

STAFF PAPER

IFRS Interpretations Committee
Meeting

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Project IFRS 3 *Business Combinations*—Continuing employmentCONTACT(S) Leonardo Piombino lpiombino@ifrs.org +44 (0)20 7246 0571

This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. 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*. The approval of a final Interpretation by the IASB is reported in IASB *Update*.

Introduction and purpose of this paper

1. In January 2012, the IFRS Interpretations Committee (the Committee) received a request for guidance on the accounting in accordance with IFRS 3 *Business Combinations* for contingent payments to selling shareholders in circumstances in which those selling shareholders become employees. The submitter asked the Committee to clarify whether paragraph B55(a) of IFRS 3 is conclusive in determining that an arrangement in which payments to an employee that are forfeited upon termination of employment is remuneration for post-combination services and not part of the consideration for an acquisition.
2. The Committee discussed the issue in the May 2012 meeting¹, with the May 2012 IFRIC *Update* reporting that:

The Committee also noted that IFRS 3 is part of the joint effort by the Board and the US-based Financial Accounting Standards Board (FASB) to promote the convergence of accounting standards. The Committee was advised that the US GAAP guidance equivalent to paragraph B55(a) is interpreted as conclusive.

Consequently, the Committee asked the staff to consult the two boards on whether they think that paragraph B55(a) of IFRS 3 and the US GAAP equivalent guidance should be conclusive when analysing the contingent payments described.

¹ See Agenda Paper 11 <http://www.ifrs.org/Meetings/IFRSInterMay12.htm>

Dependent on that consultation the boards will be asked if and how IFRSs and US GAAP should be amended.

3. The purpose of this paper is:
 - (a) to provide a summary of the issue;
 - (b) to provide a summary of the consultation with IASB members on this issue; and
 - (c) to provide an update on the consultation with FASB members on this issue.

Summary of the issue

4. Paragraphs B54 and B55 of IFRS 3 provide application guidance for determining whether arrangements for contingent payments to employees or selling shareholders are part of the business combination or are separate transactions.

These paragraphs state that [emphasis added]:

B54 Whether arrangements for contingent payments to employees or selling shareholders are contingent consideration in the business combination or are separate transactions depends on the nature of the arrangements. Understanding the reasons why the acquisition agreement includes a provision for contingent payments, who initiated the arrangement and when the parties entered into the arrangement may be helpful in assessing the nature of the arrangement.

B55 If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following **indicators**:

- (a) *Continuing employment*—The terms of continuing employment by the selling shareholders who become key employees may be an indicator of the substance of a contingent consideration arrangement. The relevant terms of continuing employment may be included in an employment agreement, acquisition agreement or some other document. **A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.** Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration.
- (b) ...

5. The issue is whether paragraph B55(a) is conclusive in determining that an arrangement in which payments to an employee that are forfeited upon termination of employment is remuneration for post-combination services and not part of the business combination transaction.
6. Different interpretations exist in practice because:
 - (a) paragraph B55 of IFRS 3 introduces subparagraphs (a) to (h) as indicators. It states that [emphasis added]: *“If it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree or is a transaction separate from the business combination, the acquirer should consider the following indicators:...”*;
 - (b) unlike subparagraphs (b) to (h), which use inconclusive language (such as ‘may indicate’, ‘may be an indicator’, ‘may suggest’ and ‘might suggest’), subparagraph (a) uses conclusive language; it states that [emphasis added]: *“...A contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post combination services...”*.
7. In other words, the issue is whether that provision of paragraph B55(a) (ie that a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services) is, on its own, conclusive that these payments are remuneration for post-combination services (ie they are not part of the business combination) or; whether instead, like subparagraphs (b) to (h), that provision is not necessarily conclusive.

Consultation with IASB members

8. We sent IASB members a paper in which we:
 - (a) explained the issue;
 - (b) explained the different views on the issue;
 - (c) provided the staff view on the issue; and

- (d) asked for IASB members' views on the issue.
9. We have not met with the whole Board, but we spoke with several IASB members on an informal basis to obtain their preliminary views on this issue. In our meetings with the different IASB members we discussed the request for clarification of the guidance in paragraph B55(a) of IFRS 3. In total we spoke with 13 IASB members.
10. We asked those Board members the following two questions:
- (a) Do you think that payments to former owners of a business who continue as employees after the business combination, should be automatically classified as post-combination expenses if, and to the extent that, the payments to the employees are conditional on services being provided after the business combination?²
- (b) Are you supportive of the IFRS being clarified subject to FASB members being of a similar view?
11. Regarding the first question, we understand that the preliminary view of many IASB members is that they would prefer that the guidance in paragraph B55(a) be indicative; consequently entities would apply judgement in determining whether payments that are contingent on the continuing employment of the selling shareholders are post-combination expenses or are part of the consideration for the acquiree.
12. Many IASB members also noted that the current wording of paragraph B55(a) is not consistent with the introduction of paragraph B55 and thought that this inconsistency should be resolved.
13. Regarding the second question, we understand that many IASB members shared the Committee's concern that we should not create divergence with US GAAP on a Standard that had previously achieved convergence.

² Note that IASB members were not asked for their views on how the Standard as currently worded should be applied.

Consultation with FASB Board members

14. We are in dialogue with the EITF Chairman and we have informed her about the Committee's decision to ask the staff to consult the two boards on this issue.
15. The FASB staff are in the process of consulting with FASB members.
16. We will update the Committee on the results of this consultation in the September 2012 meeting.