Project	**Annual Improvement Project – 2008-2010 cycle - Comment letter analysis**
Topic	**IFRS 3 *Business Combinations* – Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS**

Introduction

1. In the *Annual Improvements* exposure draft published in August 2009, the Board addressed an issue relating to the transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS 3 (2008) *Business Combination*s.

2. The objective of this paper is:

   (a) To provide background information on the issue,

   (b) To analyse the comment letters we received, and

   (c) To recommend the IFRIC amend the wording from the exposure draft as proposed in Appendices A and B.

Background

3. This issue was discussed at the May 2009 IASB Board meeting; it was set out in agenda paper reference 13C that can be found on the public website[1].

[1] http://www.iasb.org/Meetings/IASB+Board+Meeting+20+May+2009.htm

4. IFRS 3 (revised 2008) included a consequential amendment to IAS 39 *Financial Instruments: Recognition and Measurement.* This consequential amendment removed the IAS 39 scope exception relating to contingent consideration. Prior to this amendment, contingent consideration arising in a business combination was not within the scope of IAS 39 even if that contingent consideration was in the form of a financial asset or financial liability.

5. When IFRS 3 (revised 2008) amended the scope of IAS 39 for contingent consideration, there was no specification of whether this amendment should be applied prospectively or retrospectively. Neither did it specify if IAS 39 should be applied only to contingent consideration balances arising from business combinations accounted for in accordance with IFRS 3 (revised 2008) or also to outstanding contingent consideration balances from earlier business combinations.

6. The Board was advised that some constituents were referring to paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* and concluding that IAS 39 should be applied to all contingent consideration. This included contingent consideration from business combinations with an acquisition date earlier than the application date of IFRS 3 (revised 2008). However, this conclusion would be inconsistent with the principle of prospective application set out in paragraph 65 of IFRS 3 (revised 2008). This paragraph requires that assets and liabilities arising from business combinations accounted for in accordance with IFRS 3 (issued 2004) should not be adjusted upon application of IFRS 3 (revised 2008).

7. In response, the IASB proposed an amendment to IAS 39 in the August 2009 Annual Improvements Exposure Draft (ED). The proposal was to include in IAS 39 *Financial Instruments: Recognition and Measurement* a reference to IFRS 3 (issued 2004) for the accounting for contingent consideration from a business combination that occurred before the application of IFRS 3 (revised 2008). The ED also proposed equivalent amendments to IFRS 7 *Financial Instruments: Disclosures* and IAS 32 *Financial Instruments: Presentation.*

Analysis of comments received

8. The Board received 70 comment letters on the 2009 Annual Improvements of which 48 commented on the subject of this paper.

9. The comment letters breakdown as follows:

Yes:	32
Yes, but expressed concern:	15
No:	1
Total:	48

Staff analysis in response to the comments raised

Cross-reference to superseded standard

10. Some constituents[2] raised the concern that the proposed amendments refer to paragraphs 32-35 of IFRS 3 (issued 2004) which is now superseded by IFRS 3 (revised 2008). These constituents are concerned that this reference cannot be authoritative because it refers to a withdrawn version of the standard.

11. Additionally, in some jurisdictions IFRSs need be legally adopted before they are effective. As a consequence, when a revised standard is endorsed, the old standard is superseded.

12. As a result, preparers in these jurisdictions cannot legally use the requirements set out in the superseded version of IFRS 3 (revised 2004) as required by the amendment.

13. To address these concerns, the constituents propose reproducing the requirements set out in paragraphs 32-35 of IFRS 3 (issued 2004) within IFRS 7, IAS 32 and IAS 39.

[2] EFRAG CL 49, DTT CL 23, Mazars CL 51

14. Other constituents[3] believe that it would be better to clarify in the scope of these standards that only contingent consideration that is part of a business combination accounted for in accordance with IFRS 3 (revised 2008) is within the scope of these standards.

15. Under this second approach, there would be no reference to a superseded standard. However, there would not be any guidance on the accounting for contingent consideration balances relating to business combinations that occurred prior to the application of IFRS 3 (revised 2008), if only the scope of IFRS 7, IAS 32 and IAS 39 was amended.

16. The staff believes that reproducing the IFRS 3 (issued 2004) requirements within the transition provisions of IFRS 3 (revised 2008) and cross-referencing to these transition provisions from IFRS 7, IAS 32 and IAS 39 is a clearer way to address the issue.

