Contact(s) **Leonardo Piombino** lpiombino@ifrs.org +44 (0)20 7246 0571

Contact(s) **Denise Gomez Soto** dgomez@ifrs.org +44 (0)20 7246 6469

Project **New items for consideration**

Topic **IAS 7 *Statement of Cash Flows*—classification of cash payments for deferred and contingent consideration**

Introduction

1. In June 2011, the IFRS Interpretations Committee (the Committee) received a request for guidance on the classification of cash payments for deferred and contingent consideration. This question is related to the classification in the statement of cash flows of cash flows associated with a business combination. The submitter requests the Committee to add this issue to its agenda because different interpretations exist in practice regarding the classification of these cash payments in the statement of cash flows in accordance with IAS 7 *Statement of Cash Flows*.

2. We performed outreach with national standard-setters on this topic in order to find out whether the issue raised by the submitter is widespread and whether significant diversity in practice exists. The results of this outreach are included as part of the staff's analysis of this issue (refer to paragraphs 41–51).

3. The submission is reproduced in full in Appendix B to this paper.

Objective

4. The objective of this paper is to:

This paper has been prepared by the technical staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee.

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 IFRS Interpretations Committee or 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 IFRS Interpretations Committee or the IASB can make such a determination.

Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*.

Interpretations are published only after the IFRS Interpretations Committee and the Board have each completed their full due process, including appropriate public consultation and formal voting procedures. The approval of an Interpretation by the Board is reported in IASB *Update*.

(a) provide background information for the issues raised in the submission;

(b) provide an analysis of the issues, including a summary of the outreach responses received from national standard-setters;

(c) present an assessment of the issues against the Committee's agenda criteria and the annual improvements criteria; and

(d) make a recommendation to the Committee not to take this issue into its agenda and ask whether it agrees with the staff's recommendation.

Structure of the paper

5. This agenda paper is organised as follows:

   (a) **Issue 1:** discusses whether the settlement of **contingent consideration** related to a business combination should be classified as an operating, an investing or a financing activity in the statement of cash flows;

   (b) **Issue 2:** discusses whether the subsequent settlement of a **deferred consideration** related to a business combination should be classified as an investing or a financing activity in the statement of cash flows.

Background information

Contingent consideration

6. Contingent consideration is defined in Appendix A of IFRS 3 *Business Combinations* as follows:

   > **Contingent consideration**
   >
   > Usually, an obligation of the **acquirer** to transfer additional assets or **equity interests** to the former owners of an **acquiree** as part of the exchange for **control** of the **acquiree** if specified future events occur or conditions are met. However, contingent consideration also may give the **acquirer** the right to the return of previously transferred consideration if specified conditions are met.

7. The acquirer recognises the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree (IFRS 3.39).

8. In accordance with paragraph 37 of IFRS 3, the consideration transferred in a business combination is the sum of acquisition-date fair values of the:

   (a) assets transferred by the acquirer;

   (b) liabilities incurred by the acquirer; and

   (c) equity interest issued by the acquirer.

9. Paragraph 40 of IFRS 3 states that on initial recognition contingent consideration is accounted for as either:

   (a) an asset, if the acquirer has a right to receive contingent consideration

   (b) as a liability or as equity (in accordance with the guidance in IAS 32 *Financial Instruments: Presentation*), if the acquirer has an obligation to pay contingent consideration.

10. In accordance with paragraph 45 of IFRS 3, if the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the acquirer can adjust the provisional amounts recognised at acquisition date to reflect new information about facts and circumstances that existed as of the acquisition date. These adjustments are referred to as ‘measurement period adjustments’.

11. Changes in the fair value of contingent consideration resulting from events after the acquisition date are not ‘measurement period adjustments’ and are recognised in accordance with paragraph 58 as follows:

   (a) Contingent consideration recognised as an asset or a liability that is either:

      (i) within the scope of IFRS 9 *Financial Instruments,* or IAS 39 *Financial Instruments: Recognition and Measurement*, and is measured at fair value. Any resulting gain or loss is recognised in profit or loss or in other comprehensive income.

(ii) not within the scope of IFRS 9, in which case it is accounted for in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* or other IFRSs as appropriate.

(b) Contingent consideration that is classified as equity is not remeasured and settlement is accounted for within equity.

