IFRS

STAFF PAPER

November 2018

IASB® Meeting

Project	**Updating a reference to the *Conceptual Framework* (Amendments to IFRS 3)**		
Paper topic	When and how to update the reference		
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Overview of session

1. Paragraph 11 of IFRS 3 *Business Combinations* refers to the *Framework for the Preparation and Presentation of Financial Statements* (1989 *Framework*).

2. The purpose of this session to decide whether and, if so, how to update that reference so that IFRS 3 instead refers to the revised *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*).

3. This paper provides an analysis of:

   (a) problems that could arise if the reference were updated without making any other amendments to IFRS 3 (paragraphs 26–46); and

   (b) four different ways in which the Board could avoid the problems identified (paragraphs 47–76).

4. The staff discussed both these matters with the International Accounting Standards Board (Board)'s Accounting Standards Advisory Forum (ASAF) in October 2018. The analysis in this paper includes the feedback from ASAF members.

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Staff conclusions and recommendations

5. Based on our research, the staff conclude that updating the reference without making any other amendments to IFRS 3:

   (a) could create a conflict between the requirements of IFRS 3 and requirements for identifying liabilities in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IFRIC 21 *Levies*; but

   (b) would not create any other significant conflicts in practice.

6. The staff recommend that the Board:

   (a) starts the process of updating the reference now, instead of waiting until it has completed a possible future project to amend IAS 37; and

   (b) develops proposals that avoid conflicts between IFRS 3 and IAS 37 (as interpreted by IFRIC 21) by:

      (i) not only updating the reference; but also

      (ii) adding an exception to the initial recognition requirements in IFRS 3, specifying that levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 should be recognised on the acquisition of a business only if they would be identified as liabilities applying IFRIC 21 or IAS 37 respectively.

7. The approach recommended by the staff is labelled ‘Approach C2’ in this paper. The questions for the Board on the recommendations are at the end of the paper.

Background

Reason for considering this matter

8. In March 2018, the Board issued the 2018 *Conceptual Framework* to replace its previous *Conceptual Framework for Financial Reporting* published in 2010

(2010 *Conceptual Framework*). The 2010 *Conceptual Framework* had itself replaced the 1989 *Framework*.

9. In March 2018, the Board also issued *Amendments to References to the Conceptual Framework in IFRS Standards* to update references in most of the Standards referring to the 2010 *Conceptual Framework* or 1989 *Framework*. However, it did not update a reference to the 1989 *Framework* in paragraph 11 of IFRS 3 because updating that reference could have created problems for entities applying IFRS 3.

10. Paragraph 10 of IFRS 3 requires the acquirer of a business to recognise separately from goodwill, the identifiable assets acquired and liabilities assumed. Paragraph 11 of IFRS 3 refers to the definitions of an asset and a liability in the 1989 *Framework*. A footnote was added in March 2018, so that paragraph 11 now states that:

> 11 To qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in the *Framework for the Preparation and Presentation of Financial Statements*[1] at the acquisition date.
>
> 1 For this Standard, acquirers are required to apply the definitions of an asset and a liability and supporting guidance in the IASC's *Framework for the Preparation and Presentation of Financial Statements* adopted by the IASB in 2001 rather than the *Conceptual Framework for Financial Reporting* issued in 2018.

11. The definitions of an asset and a liability in the 2018 *Conceptual Framework* are different from those in the 1989 *Framework* and applied in some Standards. Furthermore, some of the concepts supporting the definitions in the 2018 *Conceptual Framework* could change the way in which the definitions are interpreted. Consequently, in some cases, applying the definitions and supporting concepts in the 2018 *Conceptual Framework* could change which assets and liabilities qualify for recognition in a business combination. In such cases, the post-acquisition accounting required by other IFRS Standards (which were developed applying the 1989 *Framework* or the 2010 *Conceptual Framework*) could then lead to immediate derecognition of assets or liabilities recognised in a business combination, resulting in so-called 'day 2' gains or losses that do not depict an economic gain or loss.

12. When the Board issued the 2018 *Conceptual Framework*, it stated that although it intended to replace all remaining references to the 1989 *Framework* with references to the 2018 *Conceptual Framework*, it did not intend to make significant changes to the requirements of IFRS Standards containing those references. Consequently, the Board decided to retain the reference in paragraph 11 of IFRS 3 until it has identified any possible unintended consequences of simply replacing the reference and, if necessary, identified ways of avoiding those consequences.

