STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**Annual Improvements to IFRSs 2010–2012 Cycle**
Paper topic	IFRS 3 *Business Combinations*—Accounting for contingent consideration in a business combination

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Introduction

1. The Exposure Draft (ED) *Annual Improvements to IFRSs 2010-2012 Cycle* (ED/2012/1) published in May 2012 (ED (May 2012)) proposed amendments to IFRS 3 *Business Combinations*. The proposed amendments aimed to clarify certain aspects of accounting for contingent consideration in a business combination.

Objective

2. The objectives of this paper are:

   (a) to provide an analysis of the comments received on this issue from the comment letters received on the ED; and

   (b) to obtain a recommendation from the IFRS Interpretations Committee ('the Interpretations Committee') as to whether this issue should be included in the final *Annual Improvements to IFRSs*.

Structure of the paper

3. The structure of the paper is as follows:

(a) Background (paragraphs 5–10)

(b) Comment letter analysis (paragraphs 11–110)

(c) Staff recommendations (paragraphs 111

4. There are also three appendices:

(a) Our recommended changes are included as appendices:

(i) **Appendix A** shows the proposed amendment, including our recommendations in this paper, highlighting differences from the currently effective Standard; and

(ii) **Appendix B** shows revisions to the wording in the previously published Exposure Draft, following our recommendations in this paper.

(b) **Appendix C** reproduces the US GAAP classification and subsequent measurement requirements for contingent consideration in a business combination.

Background

Current guidance and issues

5. The following are a summary of the issues that were being addressed by the proposed annual improvement.

6. **Issue 1—Classification:** paragraph 40 of IFRS 3, which contains classification requirements for contingent consideration, refers not only to IAS 32, but also to ‘other applicable IFRSs’ in determining whether contingent consideration is classified as a liability or equity. There is uncertainty as to when ‘other applicable IFRSs’ would be required to determine this classification.

7. **Issue 2—Subsequent measurement**: paragraph 58 of IFRS 3 contains subsequent measurement requirements for contingent consideration:

(a) **Issue 2a:** there is uncertainty over how paragraph 58(b)(ii) of IFRS 3 should be applied. IFRS 3 requires subsequent measurement of contingent consideration at fair value. Paragraph 58(b)(ii) of IFRS 3 requires changes in fair value of the contingent consideration to be measured in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, but IAS 37 does not prescribe fair value as its measurement basis.

(b) **Issue 2b:** if the contingent consideration is classified as a financial asset or financial liability, there is an inconsistency because:

(i) IFRS 3 paragraph 58(b)(i) requires contingent consideration that is a financial asset or financial liability to be measured at fair value in accordance with IFRS 9 *Financial Instruments*; but

(ii) IFRS 9 would, in some circumstances, require a financial asset or financial liability to be subsequently measured at amortised cost (unless it qualifies for the fair value option).

8. **Issue 3—Disclosures:** paragraph B64 of IFRS 3 requires disclosures for contingent consideration. However, because paragraph 58 of IFRS 3 includes references to other IFRSs, some constituents are unclear over whether other IFRSs' disclosure requirements apply in addition to the requirements in paragraph B64.

The IASB's proposal

9. The IASB proposed to address the issue of:

(a) classification, by clarifying that contingent consideration is assessed as either a financial liability or an equity instrument only on the basis of the requirements of IAS 32 *Financial Instruments: Presentation*; and

(b) subsequent measurement, by clarifying that contingent consideration that is not classified as an equity instrument is subsequently measured at fair value through profit or loss, unless the recognition of the resulting gain or loss is required in other comprehensive income in accordance with IFRS 9.

10. This was proposed by:

(a) deleting the reference to "other applicable IFRSs" in paragraph 40 because it is unclear what other IFRSs are applicable for classifying either as equity or as a liability;

(b) deleting the reference to "IAS 37 or other IFRSs as appropriate" in paragraph 58(b) because it is unclear why IAS 37 or other IFRSs would be used for subsequent measurement when they do not require fair value as their subsequent measurement;

(c) amending the classification requirements of IFRS 9 to clarify that contingent consideration that is a financial asset or financial liability can only be measured at fair value, with changes in fair value being presented in either profit or loss or in other comprehensive income depending on the requirements of IFRS 9. This is to ensure that an entity applying the contingent consideration requirements of IFRS 3 will apply fair value, ie to ensure that contingent consideration would not be measured at amortised cost;

(d) clarifying in the Basis for Conclusions that the IFRS 7 disclosures are required for financial instrument contingent consideration that is within the scope of IFRS 7

Comment letter analysis

11. The comment period for the ED ended on 5 September 2012. The IASB received 84 comment letters of which, for the proposed IFRS 3 amendments, 69 commented on Question 1 ('Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose'). 62 commented on Question 2 ('Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?'). In this paper, we have addressed the main issues raised by respondents.