Application of the proposed amendment

Existing IFRS preparers

17. The August 2009 ED proposed that the amendment shall apply for annual periods beginning on or after 1 July 2010. The ED proposal is silent on whether the amendment should be applied prospectively or retrospectively. However, one constituent[4] believes that it would be useful to specify that application should apply from the date the entity first applied IFRS 3 (revised 2008), in line with the transition principle set out in paragraph 65 of IFRS 3 (revised 2008).

18. The staff agrees clarification is needed. The staff recommends that the proposed amendment be applied from the date of application of IFRS 3 (revised 2008).

19. The staff acknowledges such clarification may affect entities that have adopted IFRS 3 (revised 2008) early and that have already accounted for pre-existing

[3] ASB-UK CL 2
[4] DTT CL 23

contingent consideration balances in accordance with IAS 39. These entities would then have to restate their accounting for pre-existing contingent consideration balances if the IFRIC decides to require such balances to be accounted in accordance with the guidance in IFRS 3 (issued 2004).

20. Two views exist:

    (a) View 1: relief should be provided for early adopters for the accounting of contingent consideration balances from business combinations that occurred before the application of IFRS 3 (revised 2008),

    (b) View 2: no relief should be provided.

21. Under view 1, early adopters would not have to restate their accounting for relevant contingent consideration balances back to the IFRS 3 (issued 2004) basis.

22. Under view 2, early adopters of IFRS 3 (revised 2008) that had applied IAS 39 to contingent consideration balances from earlier business combinations would have to restate these balances in accordance with the transition provisions in this amendment. In other words, they would have to revert to the original IFRS 3 (issued 2004) accounting treatment.

23. The staff is in favour of view 2 because it will provide better comparability between companies as all contingent consideration balances from earlier business combinations will be accounted for in the same way. Further, the staff expects that it will be uncommon that entities will have early adopted IFRS 3 (revised 2008) and applied IAS 39 requirements to contingent consideration balances from business combinations that occurred prior to the application of IFRS 3 (revised 2008).

First-time adopters

24. Some constituents[5] pointed out that accounting for contingent consideration balances that exist at transition date and which arose from business combinations prior to transition date, is a significant issue for first-time adopters. They suggest IFRS 1 *First-time Adoption of International Financial Reporting Standards* be amended to allow first-time adopters to use the same transition provisions as existing IFRS preparers. They suggest that contingent consideration balances from business combinations that occurred before the application of IFRS 3 (revised 2008) should be accounted for in accordance with the requirements in IFRS 3 (issued 2004).

25. The staff notes that IFRS 1 is silent on how to account for contingent consideration that relates to a business combination that occurred prior to the transition date, and to which the business combinations exemption in Appendix C of IFRS 1 has been applied.

26. The staff also notes that a consequential amendment from IFRS 3 (revised 2008) to IFRS 1 was made that removed prior paragraph B2(g)(ii) of IFRS 1 that dealt with existing contingent consideration balances on the date of transition for past business combinations. This former paragraph required adjusting goodwill if certain conditions were met. The staff understands that former paragraph B2(g)(ii) of IFRS 1 was removed because goodwill could not be adjusted for re-measurement of contingent consideration under IFRS 3 (revised 2008). Paragraph B2(g)(ii) is reproduced below:

> A contingency affecting the amount of the purchase consideration for a past business combination may have been resolved before the date of transition to IFRSs. If a reliable estimate of the contingent adjustment can be made and its payment is probable, the first-time adopter shall adjust the goodwill by that amount. Similarly, the first-time adopter shall adjust the carrying amount of goodwill if a previously recognised contingent adjustment can no longer be measured reliably or its payment is no longer probable.

[5] KPMG CL 52, BDO CL 53

27. The staff acknowledges two issues arise. One related to the accounting of existing contingent consideration balances on the date of transition and the other related to the subsequent accounting for these contingent consideration balances arising from business combinations that occurred prior to the transition date.

Accounting on the date of transition

28. As regards the issue on the accounting on the date of transition, the staff believes that this was addressed through the deletion of paragraph B2(g)(ii) of IFRS 1. The staff believes IFRS 1 is clear in requiring existing contingent consideration balances at the date of transition to be remeasured in accordance with IFRS 3 (revised 2008) and the resulting adjustments be recognised directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to IFRSs. The staff recommends no further changes be made to the proposed amendment in this respect.

