
IFRS® Interpretations Committee meeting

Date	March 2024
Project	Payments Contingent on Continued Employment during Handover Periods (IFRS 3)
Topic	Comment letters on tentative agenda decision
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Purpose of the paper

1. In September 2023, the IFRS Interpretations Committee (Committee) published a [tentative agenda decision](#) in response to a submission about how an entity accounts for payments to the sellers of an acquired business when those payments are contingent on the sellers' continued employment during a post-acquisition handover period.
2. In the fact pattern described in the submission:
 - (a) an entity acquires a business and, as part of the acquisition agreement, requires the sellers to continue as employees of the acquired business. The sellers' continued employment is to ensure the appropriate transfer of knowledge from the sellers to the new management team (handover of the business).
 - (b) the sellers are compensated for their services at a level comparable to other management executives. The entity also agrees to make additional payments to the sellers contingent upon both the performance of the acquired business and, as described below, the continued employment of the sellers for a limited period after the acquisition to complete the handover of the business.

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- (c) the sellers are entitled to receive the additional payments if their employment is terminated due to specified circumstances—such as death or disability—or with the entity's agreement. The sellers forfeit the additional payments if their employment is terminated in any other circumstance.
3. The Committee observed that:
- (a) evidence it gathered until the date of the tentative agenda decision did not indicate significant diversity in the accounting for payments contingent upon continued employment in fact patterns such as that described in the submission.
- (b) in these fact patterns, entities apply the accounting described in the agenda decision [Contingent payments to shareholders and continuing employment](#) (January 2013 agenda decision) and account for the payments as compensation for post-combination services rather than as additional consideration for the acquisition, unless the service condition is not substantive.¹
4. Based on its findings, the Committee concluded that the matter described in the submission does not have widespread effect. Consequently, the Committee tentatively decided not to add a standard-setting project to the work plan.
5. The objective of this paper is to:
- (a) analyse comments on the tentative agenda decision (paragraphs 7–22); and
- (b) ask the Committee whether it agrees with our recommendation to finalise the agenda decision (paragraph 23).
6. Appendix A to this paper sets out the proposed wording of the agenda decision.

¹ Appendix B to this paper reproduces the January 2013 agenda decision.

Comment letter summary

7. We received 11 comment letters by the comment letter deadline. All [comment letters](#) received, including any late comment letters, are available on our website.² This agenda paper includes analysis of only the comment letters received by the comment letter deadline.
8. Most respondents agree (or do not disagree) with the Committee's decision not to add a standard-setting project to the working plan for the reasons set out in the tentative agenda decision. Some respondents disagree with that decision because, in their view, the IASB should reconsider the requirement in paragraph B55(a) of IFRS 3 *Business Combinations*.
9. Respondents who disagreed with the Committee's conclusion—and a few who agreed (or did not disagree) with the Committee's conclusion—expressed concerns about the outcome of applying the accounting described in the January 2013 agenda decision in some situations.
10. Further details about the matters raised by respondents, together with our analysis, are presented below.

Staff analysis

Does the matter have widespread effect?

Respondents' comments

11. Feedback on the tentative agenda decision does not indicate significant diversity in the accounting for payments contingent upon continued employment in fact patterns such

² At the date of posting this agenda paper, there was one late comment letter.

as that described in the submission. The feedback confirms that, in these fact patterns, entities apply the accounting described in the January 2013 agenda decision and account for the payments as compensation for post-combination services rather than as additional consideration for the acquisition, unless the service condition is not substantive.

Staff analysis

12. We continue to agree with the Committee’s conclusion that the matter described in the submission does not have widespread effect.³

Concerns about the accounting outcome

Background

13. Paragraph B55 of IFRS 3 lists several indicators an acquirer should consider 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 a business combination. One of these indicators, included in paragraph B55(a), relates to the terms of continuing employment by the selling shareholders who become key employees. Paragraph B55(a) of IFRS 3 states that ‘a contingent consideration arrangement in which the payments are automatically forfeited if employment terminates is remuneration for post-combination services.’
14. The January 2013 agenda decision addresses a request 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 submitter said

