research. The interpretation of the results is limited to the participants of the questionnaire and is not projected to the total population. Although inferential statistics are not performed, valuable insight into the opinions of the participants were obtained as a few participants included additional comments, which Are taken into account when forming the conclusions presented in this paper. Although the research method was quantitatively designed, it consisted of some qualitative elements based on the following definition of “qualitative research” by (Henning, 2004): “a type of inquiry in which the qualities, characteristics or the properties of a phenomenon are examined for better understanding and explanation” (Van Staden; Van der Merwe, 2012).

4. Results

4.1. Information usefulness and accountability

Question 1 and Question 2 of the questionnaire aimed to obtain an understanding of the importance and the position of accountability in a ‘world’ where information usefulness is considered to be the primary objective of financial reporting (Ravenscroft, Williams, 2009; IASB, 2010a).

Figure 1: The provision of useful information is most important to users of financial statements.

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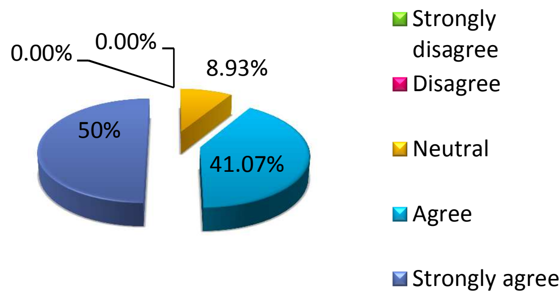
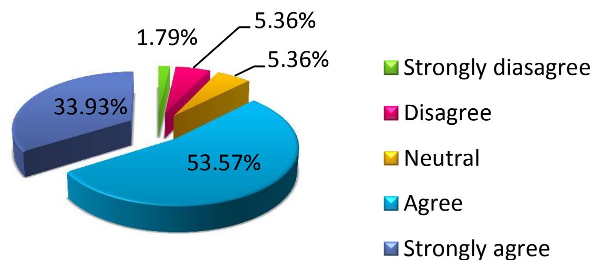


The majority (50%) of participants agree that the provision of useful information is the most important to users of the financial statements whilst 41.07% of participants strongly agree with this statement. This is in line with the focus of IFRS in placing the provision of useful information the dominant purpose of financial reporting (IASB, 2010a, paragraph OB1).

Figure 2: A reflection of accountability and stewardship is most important to users of financial statements



Majority (53.57%) of participants agreed that a reflection of accountability and stewardship is most important to users of the financial statements, and 33.93% strongly agreed with this

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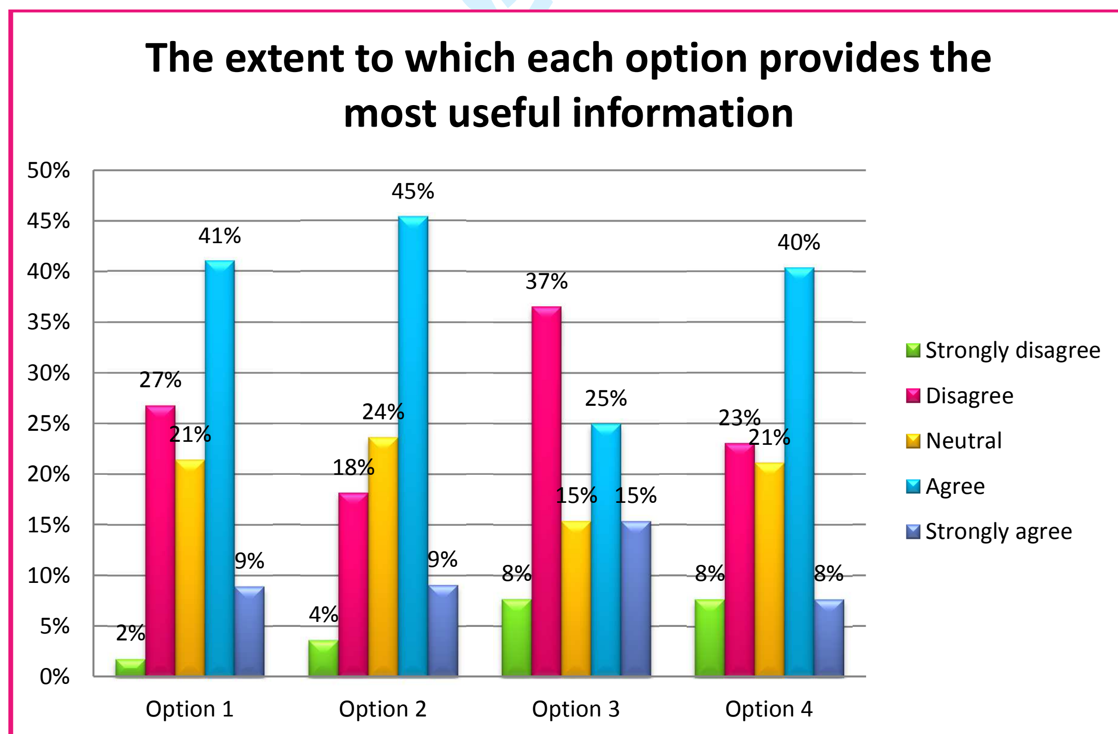
statement. This proves that although information usefulness has overridden accountability as the primary objective of accounting, accountability cannot be ignored, as it forms part of the 'living law' of accounting and is embedded in the craft (Murphy et al, 2013).