Changes introduced by the 2018 Conceptual Framework

Changes to the definitions

13. The definitions of an asset and a liability have both changed:

	1989 *Framework*	2018 *Conceptual Framework*	
	Definition	**Definition**	**Supporting concept**
Asset (of an entity)	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.	A present economic resource controlled by the entity as a result of past events.	
Economic resource	[None]	A right that has the **potential to produce** economic benefits.	
Liability (of an entity)	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.	A present obligation of the entity to transfer an economic resource as a result of past events.	The obligation must have the **potential to require** the entity to transfer an economic resource to another party (or parties).[1]

14. The main difference is the removal of the requirement for 'expected' inflows or outflows of economic benefits. The definitions in the 2018 *Conceptual Framework*

[1] Paragraph 4.37.

instead require that a right has the 'potential' to produce economic benefits or that an obligation has the 'potential' to require the entity to transfer an economic resource.

15. The difference could affect the analysis of rights or obligations with a low probability of future inflows or outflows. The term 'expected' in the 1989 *Framework* definitions has been subject to diverse interpretation. Some stakeholders may have viewed the term as a probability threshold and concluded that some rights or obligations with a low probability of future inflows or outflows do not meet the definitions of an asset or a liability. Such rights and obligations will be regarded as assets or liabilities applying the 2018 *Conceptual Framework* definitions.

New concepts to support the definition of a liability

16. Another significant change is the addition of new concepts to support the definition of a liability. These concepts state that, for an entity to have a liability, it is necessary that:
    (a) the entity has already obtained economic benefits or taken an action;
    (b) as a consequence, it will or may have to transfer an economic resource that it would not otherwise have had to transfer; and
    (c) it has no practical ability to avoid that transfer.[2]

17. Applying these new concepts, an entity could have a liability even if its obligation to transfer an economic resource is conditional on its future actions. If the entity has already obtained economic benefits or taken an action and as a consequence may have to transfer an economic resource that it would not otherwise have had to transfer, it has a liability if it has no practical ability to avoid the future actions that would trigger the transfer.

2 Paragraphs 4.29 and 4.43.

Problem previously identified by the Board

18. In developing the 2018 *Conceptual Framework* and *Amendments to References to the Conceptual Framework in IFRS Standards*, the Board tested the proposed new definitions of an asset and a liability to assess their possible implications.

19. The analysis identified an inconsistency between the 2018 *Conceptual Framework* and IAS 37 as interpreted by IFRIC 21. Applying IFRIC 21, the event that gives rise to a liability for a levy is the activity that triggers payment of the levy. In contrast, applying the liability definition and supporting concepts in the 2018 *Conceptual Framework* the event that gives rise to a liability for a levy could be an earlier activity if:

    (a) that earlier activity means the entity may have to pay a levy that it would not otherwise have had to pay; and

    (b) the entity has no practical ability to avoid the later activity that triggers payment of the levy.

20. If an entity were to apply IFRS 3 using the definitions in the 2018 *Conceptual Framework*, it might recognise on acquisition a liability for a levy whose payment will be triggered by a later event that the entity has no practical ability to avoid. However, applying IFRIC 21 thereafter, the entity would not recognise a liability until that later event had occurred. Before then, any liability recognised on acquisition would be derecognised and a day 2 gain would be recognised. Appendix A provides an example that illustrates this problem.

21. IFRIC 21 is an interpretation of IAS 37. So conflicts of the type described above could arise not only for levies but also for other obligations that are conditional on the entity's future actions and are within the scope of IAS 37.

Subsequent staff research

22. In June 2018, the staff wrote to ASAF members and large accounting firms asking them if they were aware of:

    (a) any other inconsistencies between the 2018 *Conceptual Framework* and IFRS Standards that could create problems in applying IFRS 3 if the Board simply replaced the reference to the 1989 *Framework* with a reference to the 2018 *Conceptual Framework;* or

    (b) other unintended consequences of updating the reference in IFRS 3.

23. Five ASAF members and two accounting firms responded.

24. Some respondents expressed explicit support for updating the reference. One suggested that a reference to a superseded 1989 *Framework* is not a satisfactory long-term solution. One noted that the co-existence of different definitions of an asset and a liability across IFRSs and the 2018 *Conceptual Framework* makes IFRS requirements less understandable and subject to cross-cutting issues. Another thought it is desirable to update all references for consistency, suggesting that any resulting changes to accounting application should be assessed and addressed on a case by case basis.

25. Respondents identified few specific possible conflicts other than the conflict with IFRIC 21. Matters they identified included:

    (a) a possible conflict with requirements for contingent assets within the scope of IAS 37 (discussed in paragraphs 26–35);

    (b) a possible conflict with IFRS Standards that prohibit recognition of assets or liabilities with a low probability of future inflows or outflows (discussed in paragraphs 36–43); and

    (c) other matters that we think do not require discussion at the Board meeting (listed in Appendix B to this paper).

