

STAFF PAPER

IFRS Interpretations Committee
Meeting

January 2013

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

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, or continue as, 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. The question arose because the submitter asserted that paragraph B55 introduces subparagraphs (a) to (h) as indicators, but paragraph B55(a) uses conclusive language stating that the arrangement described is remuneration for post-combination services.
2. The Interpretations Committee discussed the issue in the May 2012¹, July 2012² and September³ meetings.

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>

³ See Agenda Papers 4 and 4A <http://www.ifrs.org/Meetings/Pages/IFRSInterSept12.aspx>

3. In the September 2012 meeting, the Interpretations Committee tentatively decided not to add this issue to its agenda at this time to have the opportunity to work on this issue jointly with the Emerging Issues Task Force (EITF), because working on this issue alone raises the risk of creating divergence with US GAAP and the FASB want to wait until their post-implementation review on business combinations was complete before looking at this issue.
4. We received four comment letters on the tentative agenda decision. We analyse the comment letters in the following paragraphs.

Comment analysis

5. One respondent⁴ disagrees with the Interpretations Committee's observation that an arrangement in which contingent payments are automatically forfeited if employment terminates should lead to a conclusion that the arrangement is compensation for post-combination services because the tentative agenda decision does not provide a justification for this observation. Deloitte does not believe that either a desire to avoid divergence with US GAAP or to wait for the completion of FASB's post-implementation review of FASB Statement No. 141R *Business Combinations* are appropriate reasons to reach a premature conclusion on this issue.
6. Deloitte thinks that the issue should be solved by an amendment to IFRS 3 which would allow for a fuller analysis and debate of the appropriate treatment for transactions of this kind. For example, if under the terms of a business combination all selling shareholders become employees and all consideration for their share is forfeited upon termination of employment, the contingent payments should not be treated entirely as post-combination expenses, because this accounting treatment does not provide a faithful representation of the transaction.
7. We agree that paragraph B55 of IFRS 3 should be clarified, but we think that there is not a pressing need to address this issue. Consequently we think that the Interpretations Committee can wait for the completion of the post-implementation

⁴ Deloitte

review of FASB Statement No. 141R, in order to coordinate any work on this issue with FASB.

8. Three respondents agree with the decision not to add this issue to the Interpretations Committee's agenda.
9. One of the respondents⁵ that agrees with the tentative agenda decision is concerned that the wording of the following paragraph of the tentative agenda decision may lead to different interpretations.

The Interpretations Committee observed that an arrangement in which contingent payments are automatically forfeited if employment terminates should lead to a conclusion that the arrangement is compensation for post-combination services rather than additional consideration for an acquisition, unless the arrangement is not substantive.

Consequently, Ernst & Young suggests replacing the word “should” with “would” to improve consistency in the application of paragraph B55(a). In addition, Ernst & Young suggests replacing the sentence “unless the arrangement is not substantive” with “unless the service condition is not substantive”.

10. We agree with the proposed modifications.
11. Another respondent⁶ thinks that the explanation of the conclusion in the final sentence of the tentative agenda decision may be interpreted as pre-judging the conclusion of any future consideration of this issue and suggests deleting this explanation. The final paragraph of the tentative agenda decision is reproduced below for ease of reference.

After evaluating the potential effects of this issue, the Interpretations Committee [decided] not to add this issue to its agenda at this time to avoid creating divergence with US GAAP on a Standard that had previously achieved convergence.

⁵ Ernst & Young

⁶ PricewaterhouseCoopers

12. We understand the respondent's concern and so we propose an amendment to the last paragraph of the tentative agenda decision as shown in Appendix A to this paper.

Staff recommendation

13. After considering the comments received on the tentative agenda decision, we recommend that the Interpretations Committee should finalise its decision not to add this issue to its agenda. However, on the basis of the comment analysis above, we propose changes to the wording of the tentative agenda decision as illustrated in Appendix A to this paper.

Questions for the Interpretations Committee

1. Does the Interpretations Committee agree with the staff's recommendation that the Interpretations Committee should finalise its decision not to add this issue to its agenda?
2. Does the Interpretations Committee have any comments on the proposed wording in Appendix A for the final agenda decision?