Deferred consideration

12. We observe that the term 'deferred consideration' is not referred or used in IFRS 3 (issued in 2008). However, this term had been referred to in IFRS 3 issued in 2004. In particular, paragraph 26 of that standard stated that [emphasis added]:

> 26 Assets given and liabilities incurred or assumed by the acquirer in exchange for control of the acquiree are required by paragraph 24 to be measured at their fair values at the date of exchange. **Therefore, when settlement of all or any part of the cost of a business combination is deferred, the fair value of that deferred component shall be determined by discounting the amounts payable to their present value at the date of exchange**, taking into account any premium or discount likely to be incurred in settlement.

13. We think that deferred consideration is implicitly included as part of the consideration transferred in a business combination in paragraph 37 of IFRS 3 (2008), because this includes (emphasis added) 'the assets transferred by the acquiree, **the liabilities incurred by the acquirer to former owners of the acquiree** and the equity interests issues by the acquirer'.

14. Consequently, we think that 'deferred consideration' is a part of the consideration transferred in a business combination that will be settled at some future date.

15. We think that the main differences between contingent consideration and deferred consideration are the following:

    (a) a deferred consideration is usually recognised as a liability by the acquirer, whereas a contingent consideration can be classified as either an asset or a liability depending on the terms of the arrangement; and

(b) the amount of a contingent consideration payment is by definition conditional on future events or conditions, whereas the amount of a deferred consideration payment can be fixed at the acquisition date.

Staff analysis

Issue 1—classification of contingent consideration cash flows

Description of the issue

16. The submitter's request reflects a situation in which an acquirer settles an obligation to pay contingent consideration. We understand that in accordance with paragraphs 39 and 40 in IFRS 3, the acquirer has recognised this contingent consideration as part of the consideration transferred in a business combination and the obligation has been recorded as part of the liabilities incurred by the acquirer to former owners of the acquiree.

17. The submitter asks whether, in accordance with IAS 7, the settlement of contingent consideration should be classified as:

    (a) an **investing activity**, because, in accordance with paragraph 39 of IAS 7, cash flows arising from obtaining control of a business shall be classified as investing activities.

    (b) a **financing activity**, because the vendor is providing finance to the acquirer.

    (c) an **operating activity**, because it is a payment linked to the performance of the acquired business.

18. We will analyse these views in the following paragraphs.

View 1—Contingent consideration as an 'investing activity'

19. Proponents of this view observe that the acquisition-date fair value of contingent consideration is recognised as part of the consideration transferred in exchange for the acquiree in accordance with paragraph 39 in IFRS 3. This paragraph states that [emphasis added]:

> 39 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement (see paragraph 37). **The acquirer shall recognise the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.**

20. Because contingent consideration leads to the recognition of the acquiree's net assets, proponents of this view think that payments of contingent consideration meet the definition of an investing cash flow in accordance with IAS 7.16, because 'only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities'.

21. Proponents of this view also observed that contingent consideration can be considered to be an investing cash flow in accordance with paragraph 39 of IAS 7. This paragraph states that:

> **39 The aggregate cash flows arising from obtaining or losing control of subsidiaries or other businesses shall be presented separately and classified as investing activities.**

22. Advocates of this classification see the payment of contingent consideration as a way to obtain control of a business. Consequently they think that this payment should be classified as an investing activity.

View 2—Contingent consideration as a 'financing activity'

23. Proponents of View 2 view the acquisition-date fair value contingent consideration as a liability incurred by the acquirer to former owners of the acquiree. In particular, they note that according to paragraph 40 of IFRS 3, the acquirer classifies an obligation to pay contingent consideration as a liability or as equity. This paragraph states that [emphasis added]:

> 40 **The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity** on the basis of the definitions of an equity instrument and a financial liability in paragraph 11 of IAS 32 Financial Instruments: Presentation, or other applicable IFRSs. The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met. Paragraph 58 provides guidance on the subsequent accounting for contingent consideration.

24. As a consequence, proponents of this view claim that the payment of contingent consideration meets the definition of a financing activity because:

(a) a vendor (seller) is providing finance to the acquirer in the business combination; and

(b) the payment of contingent consideration represents a repayment of a financial liability by the acquirer.