Other problems that could arise from updating the reference

Contingent assets within the scope of IAS 37

Respondents' suggestions

26. Some respondents suggested that the Board consider whether updating the reference to the 2018 *Conceptual Framework* would create an inconsistency between IFRS 3 and IAS 37 requirements for contingent assets. They noted that:
    (a) IFRS 3 has specific requirements for initial and subsequent recognition of contingent liabilities, but no such requirements for contingent assets; and
    (b) paragraph BC276 of the Basis for Conclusions on IFRS 3 explains why IFRS 3 does not require contingent assets to be recognised on acquisition. The explanation refers to assets being 'unconditional rights'. However, the 2018 *Conceptual Framework* definition of an asset does not require a right to be unconditional.

27. These respondents suggested that, applying the 2018 *Conceptual Framework* definition of an asset, contingent assets would be recognised on acquisition because that definition does not refer to the probability of cash inflows. Contingent assets that were not 'virtually certain' to result in an inflow of economic benefits would be derecognised on day 2 applying IAS 37.

28. One respondent suggested that, if the Board updates the IFRS 3 reference to the 2018 *Conceptual Framework*, it should at the same time clarify the implications for contingent assets.

Staff analysis

29. IAS 37 defines contingent assets as possible assets whose existence will be confirmed only by one or more uncertain future events not wholly within the control of the entity. A typical example of a contingent asset is a claim that an entity is pursuing through

the courts—whether the entity has a claim (an asset) is uncertain and the uncertainty will be resolved only by a court ruling.

30. IAS 37 specifies that contingent assets should not be recognised unless an inflow of economic benefits is ‘virtually certain’. It explains that if the inflow is virtually certain, the entity has an asset not a contingent asset.

31. IFRS 3 requires recognition of assets and liabilities. It does not permit or require recognition of possible assets and liabilities, that is assets and liabilities whose existence is uncertain. This is explicit in IFRS 3 for possible *liabilities* because IFRS 3 has specific requirements for contingent liabilities.[3] It is not explicit in IFRS 3 for possible *assets*, but can be inferred from the Basis for Conclusions accompanying IFRS 3:

> BC276 … the IASB observed that the definition of a contingent asset in IAS 37 includes only ‘possible assets’. A contingent asset arises when it is uncertain whether an entity has an asset at the end of the reporting period, but it is expected that some future event will confirm whether the entity has an asset. Accordingly, the IASB concluded that *contingent assets should not be recognised*, even if it is virtually certain that they will become unconditional or non-contingent. If an entity determines that an asset exists at the acquisition date (ie that it has an unconditional right at the acquisition date), that asset is not a contingent asset and should be accounted for in accordance with the appropriate IFRS. [emphasis added]

32. The 2018 *Conceptual Framework* is clear that *if* an entity has a right, that right can meet the definition of an asset even if there is only a low probability that it will produce economic benefits. But the 2018 *Conceptual Framework* is also clear that if there is uncertainty about *whether* an entity has a right, it is uncertain whether an asset exists. Paragraph 4.13 of the 2018 *Conceptual Framework* states that:

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3 Paragraphs 22–23 of IFRS 3.

> In some cases, it is uncertain whether a right exists. For example, an entity and another party might dispute whether the entity has a right to receive an economic resource from that other party. Until that existence uncertainty is resolved—for example, by a court ruling—it is uncertain whether the entity has a right and, consequently, whether an asset exists.

33. The 2018 *Conceptual Framework* also envisages that where there is uncertainty about the existence of an asset, an entity might not recognise the possible asset in its financial statements. Paragraph 5.14 states that:

> Paragraphs 4.13 and 4.35 discuss cases in which it is uncertain whether an asset or liability exists. In some cases, that uncertainty, possibly combined with a low probability of inflows or outflows of economic benefits and an exceptionally wide range of possible outcomes, may mean that the recognition of an asset or a liability, necessarily measured at a single amount, would not provide relevant information. Whether or not the asset or liability is recognised, explanatory information about the uncertainties associated with it may need to be provided in the financial statements.

34. Thus, an item meeting the definition of a contingent (possible) asset applying IAS 37 would also be regarded as a possible asset, and not necessarily recognised, applying the 2018 *Conceptual Framework*. The staff think this means that updating the IFRS 3 reference to the 2018 *Conceptual Framework* would not override the IFRS 3 requirements for contingent assets.

35. The IFRS 3 prohibition on recognising contingent assets might be clearer if stated within the Standard, not only in the Basis for Conclusions. If the Board decides to update the reference in IFRS 3, the staff will consider whether and how the IFRS 3 requirements for contingent assets could be clarified at the same time.

Assets and liabilities with a low probability of future inflows or outflows

Respondents' suggestions

36. Some respondents suggested that the Board consider whether updating the reference to the 2018 *Conceptual Framework* could change the IFRS 3 requirements for rights and obligations that have a low probability of producing or requiring inflows or outflows of economic benefits.