Appendix A—Proposed wording for final agenda decision

A1 The proposed wording for the final agenda decision is presented below (new text is underlined and deleted text is struck through):

IFRS 3 *Business Combinations*—Continuing employment

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, or continue as, employees. The submitter asked the Interpretations Committee to clarify whether paragraph B55(a) of IFRS 3 is conclusive in determining that payments to an employee that are forfeited upon termination of employment are remuneration for post-combination services and not part of the consideration for an acquisition. The question arose because the submitter asserted that paragraph B55 introduces subparagraphs (a) to (h) as indicators, but paragraph B55(a) uses conclusive language stating that the arrangement described is remuneration for post-combination services.

The Interpretations Committee observed that an arrangement in which contingent payments are automatically forfeited if employment terminates ~~should~~ would lead to a conclusion that the arrangement is compensation for post-combination services rather than additional consideration for an acquisition, unless the ~~arrangement~~ service condition is not substantive. The Interpretations Committee reached this conclusion based on the conclusive language used in paragraph B55(a) of IFRS 3.

The Interpretations Committee also noted that IFRS 3 is part of the joint effort by the IASB and the US-based Financial Accounting Standards Board (FASB) to promote the convergence of accounting standards. The Interpretations Committee was advised that the Post-Implementation Review of FASB Statement No. 141R *Business Combinations* is in progress, and that the opportunity to co-ordinate any work on this issue with FASB would arise after the conclusion of the Post-Implementation Review of FASB Statement No. 141R.

~~After evaluating the potential effects of this issue~~ Consequently, the Interpretations Committee [decided] not to add this issue to its agenda at this time and to revisit this issue after completion of the post-implementation review of FASB Statement No. 141R to avoid creating divergence with US GAAP on a Standard that had previously achieved convergence.

November 26, 2012

(by e-mail to ifric@ifrs.org)

IFRS Interpretations Committee
30 Cannon Street,
London EC4M 6XH
United Kingdom

Dear Sirs,

Re: Tentative agenda decision on IFRS 3 *Business Combinations* – Continuing employment

This letter is the response of the staff of the Canadian Accounting Standards Board (AcSB) to the IFRS Interpretations Committee's tentative agenda decision on accounting for contingent payments that will be automatically forfeited if employment terminates. This tentative agenda decision was published in the September 2012 IFRIC Update.

The views expressed in this letter take into account comments from individual members of the AcSB staff but do not necessarily represent a common view of the AcSB or its staff. Views of the AcSB are developed only through due process.

We agree with the Committee's decision not to add this item to its agenda for the reasons provided in the tentative agenda decision.

We would be pleased to provide more detail if you require. If so, please contact me at +1 416 204-3276 (e-mail peter.martin@cica.ca), or Kathryn Ingram, Principal, Accounting Standards at +1 416 204-3475 (e-mail kathryn.ingram@cica.ca).

Yours truly,



Peter Martin, CPA, CA
Director,
Accounting Standards

International Financial Reporting Standards
Interpretations Committee
30 Cannon Street
London
EC4M 6XH

1 November 2012

Dear IFRS Interpretations Committee members,

Tentative Agenda Decision – IFRS 3 *Business Combinations* – Continuing Employment

The global organisation of Ernst & Young is pleased to submit its comments on the tentative agenda decision relating to IFRS 3 *Business Combinations* – Continuing Employment, as published in the September 2012 *IFRIC Update*.

We support the Committee's tentative agenda decision not to add this item to its agenda. However, we are concerned that the tentative agenda decision does not clearly outline the meaning of paragraph B55(a) of IFRS 3 and therefore may not support greater consistency in its application. In particular the wording of the following paragraph may lead to different interpretations:

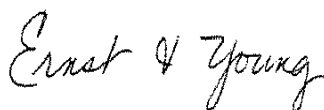
“The Interpretations Committee observed that an arrangement in which contingent payments are automatically forfeited if employment terminates should lead to a conclusion that the arrangement is compensation for post-combination services rather than additional consideration for an acquisition, unless the arrangement is not substantive.”