View 3—Contingent consideration as an 'operating activity'

25. Proponents of this view note that, in accordance with paragraph 58 of IFRS 3, changes in the fair value of contingent consideration classified as assets or liabilities that are not 'measurement period adjustments' (as described in paragraph 11 above) should be recognised in profit or loss or in other comprehensive income, because they are not recognised as part of the consideration transferred in a business combination at acquisition date. Paragraph 58 of IFRS 3 states (emphasis added):

> 58 Some changes in the fair value of contingent consideration that the acquirer recognises after the acquisition date may be the result of additional information that the acquirer obtained after that date about facts and circumstances that existed at the acquisition date. Such changes are measurement period adjustments in accordance with paragraphs 45–49. However, changes resulting from events after the acquisition date, such as meeting an earnings target, reaching a specified share price or reaching a milestone on a research and development project, are not measurement period adjustments. The acquirer shall account for changes in the fair value of contingent consideration that are not measurement period adjustments as follows:
>
> (a) Contingent consideration classified as equity shall not be remeasured and its subsequent settlement shall be accounted for within equity.
>
> **(b) Contingent consideration classified as an asset or a liability that:**
>
> **(i) is a financial instrument and is within the scope of IFRS 9 or IAS 39 shall be measured at fair value, with any resulting gain or loss recognised either in profit or loss or in other comprehensive income in accordance with IFRS 9.**
>
> (ii) is not within the scope of IFRS 9 shall be accounted for in accordance with IAS 37 or other IFRSs as appropriate.

26. Consequently, any cash paid by the acquirer for changes in the fair value of contingent consideration that are not 'measurement period adjustments' should be classified as an operating cash flow, because the payment could be seen as linked to the performance of the acquired business.

Staff view

27. In our view, cash payments for the contingent consideration that are recognised at the acquisition date and any adjustment arising during the measurement period (as defined in paragraphs 45-50 of IFRS 3) should be classified as investing activities, because these cash flows lead to the recognition of the acquiree's net assets in a business combination. Our reasoning is supported by the fact that according to paragraph 16 of IAS 7 only the expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities. We think that guidance in this paragraph (recently introduced as part of the April 2009 Improvements to IFRS) for classifying investing activities is meant to reduce diversity in practice for the classification of cash flows[1].

28. In addition, contingent consideration can be viewed as a way to obtain control of an entity as stated in paragraph 39 of IAS 7, which reinforces the fact that contingent consideration should be classified as an investing activity.

29. In our view, cash payments in excess of the amount recognised at acquisition date of the contingent consideration should be classified as operating activities, because these cash flows do not result in a recognised asset.

30. We also think that cash payments relating to interest resulting from accretion of the discount on the contingent consideration liability balance should be classified as financing or operating cash flows in accordance with other interest expenses, as stated in paragraphs 31–34 of IAS 7.

31. We do not think that a contingent consideration payment usually represents a provision of finance by the vendor, because, as explained in paragraph BC348 of the Basis for Conclusions on IFRS 3, contingent considerations are commonly

[1] One respondent to our outreach request on the classification of cash flows arising from the settlement of contingent consideration (refer to the section on *Outreach request to NSS* later in this paper) noted that the 2009 amendment to paragraph 16 of IAS 7 is still relatively new to determine whether diversity in practice will continue.

used by buyers and sellers to reach an agreement by sharing particular specified economic risks related to uncertainties about future outcomes.

Issue 2—classification of the cash flows derived from the settlement of deferred consideration

32. The submitter asks whether, in accordance with IAS 7, the subsequent settlement of **deferred consideration** for a business combination should be classified as an investing or as a financing activity in the statement of cash flows. We will analyse these two possibilities in the following paragraphs.

View 1—Classification within investing activities

33. Proponents of View 1 think that cash payments to settle a deferred consideration for a business combination should be classified as investing activities, on the basis that these are cash flows arising from obtaining or losing control of subsidiaries or businesses in accordance with paragraph 39 of IAS 7. This paragraph states that (emphasis added):

> 39 **The aggregate cash flows arising from obtaining or losing control** of subsidiaries or other businesses shall be presented separately and classified as **investing activities**.

View 2—classification within financing activities

34. Proponents of View 2 support the classification of payments of deferred consideration as financing activities for two main reasons:

    (a) payments of deferred items represent a reduction of a liability incurred by the acquirer to former owners of the acquiree; and

    (b) if the deferral period between the acquisition date and payment date of the deferred consideration is significant, the cash payment should be classified as financing .

35. Proponents of this view observe that the guidance in in US GAAP in paragraph–10–45–13 of Topic 230 *Statement of Cash Flows* in the *FASB Accounting Standards Codification*® could be used to support their conclusions. This paragraph states that (emphasis added):

> Payments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets, including interest capitalized as part of the cost of those assets. **Generally, only advance payments, the down payment, or other amounts paid at the time of purchase or soon before or after purchase of property, plant, and equipment and other productive assets are investing cash outflows. However, incurring directly related debt to the seller is a financing transaction (see paragraphs 230-10-45-14 through 45-15), and subsequent payments of principal on that debt thus are financing cash outflows**.

