



Project	Annual Improvement
Topic	Amendments to IFRS3 and IAS27 – Pre-adoption Contingent Consideration

Proposed amendment

1. The IASB has been asked to clarify the treatment of contingent consideration arising from business combinations whose acquisition dates preceded the application of the revised IFRS 3 (this agenda paper refers to those agreements as pre-adoption contingent consideration).
2. The Board deleted in phase II of its business combinations project the scope exemption in IAS 39 *Financial Instruments: Recognition and Measurement* for contingent consideration. Therefore, IAS 39 applies to all contingent consideration, including pre-adoption contingent consideration. Some constituents questioned whether this consequence is consistent with the principle of prospective application of the revised IFRS 3.

Issue: Should transitional guidance be added to IAS 39 to exempt pre-adoption contingent consideration from the scope of IAS 39?

Staff recommendation

3. The staff recommends that the Board:
 - (a) add this issue to the annual improvements project; and
 - (b) propose amending the effective date paragraph for the consequential amendment to IAS 39 to clarify that IAS 39 does not apply to pre-adoption contingent consideration.

This paper has been prepared by the technical staff of the IASCF for discussion at a public meeting of the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the IASB.

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRIC or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

Background

4. IFRS 3.32 (as issued in 2004) required the acquirer, when a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, to include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is probable and can be measured reliably. Those agreements are often referred to as contingent consideration. IFRS 3.33 (as issued in 2004) stated further that if the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.
5. The Board amended the treatment of contingent consideration in phase II of its business combinations project. IFRS 3.39 (as issued in 2008) requires the acquirer to recognise the acquisition date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree. According to IFRS 3.40 (as issued in 2008), the acquirer classifies an obligation to pay contingent consideration as a liability or equity in accordance with IAS 32. A right to returns from contingent consideration gives rise to an asset. IFRS 3.58 (as issued in 2008) addresses the subsequent measurement of contingent consideration and requires the acquirer to follow other relevant IFRSs. This means that contingent consideration that is classified as an asset or a liability will often be measured subsequently in accordance with IAS 39.
6. IAS 39.2(f) exempted contingent consideration arrangements from the scope of IAS 39. To allow the acquirer to account for contingent consideration as required by the revised IFRS 3, the Board deleted that scope exception. But the Board did not add transition requirements to IAS 39 to exempt pre-adoption contingent consideration from its scope. As a consequence, all contingent consideration, including pre-adoption contingent consideration, that meets the definition of a financial instrument must be accounted for in accordance with IAS 39.

Staff Analysis

7. IFRS 3.64 (as issued in 2008) states that the revised standard should be applied prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 July 2009. IFRS 3.65 (as issued in 2008) explains further that assets and liabilities that arose from business combinations whose acquisition dates preceded the application of this IFRS are not adjusted upon application of this IFRS.
8. We believe that according to this principle the subsequent measurement of pre-adoption contingent consideration should not follow the requirements in the revised IFRS 3 and IAS 39 should not apply. The requirements of IFRS 3 (as issued in 2004) should continue to be followed for these arrangements. If payments are required that were not included in the original business combination accounting, the cost of the prior business combinations should be adjusted.
9. We also note that there are similar conflicts for pre-adoption contingent consideration with IFRS 7 and IAS 32.
10. We recommend that the Board propose amending the effective date paragraph for the consequential amendment to IFRS 7, IAS 32 and IAS 39 to clarify that those standards do not apply to pre-adoption contingent consideration.
11. We would, however, draw the Board's attention to the agenda paper 13D which deals with the pre-existing contingent consideration. If the Board has decided to adopt View 1 in that paper, there will be internal inconsistency for the accounting of pre-adoption contingent consideration of the acquirer (under the old standard) and of the acquiree (under the revised standard).
12. *Consistency with US GAAP* - The staff notes that the recommendation is consistent with the interpretation of US GAAP. SFAS No 141R also requires entities to adopt the standard prospectively and assets and liabilities that arose from business combinations before the adoption of SFAS 141R shall not be adjusted (paragraphs 74 and 75).

Question to the Board

Does the Board agree to propose amending the effective date paragraph for the consequential amendment to IAS 39 to clarify that IAS 39 does not apply to contingent consideration from business combinations whose acquisition dates preceded the application of the revised IFRS 3?

Does the Board have any comments on the proposed wording included in Appendix A?

Appendix A

IFRS 7 *Financial Instruments: Disclosures*

A1. In IFRS 7 paragraph 44B is amended (new text is underlined). Paragraph 44H is added:

44B IFRS 3 (as revised in 2008) deleted paragraph 3(c). An entity shall apply that amendment prospectively¹ for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. The amendment does not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (as revised in 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs 32-35 of IFRS 3 (as issued in 2004)

44H Paragraph 44B was amended by *Improvements to IFRSs* issued in [date]. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies this amendment before 1 July 2010 it shall disclose that fact.

IAS 32 *Financial Instruments: Presentation*

A2. In IAS 32 paragraph 97B is amended (new text is underlined). Paragraph 97E is added.

97B IFRS 3 (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment prospectively¹ for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. The amendment does not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (as revised in 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs 32-35 of IFRS 3 (as issued in 2004).

97E Paragraph 97B was amended by *Improvements to IFRSs* issued in [date]. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies this amendment before 1 July 2010 it shall disclose that fact.

IAS 39 Financial Instruments: Recognition and Measurement

Paragraph 103D is amended (new text is underlined). Paragraph 103J is added. .

- 103D [IFRS 3](#) (as revised in 2008) deleted paragraph 2(f). An entity shall apply that amendment prospectively¹ for annual periods beginning on or after 1 July 2009. If an entity applies [IFRS 3](#) (revised 2008) for an earlier period, the amendment shall also be applied for that earlier period. The amendment does not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (as revised in 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs 32-35 of IFRS 3 (as issued in 2004).
- 103J Paragraphs 103D [and 103E] were amended by *Improvements to IFRSs* issued in [date]. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies those amendments before 1 July 2010 it shall disclose that fact.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of the proposed amendment.

- BC1 Paragraph 2(f) of IAS 39 exempted contingent consideration arrangements from the scope of IAS 39. To allow the acquirer to account for contingent consideration as required by the revised IFRS 3 *Business Combinations*, the Board deleted that scope exception in phase II of its project on business combinations.
- BC2 The deletion of the scope exception applies to all contingent consideration including contingent consideration from business combinations with an acquisition date earlier than the application date of the revised IFRS 3. The Board noted that this consequence is inconsistent with the requirement in paragraph 65 of IFRS 3 that assets and liabilities that arose from business combinations whose acquisition dates preceded the application of the revised IFRS are not adjusted upon application of the revised IFRS.
- BC3 Therefore, the Board proposes to amend paragraph 103D of IAS 39 to clarify that the requirements in IAS 39 do not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of the revised IFRS 3. Rather, an entity accounts for such contingent consideration in accordance with the requirements in paragraphs 32-35 of IFRS 3 (as issued in 2004). The Board does not believe that the proposed amendments will affect the convergence of IFRS 3 *Business Combinations* and SFAS 141(R) *Business Combinations*.

¹ The amendment is made in relation to the agenda paper 13A –Consequential Amendments