We believe that replacing the word “should’ with “would” would make the statement stronger and improve consistency in the application of paragraph B55(a). Moreover, we believe that the phrase “unless the arrangement is not substantive” in the above statement should be read as “unless the service condition is not substantive”.

We concur with the Committee that the interpretation of paragraph B55(a) of IFRS 3 should be consistent with the guidance under US GAAP.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully

A handwritten signature in cursive script that reads 'Ernst & Young'.

Mr Wayne Upton
Chairman
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Email: ifric@ifrs.org

28 November 2012

Dear Mr Upton,

Tentative agenda decision: IFRS 3 Business Combinations – Continuing employment

Deloitte Touche Tohmatsu Limited is pleased to respond to the IFRS Interpretation Committee's publication in the September 2012 *IFRIC Update* of the tentative decision not to take onto the IFRIC's agenda a request for interpretation of the appropriate accounting in accordance with IFRS 3 for contingent payments to selling shareholders in circumstances in which those selling shareholders become, or continue as, employees (specifically on whether paragraph B55(a) of IFRS 3 is conclusive in determining that payments to an employee that are forfeited upon termination of employment are remuneration for post-combination services).

We do not agree with the IFRS Interpretations Committee's observation that an arrangement in which contingent payments are automatically forfeited if employment terminates should lead to a conclusion that the arrangement is compensation for post-combination services as the tentative agenda decision does not provide a justification by reference to the Standard for this observation, nor does it rebut the submitter's correct assertion that paragraph B55 introduces subparagraphs (a) to (h) as indicators but paragraph B55(a) uses conclusive language stating that the arrangement described is remuneration for post-combination services.

More generally, we do not believe that either a desire to avoid divergence with US GAAP or to wait for the completion of FASB's post-implementation review of FAS141R are appropriate reasons to reach a premature conclusion on this important issue. If the inconsistency in paragraph B55 is to be resolved, it should be by means of an amendment to the Standard which would allow for a fuller analysis and debate of the appropriate treatment for transactions of this kind and, if practice is to be changed, for proper transitional provisions to be applied.

The need for a deeper consideration is illustrated by circumstances in which under the terms of a business combination *all* selling shareholders become employees and *all* consideration for their shares is forfeited upon termination of employment. These arrangements can arise in business combinations where there is no other means of securing intangible assets (for example, customer relationships and business know-how) that would be lost were the shareholder/employee to leave

the business, thereby causing a significant deterioration in the fair value of the business acquired. Such payments may, in economic terms, include an element of remuneration but treating them entirely as such (potentially resulting in a significant bargain purchase gain at the date of acquisition, due in part to recognition of those intangible assets, followed by remuneration expense which could be multiple times the acquiree's profits) does not provide a faithful representation of the transaction.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0)20 7007 0884.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'V. Poole', is positioned above the printed name.

Veronica Poole
Global IFRS Leader
Technical



Mr Michael Stewart
Director of Implementation Activities
International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

27 November 2012

Dear Mr Stewart

Tentative agenda decision: IFRS 3 Business Combinations – Continuing employment

We are responding to the invitation to comment on the above tentative agenda decision, published in the September 2012 edition of IFRIC Update, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the tentative agenda decision. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree with the Committee's decision not to take this item onto the agenda and that the guidance in IFRS 3 is expressed as a requirement rather than an indicator. We also support the Committee's view that it should avoid creating divergence between IFRS and US GAAP in a converged standard, particularly when the post-implementation review of IFRS 3 is expected to commence in 2013. We hope that the post-implementation review will result in a thorough consideration of all issues identified.

However, the explanation of the conclusion in the final sentence of the tentative agenda decision may be interpreted as pre-judging the conclusion of any future consideration of this question. We suggest that this sentence is deleted.

If you have any questions in relation to this letter please do not hesitate to contact John Hitchins (020 7804 2497), Mary Dolson (020 7804 2930) or Tony de Bell (020 7213 5336).

Yours faithfully

A handwritten signature in blue ink that reads 'PricewaterhouseCoopers'.