Project	**Annual Improvements Project – 2009 - 2011 cycle**
Topic	**IFRS 3 (revised 2008) *Business Combinations* – Accounting for contingent consideration from business combinations that occurred prior to the date of application of IFRS3R for first-time adopters**

Introduction

1. At the IFRIC meeting in January 2010, the IFRIC deliberated comments received on an Annual Improvement from the *Improvements to IFRSs* exposure draft published in August 2009. The issue related to the transition requirements for contingent consideration from a business combination that occurred before the effective date of the revised IFRS 3 (2008) *Business Combinations*.

2. The IFRIC agreed with the staff recommendation to finalise this Annual Improvement.

3. This Annual Improvement clarifies the transition relief for contingent consideration for existing IFRS preparers. However, there is no equivalent relief for first-time adopters. The IFRIC requested that the staff consider whether similar relief should be provided to first-time adopters. This paper provides the staff's analysis of this issue.

4. The objective of this paper is:

    (a) To provide background information on the issue,

    (b) To provide an analysis of the issue,

    (c) To provide staff's recommendations,

(d) To ask questions for the IFRIC as to which path forward should be followed on this issue.

Background

5. The issue was set out in paragraphs 24-34 of the Agenda Paper 9 discussed at the January 2010 IFRIC meeting that can be found on the public website[1].

6. A concern was expressed by some constituents and some IFRIC members about the lack of equivalent relief provided to first-time adopters. The Board did not provide equivalent relief to first-time adopters at the time it issued IFRS 3 (revised 2008). Instead the Board deleted a paragraph in the Business Combinations exemption in IFRS 1 *First-time Adoption of International Financial Reporting Standards* relating to contingent consideration. This paragraph had permitted contingent consideration balances arising from business combinations accounted for under previous GAAP to be adjusted against goodwill at transition date.

7. This paragraph 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.

8. Consequently the current requirement under IFRS 1 is that any outstanding contingent consideration balance at transition date that is a financial asset or liability is recognised at fair value with a corresponding adjustment to opening retained earnings (or other appropriate component of equity). Post transition, changes in such balances are accounted for in accordance with

[1] http://www.iasb.org/NR/rdonlyres/918F5074-7387-4AA7-A259-B831347539FB/0/1001ap9obsAIPIFRS3Transitionrequirementsforcontingentconsideration.pdf

IFRS 3 (revised 2008), i.e. at fair value through profit or loss or other comprehensive income in accordance with IAS 39.

Staff analysis

The issue

9. Some 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: contingent consideration balances arising 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).

10. This would have the effect of:

    (a) Recognising contingent consideration balances at best estimate only if they are probable at transition date,

    (b) Recognising any adjustments to contingent consideration balances at transition date as adjustments against goodwill, and

    (c) Recognising any post transition remeasurements of contingent consideration also against goodwill.

11. 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.

12. The staff also notes that the consequential amendment from IFRS 3 (revised 2008) to IFRS 1 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. Former paragraph B2(g)(ii) is reproduced in paragraph 7 of this paper.

13. At this stage and taking into account outreach feedback received so far, the staff analyses the issue as bringing about the following issues:

    (a) Previous GAAPs may be similar to IFRS 3 (issued 2004) or very different,

    (b) If an exemption is granted for first-time adopters, should this be at transition date only, for subsequent remeasurements of contingent consideration only or for both,

Different previous GAAPs

14. First-time adopters could be transiting from a GAAP that is very similar to IFRSs or very different. Some constituents have suggested an exemption could be limited to situations where a previous GAAPs were similar to IFRS 3 (issued 2004) in that contingent consideration adjustments are required to be recorded against goodwill.

15. These constituents are aware that such a limitation would require the assessment of the similarities between IFRS 3 (issued 2004) and the relevant previous GAAP. They also note that this would entail a differentiation between first-time adopters whose previous GAAPs are similar to IFRS 3 (issued 2004) and those that aren't.

16. As to the assessment of similarities, the staff thinks this would prove difficult to implement. Assessing whether previous GAAPs are similar or not could be an arbitrary determination.