37. Those respondents noted that, because the term 'expected' in the 1989 *Framework* definitions has been interpreted by some as a probability threshold, removing that term could result in more rights or obligations being considered to meet the definition of an asset or a liability and hence recognised on acquisition. These might include items that would be derecognised on day 2 applying the recognition criteria in other Standards, such as IAS 37 or IAS 38 *Intangible Assets*.

38. One respondent specifically referred to IAS 16 *Property, Plant and Equipment*, which requires the cost of an item of property, plant and equipment to be recognised as an asset only if it is probable that future economic benefits associated with the item will flow to the entity. The respondent noted that this recognition criterion could lead to a day 2 loss for property, plant or equipment recognised on acquisition, but acknowledged that problems might arise infrequently in practice—it would normally be expected that any property, plant or equipment assigned a significant fair value on acquisition would produce future economic benefits in one way or another.

Staff analysis

39. IFRS 3 does not contain a probability recognition criterion. The Basis for Conclusions clarifies that 'thus it requires the acquirer to recognise identifiable assets acquired and liabilities assumed regardless of the degree of probability of an inflow or outflow of economic benefits'.[4]

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[4] Paragraph BC126 of IFRS 3.

40. Some IFRS Standards—such as IAS 12 *Income Taxes*, IAS 37, IAS 38 and IAS 16—do have a probability recognition criterion. They require recognition of an asset or a liability only if it is probable that the asset or liability will result in inflows or outflows of economic benefits.

41. Conflicts between those Standards and IFRS 3 are avoided in different ways, depending on the type of asset or liability:

    (a) IFRS 3 contains an exception to its recognition and measurement principles for deferred tax assets and liabilities. It requires those assets and liabilities to be recognised and measured on acquisition applying the requirements of IAS 12, including the recognition criteria in that Standard.

    (b) IFRS 3 has initial recognition requirements for contingent liabilities that are different from those in IAS 37, but it also contains specific requirements for the subsequent recognition and measurement of those contingent liabilities. These requirements override the requirements of IAS 37 and serve to prevent day 2 gains or losses.

    (c) IAS 38 contains specific requirements for intangible assets acquired as part of the acquisition of a business. IAS 38 applies a probability recognition criterion, but states that for intangible assets acquired as part of a business combination, the criterion is always considered to be satisfied.

42. Thus, for the types of assets and liabilities that typically could have a low probability of producing or requiring inflows or outflows of economic benefits, there are requirements in either IFRS 3 or the applicable Standard to prevent conflicts between them. These requirements would continue to apply if IFRS 3 were updated to refer to the new definitions. So the staff think that updating IFRS 3 to refer to the new definitions would not cause problems for those assets or liabilities.

43. IFRS 3 has no specific exceptions to avoid conflicts between its general requirements and IAS 16, which also has a probability recognition criterion. However, as a respondent acknowledged, it would normally be expected that any property, plant or equipment assigned a material fair value on acquisition would produce future

economic benefits in one way or another—if not needed in the business, it could be sold. So the staff think that it is unlikely that applying the 2018 *Conceptual Framework* to identify property, plant and equipment assets will cause problems in practice.

Staff conclusions

44. For the reasons explained above, the staff do not think that updating the IFRS 3 reference to the 2018 *Conceptual Framework* would create significant new conflicts between IFRS 3 and:
    (a) requirements in IAS 37 for contingent assets (possible assets whose existence is uncertain); or
    (b) requirements in IFRS Standards addressing rights and obligations that definitely exist but have a low probability of producing or requiring inflows or outflows of economic benefits.

45. So, based on our research, the staff conclude that updating the reference without making any other amendments to IFRS 3:
    (a) could create a conflict between the requirements of IFRS 3 and requirements for identifying liabilities in IAS 37 and IFRIC 21; but
    (b) would not create any other significant conflicts in practice.

46. The staff discussed these conclusions with ASAF members at the October 2018 ASAF meeting. All ASAF members agreed with the staff conclusions.

Question for the Board

Question 1—Staff conclusions
Do you agree with the staff conclusions in paragraph 45?

Ways of avoiding the problems identified

Introduction

47. If the Board agrees with the staff conclusions in paragraph 45, the next step would be to consider ways in which the Board could update the reference without creating conflicts between the requirements of IFRS 3 and requirements for identifying liabilities in IAS 37 and IFRIC 21.

48. The staff have identified four different ways in which the Board could achieve this outcome. It could:

    (a) APPROACH A—leave the reference to the 1989 *Framework* in IFRS 3 for now, updating it only if and when the Board amends IAS 37 to align that Standard's requirements with the 2018 *Conceptual Framework.* (See paragraphs 50–55.)