³ Assessing whether a matter has widespread effect requires considering not only whether the fact pattern or transaction described in a submission is prevalent, but also whether the existence of different views—and consequently diversity in accounting—for that fact pattern or transaction is widespread.

paragraph B55 introduces subparagraphs (a)–(h) as indicators, but paragraph B55(a) uses conclusive language stating that the arrangement described is remuneration for post-combination services. The agenda decision explains:

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

Respondents' comments

15. Some respondents say the requirement in paragraph B55(a) of IFRS 3 is 'rule-based'. They say it could result in outcomes that do not faithfully reflect the economic substance of the arrangement—and, therefore, in information that is not useful to users of financial statements. For example, a few respondents say the requirement could:
- (a) result in an entity recognising remuneration to selling shareholders greater than the remuneration of employees of similar experience;
 - (b) inappropriately result in an entity recognising a gain from a bargain purchase in the accounting for the business combination;⁴ and
 - (c) potentially be used for managing earnings or to avoid recognising goodwill.
16. These respondents say that whether payments in a contingent consideration arrangement are automatically forfeited if employment terminates should not be

⁴ RSM International provides an example in which, in its view, the accounting outcome of applying paragraph B55(a) does not reflect the economic substance of the arrangement.

conclusive of whether the remuneration is for post-combination services, but rather an indicator that an entity considers. In those respondents' view, an entity should consider that indicator along with the other indicators included in paragraph B55(a)–(h). For example, RSM International says that:

We would agree that automatic forfeiture of post-acquisition payments on termination of employment is a strong indicator that the arrangement is not part of the business combination. However, we believe that there may be exceptions to this, and that IFRS 3 should allow preparers to consider all the relevant factors listed in Paragraph B55 when reaching a conclusion. We would suggest that the language in B55 could be softened to suggest a rebuttable presumption, rather than an absolute requirement to treat such arrangements as remuneration for post-combination services.

17. The FSR - Danish Auditors (FSR) acknowledges the matter was not identified as a high priority in the IASB's recently completed Third Agenda Consultation. Nonetheless, it says the matter continues to raise concerns in its jurisdiction because some view the requirement in paragraph B55(a) as being inconsistent with the principles in the *Conceptual Framework for Financial Reporting* and the requirements in IAS 1 *Presentation of Financial Statements*. The FSR also:
- (a) describes a situation in which an entity was required to recognise payments as remuneration for post-combination services even though, in its view, the service condition was not substantive and the payments were consideration for the acquisition.
 - (b) refers to a publication about related requirements under another accounting framework and to comments received during the exposure of the January 2013 agenda decision expressing some concerns about that agenda decision.

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18. In contrast, David Hardidge says that, in the fact pattern described in the agenda decision, recognising the contingent payments as remuneration reflects the economic substance of the arrangement:

... in substance the seller-manager is adding value to the business that either did not exist as at acquisition date, or that the business did not control as at acquisition date. Consequently, I believe that the additional payment should be recognised as a service expense, even if the seller-manager is compensated at a 'market level' in addition to the payout.

Staff analysis

19. We acknowledge respondents' concerns about the outcomes of applying the accounting described in the January 2013 agenda decision in some situations. However, the Committee's role is not to assess the usefulness of the information that results from applying the requirements in IFRS Accounting Standards—such assessment is made by the IASB when it develops or amends those requirements.
20. As discussed in [Agenda Paper 2](#) for the Committee's September 2023 meeting, the IASB considered concerns such as those raised by respondents during the post-implementation review of IFRS 3.⁵ The IASB assessed the issue as being of low significance but said that depending on the feedback received from the 2015 Agenda Consultation, it could start working on this matter (for example, by investigating in which circumstances these payments should be considered as consideration transferred in the acquisition). However, the IASB did not identify this matter as a high priority in its 2015 Agenda Consultation or the recently completed Third Agenda Consultation.

⁵ See paragraphs 27–28 of that agenda paper.

21. If the Committee agrees with our recommendation to finalise the agenda decision, we will ask the IASB whether it objects to the agenda decision. As with other agenda decisions, we will inform the IASB about the feedback on the tentative agenda decision, including respondents' concerns about the outcomes of applying the accounting described in the January 2013 agenda decision in some situations.