36. They think that the guidance in Topic 230–10–45–13 (shown above) is implicit in IAS 7, because according to paragraph 17 of IAS 7, cash payments by a lessee for the reduction of the outstanding liability relating to finance lease are cash flows arising from financing activities.

37. Consequently, proponents of this view would consider:

    (a) the deferred consideration to be a provision of finance by the vendor; and

    (b) that the payment is a financing cash flow.

Staff view

38. We agree with View 1, because we think that the subsequent settlement of a deferred consideration for a business combination should be classified as an investing activity. We hold this opinion because:

    (a) according to paragraph 39 of IAS 7, cash flows arising from obtaining control of a business shall be classified as investing activities; and

    (b) deferred considerations for business combinations result in recognised assets (ie the net assets of the business acquired) and according to paragraph 16 of IAS 7 only the expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities.

39. In addition, we think that cash payments in excess of the amount recognised at acquisition date resulting from adjustments to the amount payable (which in our view would be unusual because we think that usually deferred consideration is

fixed at acquisition date) should be classified as operating activities because those cash flows do not result in a recognised asset. Likewise, cash payments relating to interest resulting from accretion of the discount on the deferred consideration liability balance should be classified in financing or operating cash flow in accordance with other interest expenses as stated in paragraphs 31–34 of IAS 7.

40. We think that View 2 has some merit, because we agree that when the period between the acquisition date and the payment date of the deferred consideration is significant (ie more than one year), the payment could represent a provision of finance by the vendor, and as a consequence it could be classified as a financing activity. However, according to the current requirements of IAS 7, View 1 is our preferred view for the reasons stated in paragraph 37. We also think that View 1 for deferred consideration is consistent with our view on the classification of cash flows for contingent consideration. We think that if the Committee prefers View 2, IAS 7 should be amended in order to clarify that in some circumstances (ie when a deferred consideration payment represents a provision of finance by the vendor), a deferred consideration payment should be classified as a financing activity.

Outreach request to national standard-setters

41. We asked a group of standard-setters in different countries to provide us with feedback on whether the issue raised in the submission:

    (a) is widespread and has practical relevance; and

    (b) indicates that there are significant divergent interpretations (either emerging or existing in practice).

42. In our request we included the information that we have reproduced in Appendix B of this paper. We asked the national standard-setters the following two questions:

(a) *In your experience, how common are the cash payments for deferred and/or contingent considerations within your jurisdiction? If they occur, could you provide us with information that the Committee could use to assess how widespread the issue is?*

(b) *In your view, is there diversity in practice in the classification of the cash payments for deferred and/or contingent considerations? Please describe the predominant classification that you observe in your jurisdiction.*

43. We received eight responses from the following jurisdictions: Asia-Oceania (3), Europe (2), Africa (1) and North America (2)[2]. Five respondents considered Issue 1 to be prevalent and three of them noted divergent interpretations in practice. Only two respondents considered Issue 2 to be prevalent and noted divergent interpretations in practice.

Is the transaction prevalent?

Issue 1 Contingent consideration

44. Five national standard setters considered Issue 1 to be prevalent in practice. These respondents agree that the use of contingent consideration agreements has increased over recent years, for example in situations where a transaction price cannot be agreed immediately, so that part of the consideration has to be made contingent on future sales forecasts or profit.

45. Three national standard-setters did not consider the issue to be prevalent. One respondent thinks that with current disclosures, users are able to determine the relevant cash flows and therefore questions whether the issue raised about the classification of contingent consideration should be taken onto the Committee's agenda.

Issue 2 Deferred consideration

46. Only two national standard setters considered the issue on deferred consideration to be prevalent in practice. One respondent states that deferred

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[2]We received another reply from a global accounting firm located in Spain, but we did not consider it as part of our analysis as we are only considering replies from NSS.

consideration is very common in the mining industry. Another respondent notes that business combinations commonly include deferred consideration (from its own experience approximately 90 per cent of business combinations include deferred considerations).

Feedback received on the existence of diversity in practice

Issue 1 Contingent consideration

47. Three respondents reported differing views in practice in the classification of payments for contingent consideration.