    (b) APPROACH B—start the process of updating the reference now, developing proposals that avoid conflicts between IFRS 3 and IAS 37 (as interpreted by IFRIC 21) by:

        (i) not only updating the reference; but also

        (ii) adding requirements to IFRS 3 for the subsequent recognition and measurement of liabilities assumed on the acquisition of a business and within the scope of IAS 37, including levies within the scope of IFRIC 21. Acquirers would apply the new IFRS 3 requirements to those liabilities, instead of the recognition and measurement requirements of IAS 37 and IFRIC 21, until the liabilities were extinguished.

        (See paragraphs 56–64.)

    (c) APPROACHES C1 or C2—start the process of updating the reference now, developing proposals that avoid conflicts between IFRS 3 and IAS 37 (as interpreted by IFRIC 21) by:

(i) not only updating the reference; but also

(ii) creating an exception to the initial recognition requirements in IFRS 3. This would be an exception to the requirement to apply the definitions in the 2018 *Conceptual Framework* to identify the assets and liabilities recognised on the acquisition of a business.

There could be two versions of this approach. The exceptions could apply to:

(i) all assets and liabilities that are specifically addressed by another IFRS Standard—APPROACH C1; or

(ii) only levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37—APPROACH C2.

(See paragraphs 65–76.)

49. At the October ASAF meeting, the opinions of the ASAF members were split, with at least one ASAF member (or member of a group that he or she represented) supporting each of the four approaches described above. Some ASAF members noted that members of their groups had expressed few reactions and/or a range of different views on when and how the Board should update the reference.

Approach A—Update the reference only if and when the Board amends IAS 37

Introduction

50. The Board has a project on IAS 37 in its research pipeline and expects that project to become active before the end of this year. The purpose of that project will be to gather evidence to enable the Board to decide whether to undertake a project to develop proposals to amend aspects of IAS 37. If the Board undertakes such a project, one topic it could consider is whether to develop a proposal to align the IAS 37 definition of a liability and IAS 37 requirements for identifying liabilities (including the requirements of IFRIC 21) with the liability definition and supporting concepts in the 2018 *Conceptual Framework*. If the Board were to align these aspects of IAS 37 with

the 2018 *Conceptual Framework*, it could update the IFRS 3 reference to the 2018 *Conceptual Framework* at the same time without creating any conflicts.

ASAF members' views

51. Two ASAF members said that if the Board decides to amend IAS 37, they would be content for the existing reference to the 1989 *Framework* to remain in IFRS 3 until it has done so—IFRS 3 could be updated at the same time as IAS 37, avoiding any changes to IFRS 3 before the Board has finalised the amendments to IAS 37.

52. However, one member said she opposed this approach, urging the Board to update the reference as soon as practicable. She argued that people are already confused about when preparers should refer to the *Conceptual Framework*—if they also had to decide which version of the *Conceptual Framework* to refer to, they could get to the wrong answer. She also noted that the Board has not yet decided whether and how to amend IAS 37 and said she thought that project should not be rushed—the Board should take the time it needs to get the amendments right.

Staff analysis

53. As pointed out by one ASAF member, there is no guarantee that Board will amend IAS 37 and, even if it does, the process of developing proposed amendments and carrying out the due process required to finalise them could take some years. In the meantime, the Board would be unable to withdraw the 1989 *Framework* and so would have two *Conceptual Frameworks* in issue.

54. Since the Board issued the 2018 *Conceptual Framework*, the Interpretations Committee has received questions about when and how preparers of financial statements should refer to the *Conceptual Framework* for assistance in developing accounting policies. As a staff paper discussed by the Board at its July meeting

explained, such decisions may require detailed analysis.[5] That analysis could be further complicated by the existence of two different *Conceptual Frameworks*.

Staff recommendation

55. For the reasons in paragraphs 53–54, the staff do not recommend Approach A, that is waiting until the Board has completed a possible future project to amend IAS 37. The staff instead recommend that the Board starts the process of updating the reference now.

Approach B—Add requirements for subsequent accounting of liabilities to IFRS 3

Introduction

56. If the Board decides to start the process of updating the IFRS 3 reference now, it will need to consider how best to update the reference without creating conflicts between the requirements of IFRS 3 and requirements for identifying liabilities in IAS 37 and IFRIC 21.

57. One possible approach (Approach B) would be to:

    (a) update the reference, thus requiring acquirers to apply the 2018 *Conceptual Framework* to identify the liabilities assumed on the acquisition of a business—including levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37; but

    (b) avoid conflicts by adding requirements to IFRS 3 for the subsequent recognition and measurement of liabilities assumed on the acquisition of a business that are within the scope of IAS 37, including levies within the scope of IFRIC 21. Acquirers would apply the new IFRS 3 requirements to those

[5] IASB meeting July 2018, Agenda Paper 10 *When and how preparers of financial statements refer to the Conceptual Framework*.

liabilities, instead of the recognition and measurement requirements of IAS 37 and IFRIC 21, until the liabilities were extinguished.