Therefore, both root metaphors, information usefulness as well as accountability (Ravenscroft, Williams, 2009) must be taken into account when deciding which accounting principles to apply to account for a specific transaction.

4.2. Accounting options developed for the accounting for contingent or variable payments relating to the acquisition of property, plant and equipment

Striking a balance between the trade-off between information usefulness and accountability is key to achieving a faithful representation of the economic substance of the transaction. The findings relating to the four options are summarised into two bar charts that are presented below. Figure 3 deals with the information usefulness side of the scale figure 4 deals with the accountability side.

Figure 3: The extent to which each option provides the most useful information



Option 2 appears to be the accounting option perceived to provide the most useful information with 45% and 9% of participants agreeing and strongly agreeing respectively; with the statement that Option 2 provides the most useful information to users of the financial statements. This is followed closely by Option 1 with 41% and 9% agreeing and strongly

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agreeing with the statement that Option 1 provides the most useful information to users of financial statements. Option 1 and Option 2 both propose that the fair value of the contingent payment be capitalised to the cost of PPE is indicative that neoliberalism is continuing to have an impact of accounting. 50% of participants are in support of Option 1, which may create an unrealised gain in profit and loss, proves that positivism is still relevant today. 40% and 48% of participants are in support of Option 3 and Option 4 respectively. These are still high percentages, but they do not comprise a majority of the response by the participants which is present in both Option 1 and Option 2. This may indicate that accountability has somewhat been put onto the back burner as Option 3 and Option 4 had more of an accountability flavour in comparison to Option 1 and Option 2 (Ravenscroft; Williams, 2009; Watts; Zimmerman, 1978; Stojlkovic, 2010).

The option that was least favoured was Option 3 with 8% and 37% of participants strongly disagreeing and disagreeing respectively. In section 2.2 of this paper, the odds were skewed in Option 3's favour of possibly being the most appropriate option of the four. It is interesting to note that that majority disagreed with the statement that Option 3 provides the most useful information. Option 4 was the second least popular option with 8% and 23% of participants strongly disagreeing and disagreeing respectively with the statement that Option 4 provides the most useful information. An average of 20.25% of participants had a neutral response, indicating that majority of those that completed the questionnaire had an opinion on the matter.

The accounting options with elements of fair value accounting seem to provide the most useful information to participants of the questionnaire.

Figure 4: The extent to which the accounting options reflect accountability and stewardship

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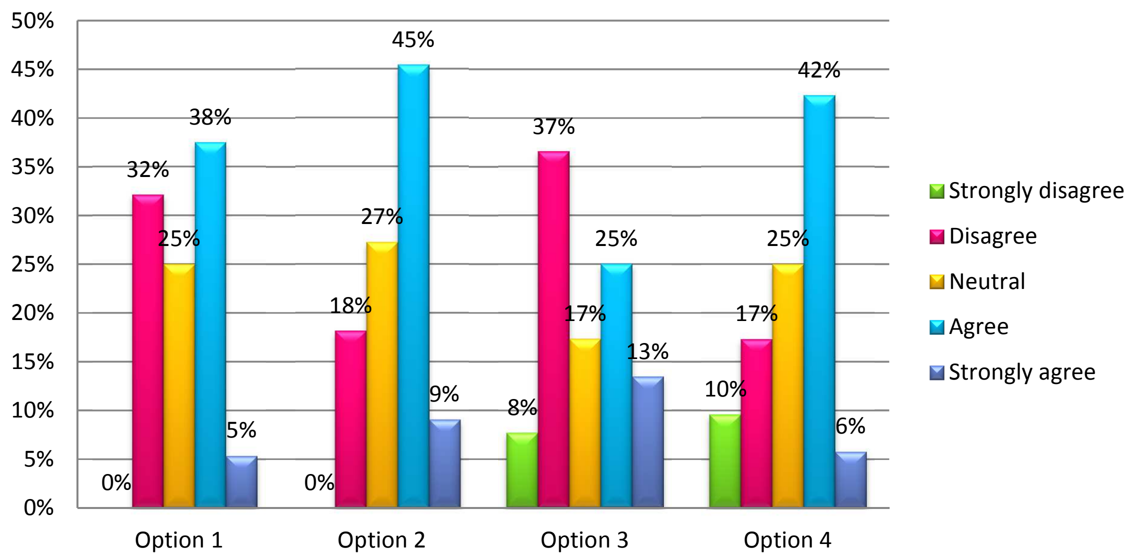