48. Respondents mentioned that in their jurisdictions, acquirers have different points of view about the classification of the settlement of contingent consideration:

    (a) some would view the settlement as being part of investing activities, and that it is a payment that results in a recognised asset in relation to the business combination;

    (b) some would view the settlement as part of financing activities, and that it is a payment to settle a financing liability; and

    (c) some disaggregate the payment into the amount that was initially measured at the time of entering the business combination (and would classify it as part of investing activities) and any subsequent 'true up' of the contingency would be classified as part of operating activities.

    (d) some noted that, in practice, they classify the settlement of short-term payables associated with routine investing activities as investing cash flows.

49. Another respondent noted that it would classify the payment of contingent consideration as being part of investing activities, except for the unwinding of the discount, which would be a financing cash flow.

50. One respondent noted that, because the amendment to paragraph 16 of IAS 7 (which states that only expenditures resulting in a recognised asset can be classified as investing activities) is relatively recent, there is still no empirical

evidence to assess how companies solved, or will solve, this classification issue. Similarly, another respondent observed that, as its jurisdiction is currently transitioning to IFRS, they were unable to determine what will be the predominant classification in the statement of cash flows. However the respondent thinks that diversity was likely to emerge as IAS 7 is unclear, contains conflicting paragraphs and lacks specific guidance for these type of payments.

Issue 2 Deferred consideration

51. Only one national standard-setter observed different views in practice in its jurisdiction, and stated that some acquirers classify the payment as an investing activity, while others classify the payment as a financing activity, because they have estimated a liability for the amounts due.

Agenda criteria assessment

52. The staff's preliminary assessment of the agenda criteria is as follows:

    (a) *The issue is widespread and has practical relevance.*

    On the basis of our outreach, we understand that Issue 1 is widespread, whereas Issue 2 is not widespread.

    (b) *The issue indicates that there are significantly divergent interpretations (either emerging or already existing in practice). The Committee will not add an item to its agenda if IFRSs are clear, with the result that divergent interpretations are not expected in practice.*

    On the basis of our outreach:

    - we understand that diversity in practice exists in the classification of contingent consideration cash flows.
    - we understand that diversity in practice does not usually exist in the classification of deferred consideration cash flows.

    (c) *Financial reporting would be improved through elimination of the diverse reporting methods.*

    Yes.

On the basis of our outreach we understand that diversity in practice exists in the classification of contingent consideration cash flows.

(d) *The issue can be resolved efficiently within the confines of existing IFRSs and the Framework, and the demands of the interpretation process.*

Yes.

We think that the issue can be resolved efficiently within the confines of IAS 7.

(e) *It is probable that the Committee will be able to reach a consensus on the issue on a timely basis.*

Not applicable. In our opinion, no formal interpretation is needed for this issue.

(f) *If the issue relates to a current or planned IASB project, there is a pressing need to provide guidance sooner than would be expected from the IASB's activities. The Committee will not add an item to its agenda if an IASB project is expected to resolve the issue in a shorter period than the Committee requires to complete its due process.*

Not applicable. We do not believe that the IASB should add this issue into its agenda.

Assessment against the annual improvements criteria

53. We have assessed a potential amendment to IAS 7 against the enhanced annual improvements criteria to clarify the classification of cash payments for deferred and contingent consideration, which are reproduced in full below:

In planning whether an issue should be addressed by amending IFRSs within the annual improvements project, the IASB assesses the issue against the following criteria. All criteria (a)–(d) must be met to qualify for inclusion in annual improvements.

(a) The proposed amendment has one or both of the following characteristics:

(i) clarifying–the proposed amendment would improve IFRSs by:

- clarifying unclear wording in existing IFRSs, or providing guidance where an absence of guidance is causing concern.
- A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle.

(ii) correcting–the proposed amendment would improve IFRSs by:

- resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or.
- addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs.

A correcting amendment does not propose a new principle or a change to an existing principle.

[Staff analysis—this criterion is not satisfied. IAS 7 contains general guidance for the classification of cash flows as investing activities. Based on our analysis we think that the guidance in paragraph 16 of IAS 7 could be applied to the classification of contingent and deferred consideration payments related to a business combination in the statement of cash flows].

(b) The proposed amendment is well-defined and sufficiently narrow in scope such that the consequences of the proposed change have been considered.

[Not applicable]

(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach a conclusion on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.

[Staff analysis—this criterion is satisfied. We think that the Committee will be able to address these issues on a timely basis and we think that the Board should be in a position to also reach a conclusion on a timely basis. The issue could be tackled by adding a paragraph within the 'Investing activities' section that would clarify the classification of cash payments for deferred and contingent consideration. However the staff does not think that this is necessary because we think that the guidance in paragraph 16 of IAS 7 could be applied.