Accounting for subsequent changes in contingent consideration balances that exist at the date of transition

29. As regards the subsequent accounting for these contingent consideration balances arising from business combinations that occurred prior to the transition date, two views exist:

    (a) View 1: IFRS 3 (issued 2004) requirements should apply to accounting for subsequent changes in contingent consideration balances from pre-IFRS 3 (revised 2008) business combinations,

    (b) View 2: contingent consideration balances from pre-IFRS 3 (revised 2008) business combinations should not be granted the same relief as existing IFRS preparers, ie subsequent changes in these balances should be treated in accordance with IAS 39 if they relate to financial assets or financial liabilities.

30. The staff acknowledges that applying the requirements from IFRS 3 (issued 2004) as proposed in view 1 would impair consistency within the financial statements of a first-time adopter. Contingent consideration balances

would be accounted for differently depending on whether or not the business combination occurred pre-transition date.

31. Applying different accounting policies to contingent consideration balances in the first IFRS financial statements is contrary to the principle in paragraph 7 of IFRS 1. This principle requires that the same policies are applied to the opening balance sheet and all periods presented.

32. Additionally, business combinations that occurred before the date of transition and to which the IFRS 1 business combinations exemption was applied, would have been accounted for under previous GAAP without restatement. Previous GAAP might have permitted a pooling of interests basis of accounting with no goodwill recognised, or it might have permitted a form of purchase accounting with goodwill written off to reserves. In these cases, the staff believes that requiring that goodwill be adjusted for subsequent contingent consideration changes does not provide better information.

33. On the contrary, under view 2, consistency within the financial statements of a first-time adopter would be improved as all contingent consideration balances would be accounted for in the same way, regardless of when the business combinations occurred. Adjustments to balances on the date of transition would be booked against retained earnings. Any re-measurement post-date of transition would affect the income statement.

34. The staff acknowledges this impairs comparability with existing IFRS preparers for balances arising from business combinations pre-IFRS 3 (revised 2008) adoption. However, this is a short-term issue as contingent consideration balances will eventually be settled or expire.

Inconsistency in contingent consideration measurement

35. The staff was made aware of a further inconsistency related to the measurement of contingent consideration under IAS 39. IFRS 3 (revised 2008) requires in paragraph 58 that contingent consideration that is a financial instrument in the scope of IAS 39 to be accounted for at fair value through profit or loss or

through other comprehensive income (OCI) in accordance with IAS 39. However, many financial liabilities within the scope of IAS 39 are accounted for at amortised cost.

36. The staff understands that the rationale for the accounting treatment set out in paragraph 58 of IFRS 3 (revised 2008) is that most contingent consideration obligations are financial instruments and many are derivatives, hence the requirement to measure at fair value (see BC349 of IFRS 3).

37. The staff notes that IAS 39 does not specifically address the measurement of contingent consideration. Accordingly the proposed amendment has the effect of including contingent consideration balances within the scope of IAS 39, but retaining some of the measurement guidance within IFRS 3 (paragraph 58).

38. The staff notes that it would be more efficient to have all the measurement guidance for contingent consideration balances within one IFRS. The staff believes that this issue should be considered as part of the Replacement of IAS 39 Project. The staff is of the opinion that such a change should not be made within this *Annual Improvements*.

Terminology used in qualifying the transition provisions

39. Some constituents[6] ask for additional guidance on the meaning of prospective and retrospective application as they note the Board uses the terminology in different ways across the standards.

40. Such a project has wider implications than an annual improvement amendment is intended to address. The staff notes that this is an issue applicable to both IASB projects and IFRIC projects and do not propose the issue is taken up in *Improvements to IFRSs*.

[6] EFRAG CL 49

Other comments

41. One constituent[7] points out an issue relating to the accounting for contingent consideration relating to the purchase of a non-controlling interest (NCI). They note that some entities account for such contingent consideration by analogy with the requirements in IFRS 3 for contingent considerations relating to business combinations. This constituent believes that the proposed amendment should explicitly state that it also applies to contingent consideration for the purchase of NCI.

42. The staff disagrees. The accounting for the purchase of NCI is not within the scope of IFRS 3 (revised 2008). Accordingly, the staff believes that this proposed amendment should not be extended to such transactions.