17. The staff does not recommend a path that would entail a differentiation in first-time adopters on whether previous GAAPs are similar to IFRS 3 (issued 2004).

Question 1 – Differentiation based on previous GAAPs
Does the IFRIC agree that, if relief is provided to first-time adopters, there should not be any differentiation depending on whether previous GAAPs are similar to IFRS 3 (issued 2004)

Extent of relief to be considered

At transition date – initial measurement

18. The staff notes that, currently, IFRS 1 and IFRS 3 (revised 2008) read together require contingent consideration to be measured at fair value at the date of transition. Any resulting adjustment should be recognised in retained earnings.

19. As clarified by the recent approved Annual Improvements Project amendment to IFRS 3 (revised 2008), existing preparers are currently required to recognise contingent consideration arising from business combinations that occurred before the date the entity first applied IFRS 3 (revised 2008) only if probable, in accordance with [future] paragraph 65B of IFRS 3 (revised 2008). This is a continuation of previous accounting policy.

20. The staff does not support allowing contingent consideration to be recognised at transition date (on first-time application) only when probable for the following reasons:

    (a) This is inconsistent with current IFRS 3 (revised 2008) and with IFRS 1's principle of applying the same policies to the opening balance sheet and all periods presented,

    (b) When measuring contingent consideration balances at fair value at the date of transition, first-time adopters would not have to use hindsight because the measurement date is transition date and not the relevant earlier acquisition date.

Question 2 – Measurement of contingent consideration at transition date
Does the IFRIC agree with the analysis set out in paragraphs 18-20 that relief should not be given from measuring contingent consideration at fair value at the date of transition?

At transition date – recognition of resulting adjustments: goodwill or retained earnings

21. The staff notes that, on the one hand, recognising adjustments against goodwill is consistent with how contingent consideration would have affected goodwill at the date of acquisition had it been initially recognised in accordance with IFRS 3 (revised 2008).

22. On the other hand, adjusting contingent consideration balances at transition date is a catch-up between the balance recognised initially at acquisition date and balance at transition date. In accordance with IFRS 3 (revised 2008), changes in balances are recognised through profit or loss, hence in retained earnings in the opening statement of financial position.

23. The staff is also aware of cases where previous GAAPs have permitted a pooling of interests basis of accounting with no goodwill recognised, or 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 does not provide better information.

24. The staff notes that recognition of adjustments against goodwill at the date of transition is inconsistent with removing former paragraph B2(g)(ii) from Business Combinations exemptions in IFRS 1 (see paragraph 7 of this paper).

25. The staff therefore recommends no amendment be proposed with respect to providing relief for first-time adopters at the date of transition for the recognition of adjustments to contingent consideration balances.

Question 3 – Recognition of adjustments to the measure of contingent consideration at the date of transition
Does the IFRIC agree with the analysis set out in paragraphs 21-24 that no relief should be given to allow adjustments to contingent consideration at the date of transition to be recognised against goodwill?

Recognition of subsequent measurement

26. The staff notes that providing an exemption in IFRS 1 for the measurement of contingent consideration post-transition would be a departure from the focus of IFRS 1. The focus of IFRS 1 is principally on the adjustment required to prepare the opening balance sheet, rather than determining the accounting post-transition.

27. In addition, accounting for changes in the balances of such contingent consideration in accordance with requirements other than those of IFRS 3 (revised 2008) impairs consistency within the financial statements of a first-time adopter. The staff believes that permitting such inconsistency does not provide better information.

28. The staff recommends that no relief be given to first-time adopters to allow subsequent measurements of contingent consideration to be recognised against goodwill.

Question 4 – Accounting for subsequent changes in contingent consideration balances
Does the IFRIC agree with the analysis carried out in paragraphs 26-27 and with the staff's recommendation that no relief should be given to allow subsequent measurements of contingent consideration to be recognised against goodwill?

Staff recommendation

29. The staff thinks that, overall, no further exemptions should be provided to first-time adopters for past business combinations for the reasons set out above.

30. Therefore the staff recommends the IFRIC not proceed with an exemption for first-time adopters on this issue.

Question 5 – Staff's recommendation
Does the IFRIC agree with the staff's recommendation not to proceed with this issue?