(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a need to make the amendment sooner than the project would.

[Staff analysis—this criterion is satisfied. There is no current IASB project on IFRS 3.]

Staff recommendation

Issue 1—Contingent consideration

54. On the basis of our technical analysis (described in the paragraphs above), our assessment of the Committee's criteria and of the annual improvements criteria,

we do not recommend that the Committee should take this issue onto its agenda or propose a potential annual improvement to IAS 7, because we think that the guidance in paragraphs 16 of IAS 7 could be applied to the classification of contingent consideration payments related to a business combination in the statement of cash flows.

Issue 2—Deferred consideration

55. On the basis of our technical analysis (described in paragraphs above), of the annual improvements criteria and our assessment of the Committee's criteria, in which we noted that the issue is not widespread, we do not recommend that the Committee should take this issue onto its agenda or propose a potential annual improvement to IAS 7. We think that, similarly to the issue raised on contingent consideration, the guidance in paragraph 16 of IAS 7 could be applied by reference for the classification of deferred consideration payments related to a business combination in the statement of cash flows.

Questions for the Committee
1. Does the Committee agree that: (i) cash payments for contingent/deferred consideration recognised at the acquisition date and any adjustment arising during the IFRS 3 measurement period should be classified as investing activities and that (ii) any cash payments in excess of the acquisition date fair value of the contingent/deferred consideration should be classified as operating activities? (iii) cash payments relating to interest resulting from accretion of the discount on the contingent/deferred consideration liability balance should be classified as financing or operating cash flows as stated in paragraphs 31–34 of IAS 7? 2. Does the Committee agree with the staff's recommendation that the Committee should not add Issues 1 and 2 to its agenda or consider an annual improvement to IAS 7?

4. Does the Committee have any comments on the proposed wording in Appendix A for the tentative agenda decision?

Appendix A—Proposed wording for tentative agenda decision

A1 The staff propose the following wording for the tentative agenda decision:

> **IAS 7 *Statement of Cash Flows*—Classification of business combination cash flows**
>
> The Interpretations Committee received a request for guidance on the classification of cash payments for deferred and contingent considerations under IAS 7 *Statement of Cash Flows*. More specifically, the submitter asked the Committee to clarify whether: (i) the settlement of contingent consideration should be classified as an operating, an investing or a financing activity in the statement of cash flows; and (ii) whether the subsequent settlement of a deferred consideration for a business combination should be classified as an investing or a financing activity in the statement of cash flows.
>
> The Committee observed that paragraphs 16 in IAS 7 provide sufficient guidance for the classification of cash payments for deferred and contingent considerations in the statement of cash flows. The Committee observed that cash payments for the contingent/deferred consideration that are recognised at the acquisition date and any adjustment arising during the measurement period (as defined in paragraphs 45-50 of IFRS 3) should be classified as investing activities in accordance with paragraph 16 of IAS 7, because these cash flows lead to the recognition of the acquiree's net assets in a business combination.
>
> Cash payments relating to interest resulting from accretion of the discount on the contingent/deferred consideration liability balance should be classified in financing or operating cash flow in accordance with other interest expenses, as stated in paragraphs 31–34 of IAS 7. All other cash payments in excess of the acquisition date fair value of the contingent/deferred consideration should be classified as operating activities, because these cash flows do not result in a recognised asset.
>
> The Committee noted that Board had amended paragraph 16 of IAS 7 as part of the April 2009 Improvements to IFRS, to clarify that only expenditures that result in a recognised asset in the statement of financial position are eligible for classification as investing activities. In the light of this recent amendment to IAS 7 the Committee did not expect diversity in practice to continue.
>
> Consequently, the Interpretations Committee [decided] not to add the issue to its agenda.

Appendix B— Request

B1 The staff received the following request. All information has been copied without modification, except for details that would identify the submitter of the request and details that are subject to confidentiality.

SUBMISSION

IAS 7—Classification of business combination cash flows

Many business combinations include an element of deferred and/or contingent consideration. The subsequent settlement of deferred consideration for a business combination might be an investing cash flow as a cash flow arising from obtaining control of a business (IAS 7.39) or a financing cash flow as the provision of finance by the vendor. The settlement of contingent consideration could be the settlement of financing provided by the seller (a financing cash flow), a payment linked to the performance of the acquired business (an operating cash flow) or a cash flow arising from obtaining control of a business (an investing cash flow).

We understand that there is mixed practice and mixed views.