58. This approach would be like that already required by IFRS 3 for contingent liabilities within the scope of IAS 37. Paragraph 22 of IFRS 3 requires acquirers to recognise on the acquisition of a business some contingent liabilities that would not be recognised applying IAS 37. Paragraph 56 of IFRS 3 specifies requirements for the subsequent recognition and measurement of those contingent liabilities.

59. Acquirers could recognise more liabilities, and hence a larger amount of goodwill, applying this approach than they would recognise applying an approach that identified liabilities applying the requirements of IAS 37 and IFRIC 21.

ASAF members' views

60. Several ASAF members expressed support for Approach B. They suggested that:

    (a) recognising levies that meet the definition of a liability in the Conceptual *Framework* would be consistent with the objectives of IFRS 3.

    (b) although levy liabilities acquired with a business would be treated differently from levy liabilities incurred in other ways:

        (i) this is already the case for contingent liabilities. In the view of these ASAF members, the requirements for contingent liabilities have not given rise to problems in practice.

        (ii) the difference could be justified because the treatment of liabilities acquired with a business has implications for the measurement of goodwill.

61. However, another member noted a concern that Approach B would require preparers to apply new concepts before the Board has amended IAS 37 to provide requirements and guidance on how these concepts should be operationalised. So there is a risk that the concepts would be applied inconsistently.

Staff analysis

62. In favour of Approach B, it could be argued that it would accelerate improvements in the financial reporting of business acquisitions. IAS 37 does not identify as liabilities some obligations that are likely to have been reflected in the purchase price of a business. Recognising those liabilities on acquisition could provide more useful information to users of an acquirer's financial statements.

63. However, Approach B would have costs and risks:

    (a) acquirers would need to apply the new liability definition and supporting concepts in the 2018 *Conceptual Framework* before other entities, and without yet having any standards-level requirements and guidance on how to apply those concepts. There is a risk that:

        (i) acquirers reach different views on how to apply the concepts, leading to diversity in practice; and

        (ii) if and when the Board applies the 2018 *Conceptual Framework* to develop amendments to IAS 37, the amended IAS 37 could require accounting policies different from those that entities have developed to apply IFRS 3. Differences could lead to a second round of changes to the way in which entities apply IFRS 3.

    (b) changing the requirements for identifying liabilities in two steps (first for acquired liabilities and later for liabilities incurred in other ways) could increase complexity for preparers and users of financial statements. Between the first and second set of changes, preparers would have to develop different accounting policies for liabilities acquired on the acquisition of a business and liabilities incurred in other ways. Users would incur costs in analysing and interpreting the differences.

    (c) developing requirements to add to IFRS 3 could take time and investment by the Board (developing and consulting on proposals) and its stakeholders (understanding and commenting on proposals). Requirements would be needed for the subsequent recognition and measurement of levies within the scope of

IFRIC 21 and other liabilities within the scope of IAS 37. There may also be calls for further requirements to help entities apply the new liability definition and supporting concepts consistently.

Staff recommendation

64. The staff think for Approach B (as described in paragraph 57) the costs and risks described in paragraph 63 would outweigh the benefits described in paragraph 62. Hence the staff do not recommend that approach.

Approaches C1 and C2—Add an exception to IFRS 3

Introduction

65. An alternative approach (Approach C) would involve starting the process of updating the reference now, but developing proposals that avoid conflicts between IFRS 3 and IAS 37 (as interpreted by IFRIC 21) by:

    (a) not only updating the reference; but also

    (b) creating an exception to the initial recognition requirements in IFRS 3. This would be an exception to the requirement to apply only the definitions in the 2018 *Conceptual Framework* to identify the assets and liabilities recognised on the acquisition of a business.

66. There could be two versions of this approach:

    (a) APPROACH C1: the exception could apply broadly to any assets and liabilities that are specifically addressed by another IFRS Standard. IFRS 3 could require the assets and liabilities recognised on acquisition to meet the definitions in a Standard that specifically addresses those assets or liabilities or, in the absence of any such Standard, the definitions in the 2018 *Conceptual Framework*.

(b) APPROACH C2: the exception could apply only to levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37. IFRS 3 could:

(i) retain its general requirement for the assets and liabilities recognised on the acquisition of a business to meet the definitions of assets and liabilities in the *Conceptual Framework*; but

(ii) also specify that levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 should be recognised on the acquisition of a business only if they would be identified as liabilities applying IFRIC 21 or IAS 37 respectively.