43. Some constituents[8] believe that the wording in the proposed paragraph 4 of the Basis for Conclusions to the proposed amendments is overly restrictive as to how the effect on transition of the deletion of the scope exception may be interpreted. They propose adding "Some may interpret [the deletion …]" to account for those who understand the deletion of the scope exception applies only to business combinations that occurred after the application of IFRS 3 (revised 2008).

44. The staff believes this is a fair comment and proposes wording changes to reflect this.

Staff recommendation

45. The staff recommends the proposed amendment be modified to:

    (a) reproduce IFRS 3 (issued 2004) requirements on accounting for contingent consideration within the transition section in IFRS 3

[7] Mazars CL 51
[8] EY CL 47

(revised 2008), after paragraph 65, and refer to this guidance in the transition sections of IFRS 7, IAS 32 and IAS 39; and

(b) require that this guidance be applied to all contingent consideration balances arising from acquisitions prior to the date the entity first applied IFRS 3 (revised 2008).

46. The staff considered whether IFRS 9 *Financial Instruments,* published in November 2009 and that partially replaces IAS 39, should be amended as a consequence of this *Annual Improvements*. The staff notes that:

(a) currently the scope in IFRS 9 is “assets in the scope of IAS 39”;

(b) IFRS 9 does not specifically address contingent consideration in business combinations; and

(c) when IAS 39 is superseded, consequential amendments will be made to capture guidance in the IAS 39 transition provisions guidance that needs to be preserved.

47. Therefore the staff is of the opinion that IFRS 9 need not be amended as part of this *Improvements to IFRSs* to reflect the proposed changes to IAS 39.

48. In addition, the staff recommends the IFRIC ask the Board to consider, as part of its IAS 39 replacement project, bringing together in one IFRS the measurement guidance for contingent consideration that is a financial instrument.

49. The staff proposes wording for these changes in Appendices A and B.

Questions to the IFRIC

Question 1 – Proposed changes
Does the IFRIC agree with the staff recommendation in paragraph 41?

Question 2 – Proposed wording
Does the IFRIC agree with the proposed changes set out in Appendices A and B? If not, what wording would the IFRIC suggest?

Question 3 – Referring to the Board to address the inconsistency between IFRS 9/IAS 39 and IFRS 3 (revised 2008) on the measurement of contingent consideration
Does the IFRIC agree with the staff recommendation in paragraph 44 to ask the Board to consider, as part of its IAS 39 replacement project, bringing together in one IFRS the measurement guidance for contingent consideration that is a financial instrument?

Appendix A – Proposed drafting of final amendment

A1. This appendix includes the proposed drafting of the final amendment. It is based on the text included in the Bound Volume as of 1 January 2009. New text is underlined and deleted text is struck through.

Amendments to IFRS 3 *Business Combinations* (as revised in 2008)

Paragraphs 64B and 65A to 65E are added.

Effective date and transition

Effective date

64B Paragraphs 65A to 65E were added by *Improvements to IFRSs* issued in April 2010. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. The accounting required by those amendments shall be applied from the application date of IFRS 3 (revised 2008). The amendments shall be applied to contingent consideration balances arising from business combinations with an acquisition date prior to the application date of IFRS 3 (revised 2008).

Transition

65A Contingent consideration balances that arise from business combinations whose acquisition dates preceded the application of this IFRS shall not be adjusted upon application of this IFRS. After the application of this IFRS, paragraphs 65B-65E shall be applied in the subsequent accounting of those balances. Paragraphs 65B-65E shall not apply to the accounting for contingent consideration balances arising from business combinations with acquisition dates on or after the application date of this IFRS.

65B When a business combination[9] agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall 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.

65C A business combination agreement may allow for adjustments to the cost of the combination that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such adjustment at the time of initially accounting for the combination without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.

65D However when a business combination agreement provides for such an adjustment, that adjustment is not included in the cost of the combination at the time of initially accounting for the combination if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes

[9] Business Combination is specifically used in paragraphs 65A to 65E to refer exclusively to business combinations whose acquisition date preceded the application of IFRS 3 (revised 2008).

probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

65E In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the business combination and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the business combination is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

Basis for Conclusions on amendments to IFRS 3 *Business Combinations* (as revised in 2008)

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

In the Basis for Conclusions, a heading after paragraph BC434 and paragraphs BC434A to BC434C are added.