Other comments

22. The following table summarises respondents' comments on other matters together with our analysis of these comments.

Respondent's comments	Staff analysis and conclusion
<p><i>1. Employment termination</i></p> <p>The Institute of Chartered Accountants of Nigeria (ICAN) says there may be questions about (a) what constitutes employment termination, and (b) the accounting when there is early employment termination. It says such questions may require wider consultation. However, it agrees with the Committee's decision not to add a standard-setting project to the agenda until such wider consultations have been made.</p>	<p><i>We recommend no change.</i></p> <p>Considering questions about what constitutes employment termination and the accounting when there is early employment termination would be beyond the scope of the questions asked in the submission.</p>
<p><i>2. Meaning of 'not substantive'</i></p> <p>The January 2013 agenda decision states that 'an arrangement in which contingent payments are automatically forfeited if employment terminates would lead to a conclusion that the arrangement is compensation for post combination services ... <i>unless the service condition is not substantive</i> (emphasis added)'. </p>	<p><i>We recommend no change.</i></p> <p>Providing guidance about whether service conditions are substantive in the situations described by the respondent would be beyond the scope of the questions asked in the submission.</p>

<p>RSM International suggests providing additional guidance on how to assess whether a service condition is not substantive. The respondent said such guidance could include clarifying whether this is the case when the service condition:</p> <p>(a) might not be legally or practicably enforceable;</p> <p>(b) requires the seller to perform no or minimal duties; or</p> <p>(c) includes ‘good leaver’ conditions that might make the service condition not substantive.</p>	
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Staff recommendation

23. Based on our analysis in paragraphs 7–22, we recommend finalising the agenda decision, with changes to the wording of the tentative agenda decision as marked in the appendix to this paper. If the Committee agrees with our recommendation, we will ask the IASB whether it objects to the agenda decision at the first IASB meeting at which it is practicable to present the agenda decision.

Questions for the Committee

1. Does the Committee agree with our recommendation to finalise the agenda decision as explained in paragraph 23?
2. Do Committee members have any comments on the wording of the agenda decision in the appendix to this paper?

Appendix A—proposed wording of the agenda decision

Payments Contingent on Continued Employment during Handover Periods (IFRS 3 *Business Combinations*)

The Committee received a request about how an entity accounts for payments to the sellers of a business it has acquired if those payments are contingent on the sellers' continued employment during a post-acquisition handover period.

Fact pattern

In the fact pattern described in the request:

- (a) an entity acquires a business and, as part of the acquisition agreement, requires the sellers to continue as employees of the acquired business. The sellers' continued employment is to ensure the appropriate transfer of knowledge from the sellers to the new management team (handover of the business).
- (b) the sellers are compensated for their services at a level comparable to other management executives. The entity also agrees to make additional payments to the sellers contingent upon both the performance of the acquired business and, as described below, the continued employment of the sellers for a limited period after the acquisition to complete the handover of the business.
- (c) the sellers are entitled to receive the additional payments if their employment is terminated due to specified circumstances—such as death or disability—or with the entity's agreement. The sellers forfeit the additional payments if their employment is terminated in any other circumstance.

Findings

Evidence gathered by the Committee indicated no ~~[to date]~~ ~~does not indicate~~ significant diversity in the accounting for payments contingent upon continued employment in fact patterns such as that described in the request. In these fact patterns, entities apply the accounting described in the agenda decision [Contingent payments to shareholders and continuing employment](#) (published in January 2013) and account for the payments as

compensation for post-combination services rather than as additional consideration for the acquisition, unless the service condition is not substantive.

Conclusion

Based on its findings, the Committee concluded that the matter described in the request does not have widespread effect. Consequently, the Committee {decided} not to add a standard-setting project to the work plan.

Appendix B—January 2013 Agenda Decision

B1. We have reproduced below the January 2013 Agenda Decision:

Contingent payments to shareholders and 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)–(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 would lead to a conclusion that the arrangement is compensation for post combination services rather than additional consideration for an acquisition, unless the service condition is not substantive. The Interpretations Committee reached this conclusion on the basis of 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 the FASB would arise after the conclusion of the Post-implementation Review of FASB Statement No. 141R. 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.