67. A recognition exception for levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 could be similar to the exception already in IFRS 3 for employee benefits. Paragraph 26 of IFRS 3 requires an acquirer to recognise and measure a liability or asset related to the acquiree's employee benefit arrangements in accordance with IAS 19 *Employee Benefits*.

68. An effect of Approach C is that assets and liabilities within the scope of the exception would be identified on the acquisition of a business and thereafter in the same way as identical assets and liabilities acquired or incurred other than by acquisition of a business.

ASAF members' views

69. One member expressed support for exploring Approach C1. The member suggested that such an approach would be consistent with the way in which preparers of financial statements are required to use the *Conceptual Framework* more generally.

70. Two ASAF members said there was a support for Approach C2 in their groups but did not give specific reasons for this support.

Staff analysis—Approach C1

71. Applying Approach C1, an acquirer would apply the 2018 *Conceptual Framework* definitions only for assets and liabilities that are not within the scope of another IFRS Standard. Such an approach would be similar to the approach preparers of financial statements follow in some other circumstances—applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* preparers refer to the definitions, recognition criteria or measurement concepts in the 2018 *Conceptual Framework* for assistance in developing accounting policies if no IFRS Standard specifically applies to a transaction, other event or condition and no IFRS Standards deal with similar or related issues.

72. Furthermore, Approach C1 could help avoid other as-yet-unidentified conflicts caused by updating the IFRS 3 reference to the 2018 *Conceptual Framework*, if there are any. Although the only conflict we have identified is between IFRS 3 and IAS 37 (as interpreted by IFRIC 21), it could be that there are others.

73. On the other hand, amending IFRS 3 to require acquirers to apply the 2018 *Conceptual Framework* definitions only for assets and liabilities that are not within the scope of another Standard could have unintended consequences. To avoid those consequences, more research would be needed to identify whether and how such an exception could affect IFRS 3 requirements.

Staff analysis—Approach C2

74. Approach C2, which would involve adding an exception only for levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 would not address other as-yet-unidentified conflicts between IFRS 3 and other IFRS Standards, if there are any.

75. However, if we are correct to conclude that the only significant conflict in practice would be the conflict between IFRS 3 and IAS 37 (as interpreted by IFRIC 21), Approach C2 would have several advantages:

(a) it would allow the Board to meet its stated aim of updating references to the *Conceptual Framework* without changing the requirements of existing Standards;

(b) it would largely avoid the costs and risks identified for Approach B (see paragraph 63)—it would be less vulnerable to diversity in practice and simpler to develop and apply than Approach B; and

(c) the exception should be relatively easy to remove if and when the requirements of IAS 37 and IFRIC 21 become aligned with the definitions and concepts in the 2018 *Conceptual Framework*.

Staff recommendation

76. For the reasons in paragraph 75, the staff recommend that the Board follows Approach C2 instead of Approach C1. In other words, the staff recommend that the Board develops proposals that avoid conflicts between IFRS 3 and IAS 37 (as interpreted by IFRIC 21) by specifying that levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 should be recognised on the acquisition of a business only if they would be identified as liabilities applying IFRIC 21 or IAS 37 respectively.

Questions for the Board

Question 2—Rejecting Approach A
Do you agree the Board should start the process of updating the reference now, instead of waiting until it completes a possible future project to amend IAS 37? (See staff recommendation in paragraph 55.)

Question 3—Developing Approach C, not Approach B

Do you agree the Board should develop proposals that avoid conflicts between IFRS 3 and IAS 37 (as interpreted by IFRIC 21) by adding an exception to the initial recognition requirements in IFRS 3 (Approach C)—instead of by adding to IFRS 3 requirements for the subsequent recognition and measurement of levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 (Approach B)?

(See staff recommendation in paragraph 64.)

Question 4—Developing Approach C2, not Approach C1

(a) Do you agree that the exception should apply only to levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 (Approach C2)—not to all assets and liabilities that are specifically addressed by another IFRS Standard (Approach C1)?

(b) Do you agree that the exception should specify that levies within the scope of IFRIC 21 and other liabilities within the scope of IAS 37 should be recognised on the acquisition of a business only if they would be identified as liabilities applying IFRIC 21 or IAS 37 respectively?

(See staff recommendations in paragraph 76.)

Appendix A

Example illustrating a possible consequence of updating the IFRS 3 *Business Combinations* reference to the *Conceptual Framework*

Example—Levy triggered when entity generates revenue in two years

A government charges a levy on entities as soon as they generate revenue in 20X1. The amount each entity pays is calculated by reference to the revenue the entity generated in 20X0. The levy is within the scope of IFRIC 21 *Levies*.

An entity's reporting period ends on 31 December 20X0. The entity generated revenue in 20X0, and in 20X1 it starts to generate revenue on 3 January 20X1.