Option 2 seems to reflect the most accountability[1] with 45% and 9% agreeing and strongly agreeing respectively. This is identical to the result in bar chart 1 indicating that information usefulness and accountability cannot always be regarded as being independent of the other as they are linked in their ultimate purpose (Ravenscroft; Williams, 2009). Option 4 follows closely as 42% and 6% agree and strongly agree respectively that option 4 reflects the most accountability and stewardship. It is interesting to note that option 4 was the second least popular option in information usefulness but is the second most popular option in accountability. This may be somewhat contradictory to the trend identified with Option 2.

The option least favoured is Option 3, with 8% and 37% strongly disagreeing and disagreeing respectively. Once again, this is surprising as option 3 indicated the highest level of accountability in section 2.2. 32% of participants did not think that option 1 reflected the most accountability and stewardship. Neutral responses had an average of 23.5% indicating that the majority of participants had an opinion on the matter.

Accounting options that had adjustments to property, plant and equipment were considered to be the most reflective of the notion of accountability and stewardship.

[1] Cost less depreciation and impairment reflect the management of resources 'better' as opposed to fair value, as cost less accumulated depreciation is an entity specific number, not a market related one like fair value.

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From the above analysis, it can be seen that fair value accounting is favoured (Ravenscroft; Williams, 2009) and so were accounting options that resulted in an adjustment to property, plant and equipment. Positivism is still relevant today, as management would chose options that provide the most beneficial result (Watts; Zimmerman, 1978). The pluralism attribute of accounting is evident as there is no 'clear cut winner' relating to which option is most appropriate, and faithfully represents the transactions. The participants have interpreted the accounting options, as well as the transaction and its consequences on the financial statements, in a number of different manners which has result in a fairly evenly dispersion of results with no one option taking precedence over the others.

5. Conclusion

Based on the above, the results of this research are inconclusive and further research needs to be conducted. Accounting for variable or contingent payments relating to the acquisition of property, plant and equipment is an issue that has been identified by the IASB, and is an issue that requires a solution as soon as possible (IASB, 2011). The lack of guidance on this transaction has the ability to result in inconsistencies of the financial statements on entities which undermines comparability of financial statements of different entities, or of different periods of the same entity. This paper has explored possible accounting options, but neither of them can be considered with a reasonable level of certainty, complete or appropriate. It is clear, that each scenario would be different, and the technicalities of that scenario would result in a different option being the most appropriate one.

It has been established that accountability cannot be traded off for the provision of useful information. Instead, the two notions should be applied simultaneously, as they represent the heart of accounting (Ravenscroft; William, 2009). Ultimately, accounting is a form of communication from the entity to its stakeholders, and the information communicated should be complete, faithfully represented, relevant and free from error (IASB, 2010a, paragraphs QC6-QC16). The accounting treatment for contingent payments in relation to the acquisition or property, plant and equipment is a transaction that opens up doors for further research, in an attempt to assist the IASB in developing a methodology to account for this transaction.

Accounting has the potential to find a solution to a problem that an organisation is facing. This is neither an easy nor quick process. In fact, it is a painstaking one. The result of which however, could be revolutionary (Hopwood, 1987).

This research paper is an attempt at exploring possible ways to account for contingent payments relating to the acquisition of PPE. It deals with theories that formed the foundation of accounting and draws from existing IFRS literature, and is in no manner exhaustive. This

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transaction opens up opportunities for further research as it is one that is current and topical, and is also one that requires a solution, as there is currently no guidance available (IASB, 2011). The main limitation of this paper arises as a result of the sample size, and larger populations are needed with multiple stakeholder groups to explore the issue more clearly. Further research can be done to develop ways to account for this transaction, to test the frequency of this transaction and the specifications thereof, and also the impact on entities accounting for this transaction in different ways on the financial statements and other aspects of the business, to gain a better understanding of both the transaction, and the current situation of its accounting.

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