Effective date and transition

Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS

BC434A Paragraph 3(c) of IFRS 7 *Financial Instruments: Disclosures*, paragraph 4(c) of IAS 32 *Financial Instruments: Presentation* and 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 decided to delete those scope exceptions in the second phase of its project on business combinations.

BC434B Some interpreted the deletion of the scope exception as meaning that IAS 39 would apply 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 interpretation 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.

BC434C Therefore, the Board decided to reproduce paragraphs 32-35 of IFRS 3 (as issued in 2004) as paragraphs 65B-65E in IFRS 3 (revised 2008), to add paragraph 65A and to amend paragraph 44B of IFRS 7, paragraph 97B of IAS 32 and paragraph 103D of IAS 39. The Board did this 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 and to provide guidance on how to account for such balances. The Board does not believe that the proposed amendments will affect the convergence of IFRS 3 and SFAS 141(R).

Appendix to proposed amendments to IFRS 3

Amendments to other IFRSs

IFRS 7 *Financial Instruments: Disclosures*

Paragraph 44B is amended and paragraph 44H is added.

Effective date and transition

44B IFRS 3 (as revised in 2008) deleted paragraph 3(c). An entity shall apply that amendment 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. <u>The amendment does not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (revised 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs 65A-65E of IFRS 3 (revised 2008).</u>

44H Paragraph 44B was amended by *Improvements to IFRSs* issued in April 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010 from the date the entity first applied IFRS 3 (revised 2008). Earlier application is permitted. If an entity applies the amendment before 1 July 2010 it shall disclose that fact.

IAS 32 *Financial Instruments: Presentation*

Paragraph 97B is amended and paragraph 97E is added.

Effective date and transition

97B IFRS 3 (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment 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. <u>The amendment does not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (revised 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs 65A-65E of IFRS 3 (revised 2008).</u>

97E Paragraph 97B was amended by *Improvements to IFRSs* issued in April 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010 from the date the entity first applied IFRS 3 (revised 2008). 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 and paragraph 103N is added.

Effective date and transition

103D IFRS 3 (as revised in 2008) deleted paragraph 2(f). An entity shall apply that amendment 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. <u>The amendment does not apply to contingent consideration that arose from a business combination whose acquisition date preceded the application of IFRS 3 (revised 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs 65A-65E of IFRS 3 (revised 2008).</u>

103N Paragraph 103D was amended by Improvements to IFRSs issued in April 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010 from the date the entity first applied IFRS 3 (revised 2008). Earlier application is permitted. If an entity applies the amendment before 1 July 2010 it shall disclose that fact.

Appendix B – Proposed drafting edits from Exposure Draft

B1. This appendix includes the proposed drafting edits from the proposed amendment included in the exposure draft of proposed Improvements to IFRSs published in August 2009. This appendix presumes all changes proposed in the exposure draft were accepted and only shows incremental changes newly recommended by the staff based on an analysis of the comment letters received. Incremental new text is double underlined and incremental deleted text is double struck through.

Amendments to IFRS 3 *Business Combinations* (as revised in 2008)

Paragraphs 64B and 65A to 65E are added.

Effective date and transition

Effective date

64B Paragraphs 65A to 65E were added by Improvements to IFRSs issued in April 2010. An entity shall apply those amendments for annual periods beginning on or after 1 July 2010. Earlier application is permitted. If an entity applies the amendments for an earlier period it shall disclose that fact. The accounting required by those amendments shall be applied from the application date of IFRS 3 (revised 2008). The amendments shall be applied to contingent consideration balances arising from business combinations with an acquisition date prior to the application date of IFRS 3 (revised 2008).

Transition

65A Contingent consideration balances that arise from business combinations whose acquisition dates preceded the application of this IFRS shall not be adjusted upon application of this IFRS. After the application of this IFRS, paragraphs 65B-65E shall be applied in the subsequent accounting of those balances. Paragraphs 65B-65E shall not apply to the accounting for contingent consideration balances arising from business combinations with acquisition dates on or after the application date of this IFRS.

65B When a business combination[10] agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall 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.

