

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 Interpretations 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 Interpretations 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 Interpretations Committee discussed the issue in the May 2012¹ and July 2012² meetings.
3. In the May 2012 meeting, the Interpretations Committee asked the staff to consult the IASB and the FASB on whether they think that paragraph B55(a) of IFRS 3 and the equivalent guidance in US GAAP should be conclusive when analysing the contingent payments described.

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

² See Agenda Paper 7 <http://www.ifrs.org/Meetings/Pages/IFRICJuly2012.aspx>

4. In the July 2012 meeting, the Interpretations Committee was advised that the preliminary view of many IASB members is that they would prefer that IFRS 3 be amended such that the guidance in paragraph B55(a) of IFRS 3 should be indicative and that many IASB members shared the Interpretations Committee's concern that they should not create divergence with US GAAP on a Standard that had previously achieved convergence.
5. The purpose of this paper is:
 - (a) to provide a summary of the issue;
 - (b) to provide a summary of the consultation with IASB and FASB members on this issue;
 - (c) to make a recommendation that the Interpretations Committee should not add this issue to its agenda for the moment; and
 - (d) to ask the Interpretations Committee whether they agree with the staff recommendation.

Summary of the issue

6. 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) ...

7. 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.
8. 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:...”*; and
 - (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...”*.
9. 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, like subparagraphs (b) to (h), that provision is not necessarily conclusive.

Consultation with IASB members³

10. 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.
11. We asked those IASB 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?⁴
 - (b) Are you supportive of the IFRS being clarified subject to FASB members being of a similar view?
12. 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) to be indicative. This means that 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.
13. 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.
14. Regarding the second question, we understand that many IASB members shared the Interpretations Committee's concern that we should not create divergence with US GAAP on a Standard that had previously achieved convergence.

³ We have already provided a summary of the consultation with IASB members at the July 2012 Interpretations Committee meeting; however, for convenience, we report this consultation in this paper.

⁴ Note that IASB members were not asked for their views on how the Standard as currently worded should be applied.

Consultation with FASB members

15. The FASB staff spoke with several FASB members on an informal basis to obtain their preliminary views on this issue. The FASB members' preliminary views are based on their reading of the current US GAAP guidance. The FASB staff understand that FASB members are of the view that they should wait for the conclusion of the Post-Implementation Review of FASB Statement No. 141R *Business Combinations* before undertaking any clarification projects of that Standard.
16. The FASB staff understand that, on the whole, FASB members believe that, as currently written, the US GAAP guidance would require a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates, to be accounted as compensation for post combination services.

Staff view and recommendation

17. We think that the wording of paragraph B55(a) of IFRS 3 should be clarified, because it is causing divergence in practice. However, on the basis of the consultations with IASB and FASB members, we think that the Interpretations Committee should wait for the conclusion of the Post-Implementation Review of FASB Statement No. 141R before proposing an amendment to paragraph B55(a) of IFRS 3 in order that any changes made can be made in parallel with changes to US GAAP, thus maintaining the convergence of IFRS 3 and FASB Statement No. 141R.
18. Consequently, we recommend that the Interpretations Committee should not add this issue to its agenda for the moment.
19. Our proposed tentative agenda decision is included in Appendix A of this paper.

Questions for the Committee

1. Does the Committee agree with the staff's recommendation that the Interpretations Committee should not add this issue to its agenda at this point?

2. Does the Interpretations 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 proposed wording for the tentative agenda decision is presented below.

IFRS 3 *Business Combinations*—Continuing employment

The IFRS Interpretations 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 or continue as 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.

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

Following that consultation, the Committee was advised that the preliminary view of many IASB members is that they would prefer that IFRS 3 be amended such that the guidance in paragraph B55(a) of IFRS 3 should be indicative and that many IASB members shared the Committee's concern that they should not create divergence with US GAAP on a Standard that had previously achieved convergence.

The Committee was advised that the preliminary view of many FASB members is that they would prefer to wait for the conclusion of the Post-Implementation Review of FASB Statement No. 141R *Business Combinations* before considering whether and how to amend the US GAAP guidance.

Consequently, the Committee [decided] not to add this issue to its agenda at this time.