The entity is acquired by another entity (the acquirer) on 30 June 20X0.

Applying the 2018 *Conceptual Framework*

Applying the concepts in the 2018 *Conceptual Framework*, the liability to pay the levy would be viewed as arising when the entity:

(a) has obtained economic benefits or taken an action;

(b) as a consequence, will or may have to pay a levy that it would not otherwise have had to pay; and

(c) has no practical ability to avoid the activity that triggers the levy.[6]

Conditions (a) and (b) are satisfied progressively through 20X0 as the entity generates revenue in 20X0. If during that time the entity has no practical ability to avoid generating revenue in 20X1, condition (c) is also satisfied. The liability would be viewed as accumulating as the entity generates revenue in 20X0.

IFRIC 21

IFRIC 21 states that the event that gives rise to a liability to pay the levy is the event that triggers the payment of the levy, which in this example is the generation of revenue in 20X1. The generation of revenue in 20X0 is a necessary condition for the existence of a liability. But it is not a sufficient condition, even if the entity has no practical ability

[6] 2018 *Conceptual Framework*, paragraphs 4.29 and 4.43.

to avoid generating revenue in 20X1. Applying IFRIC 21, the entity would not recognise a liability in the reporting period ending on 31 December 20X0. It would first recognise a liability on 3 January 20X1.[7]

Acquisition and subsequent accounting

The entity is acquired on 30 June 20X0. If the acquirer were to apply IFRS 3 using the definitions in the 2018 *Conceptual Framework*, it might recognise on acquisition a liability for the amount of levy attributable to revenue earned up to 30 June 20X0. However, at 31 December 20X0, it would apply IFRIC 21 and recognise no liability. Derecognition of the liability recognised on acquisition would result in recognition of a ‘day 2’ gain.

[7] IFRIC 21, consensus paragraphs 8–9 and Illustrative Example 2.

Appendix B
Other comments from respondents to the request for assistance (see paragraphs 22–25)

	Comment	IASB Staff analysis
1	A respondent noted an existing tension between the measurement requirements of IFRS 3 *Business Combinations* (fair value) and the measurement requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (best estimate).	We acknowledge this tension but do not think that updating the reference to the *Conceptual Framework* would worsen the existing tension or cause any new tensions in this area.
2	A respondent questioned the impact that updating the reference could have on accounting for goodwill. The respondent is concerned that it is unclear whether goodwill meets the definition of an asset.	We do not think that updating the reference to the *Conceptual Framework* in IFRS 3 will have any practical implications for accounting for goodwill. IFRS 3 has specific requirements for identifying and recognising goodwill on acquisition.
3	A respondent suggested that there may be tension between the 2018 *Conceptual Framework* and IAS 38 *Intangible Assets* because, unlike IAS 38, the 2018 *Conceptual Framework*'s asset definition does not require the asset to be 'identifiable' or 'separable'. The respondent thought that it is unclear whether non-identifiable intangible assets could be recognised in a business combination, only to be derecognised on 'day 2' given the more stringent IAS 38 criteria.	Paragraph 10 of IFRS 3 requires entities to recognise separately from goodwill only the 'identifiable' assets acquired. The reference to the 2018 *Conceptual Framework* does not override that requirement.

	Comment	IASB Staff analysis
4	A respondent suggested a need to clarify IFRS 3 requirements for remote contingent liabilities. The respondent referred to the Basis for Conclusions on IFRS Practice Statement 2 *Making Materiality Judgements,* which states that information about a covenant is not material if the likelihood of a breach occurring is considered to be remote. In providing this clarification, the Board applied the disclosure threshold in IAS 37 for the disclosure of contingent liabilities. The respondent noted that IFRS 3 requires an acquirer to recognise a contingent liability assumed in a business combination at the acquisition date even if an outflow of resources is not probable but does not specifically address situations in which an outflow is remote. The respondent suggested that the need for clarification of the IFRS 3 requirements would be greater if the reference to the *Conceptual Framework* were updated. The IASB would need to explain whether the IFRS 3 recognition requirements are an exception to the recognition concepts in the 2018 *Conceptual Framework* if viewed in combination with the guidance in IFRS Practice Statement 2.	The reference to the *Conceptual Framework* in IFRS 3 is solely to the definitions of assets and liabilities – not to other concepts, such as the concepts for recognition. So, the staff think that updating the reference should have no impact on recognition decisions, beyond decisions on whether an item meets the definition of an asset or a liability. The staff further note that: Paragraph 89 of IFRS Practice Statement 2 clarifies that it does not change any requirements in IFRS Standards or introduce any new requirements. The clarification in the Basis for Conclusions on IFRS Practice Statement 2 refers only to information about covenants, not to accounting requirements for contingent liabilities more generally.