65C A business combination agreement may allow for adjustments to the cost of the combination that are contingent on one or more future events. The adjustment might, for example, be contingent on a specified level of profit being maintained or achieved in future periods, or on the market price of the instruments issued being maintained. It is usually possible to estimate the amount of any such

[10] Business Combination is specifically used in paragraphs 65A to 65E to refer exclusively to business combinations whose acquisition date preceded the application of IFRS 3 (revised 2008).

adjustment at the time of initially accounting for the combination without impairing the reliability of the information, even though some uncertainty exists. If the future events do not occur or the estimate needs to be revised, the cost of the business combination shall be adjusted accordingly.

65D However when a business combination agreement provides for such an adjustment, that adjustment is not included in the cost of the combination at the time of initially accounting for the combination if it either is not probable or cannot be measured reliably. If that adjustment subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

65E In some circumstances, the acquirer may be required to make a subsequent payment to the seller as compensation for a reduction in the value of the assets given, equity instruments issued or liabilities incurred or assumed by the acquirer in exchange for control of the acquiree. This is the case, for example, when the acquirer guarantees the market price of equity or debt instruments issued as part of the cost of the business combination and is required to issue additional equity or debt instruments to restore the originally determined cost. In such cases, no increase in the cost of the business combination is recognised. In the case of equity instruments, the fair value of the additional payment is offset by an equal reduction in the value attributed to the instruments initially issued. In the case of debt instruments, the additional payment is regarded as a reduction in the premium or an increase in the discount on the initial issue.

Basis for Conclusions on amendments to IFRS 3 *Business Combinations* (as revised in 2008)

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

Paragraphs BC3-BC5 are amended and a heading before paragraph BC3 is added.

Effective date and transition

Transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS

~~BC3~~BC434A Paragraph 3(c) of IFRS 7 *Financial Instruments: Disclosures*, paragraph 4(c) of IAS 32 *Financial Instruments: Presentation* and 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 ~~proposes~~decided to delete those scope exceptions in the second phase of its project on business combinations.

~~BC4~~BC434B Some interpreted t~~T~~he deletion of the scope exception ~~meant~~ as meaning that IAS 39 would apply 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 interpretation 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.

~~BC5~~BC434C Therefore, the Board ~~proposes~~decided to reproduce paragraphs 32-35 of IFRS 3 (as issued in 2004) as paragraphs 65B-65E in IFRS 3 (revised 2008), to add paragraph 65A and to amend paragraph 44B of IFRS 7, paragraph 97B of IAS 32 and paragraph 103D of IAS 39. The Board did this 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 and to provide guidance on how to account for such balances.~~ 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 and SFAS 141(R).

Appendix to proposed amendments to IFRS 3

Amendments to other IFRSs

IFRS 7 *Financial Instruments: Disclosures*

Paragraph 44B is amended and paragraph 44H is added.

Effective date and transition

44B IFRS 3 (as revised in 2008) deleted paragraph 3(c). An entity shall apply that amendment 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 (revised 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs ~~32-35 of IFRS 3 (as issued 2004)~~ 65A-65E of IFRS 3 (revised 2008).

44H Paragraph 44B was amended by *Improvements to IFRSs* issued in April 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010 from the date the entity first applied IFRS 3 (revised 2008). Earlier application is permitted. If an entity applies the amendment before 1 July 2010 it shall disclose that fact.

IAS 32 *Financial Instruments: Presentation*

Paragraph 97B is amended and paragraph 97E is added.

Effective date and transition

97B IFRS 3 (as revised in 2008) deleted paragraph 4(c). An entity shall apply that amendment 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 (revised 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs ~~32-35 of IFRS 3 (as issued 2004)~~ 65A-65E of IFRS 3 (revised 2008).

97E Paragraph 97B was amended by *Improvements to IFRSs* issued in April 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010 from the date the entity first applied IFRS 3 (revised 2008). 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 and paragraph 103N is added.

Effective date and transition

103D IFRS 3 (as revised in 2008) deleted paragraph 2(f). An entity shall apply that amendment 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 (revised 2008). Such contingent consideration is accounted for in accordance with the requirements in paragraphs ~~32-35 of IFRS 3 (as issued 2004)~~ 65A-65E of IFRS 3 (revised 2008).

103N Paragraph 103D was amended by Improvements to IFRSs issued in April 2010. An entity shall apply that amendment for annual periods beginning on or after 1 July 2010 from the date the entity first applied IFRS 3 (revised 2008). Earlier application is permitted. If an entity applies the amendment before 1 July 2010 it shall disclose that fact.