Question 1—Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If not, why and what alternative do you propose?

Non-financial asset/liability contingent consideration

Views received

12. ESMA, Volkswagen, Business Europe, Repsol, SAICA, EFRAG, ARDF, ICAEW and ASCG raised concerns about the proposed amendment to paragraph 40. The concerns raised include:

    (a) the amendment implies that all contingent consideration is a financial instrument;

    (b) the amendments could lead to confusion in practice;

    (c) further research is required before the reference to "other applicable IFRSs" should be deleted; and

    (d) what requirements should be applied to contingent consideration that does not meet the definition of a financial instrument and how it should be classified.

13. Some of these respondents suggested solutions to the issues raised, for example, amending the wording in paragraph 40, not deleting the reference to "other applicable Standards", further investigating whether all types of contingent consideration that are not equity really do take the form of a financial liability and specifying that such items be classified as liabilities (for obligations to pay contingent consideration) or assets (for conditional rights to return consideration).

15. The AcSB commented that they were aware of contingent consideration that is settled by the transfer of non-financial items, such as software licences, PP&E and inventory items. However, they agreed with the proposed amendment to paragraph 40 because they think that the relevant principle is that contingent consideration, other than that meeting the definition of equity, should be measured at fair value, and agreed that it is not necessary to refer to Standards other than IAS 32.

16. Repsol, Roche Group, BDO, EFRAG, ARDF, Sanofi-Aventis and ANC also raised concerns about the proposed amendments to paragraph 58 regarding subsequent

measurement and non-financial asset/liability contingent consideration. Some thought that the proposed amendments to this paragraph also implied that contingent consideration can only be a financial instrument and that this could create confusion.

Staff analysis

17. We think that the proposed amendments are clear that contingent consideration can be either a financial instrument or a non-financial asset/liability.

18. We think that the proposed wording in paragraph 40 of IFRS 3 (the classification requirements for contingent consideration) imply that contingent consideration can be a non-financial asset/liability:

> The acquirer shall classify an obligation to pay contingent consideration **that meets** the definition of a financial instrument as a financial liability or as equity… [emphasis added]

This paragraph does not limit contingent consideration to only when it meets the definition of a financial instrument.

19. We think that this paragraph 40 is necessary only to identify whether contingent consideration is classified as equity, because equity has a different subsequent measurement requirement to all other contingent consideration, ie it is not remeasured and shall be accounted for within equity.

20. Non-financial asset/liability and financial instrument (that is not equity) contingent consideration has the same subsequent measurement requirement, being fair value through profit or loss, with some financial instruments within the scope of IFRS 9 being required to recognise some changes in fair value through other comprehensive income.

21. We also think that the proposed paragraph 58 makes it clear that contingent consideration is not only a financial instrument:

> 58(b) **Other contingent consideration** shall be measured at fair value at each reporting date, with any resulting gain or loss recognised in profit or loss for the period,… [emphasis added]

Again, referring to 'other contingent consideration', ie contingent consideration other than equity, it is consistent with the notion that contingent consideration is not just limited to financial instruments.

22. Lastly, BC5 to these proposed amendments makes it clear that the proposed amendments are not eliminating non-financial asset/liability contingent consideration:

> The Board also noted that the subsequent measurement requirements in paragraph 58(b) **for contingent consideration that is not a financial instrument** conflict with the measurement requirements in other applicable IFRSs…. [emphasis added]

This Basis for Conclusions paragraph actively acknowledges that there is non-financial asset/liability contingent consideration.

23. However, we do think that the current wording in the proposed 58(b) (the subsequent measurement paragraph for non-equity contingent consideration) could be read to imply that contingent consideration must be within the scope of IFRS 9, therefore implying that contingent consideration must be a financial instrument:

> 58(b) Other contingent consideration shall be measured at fair value at each reporting date, with any resulting gain or loss recognised in profit or loss for the period, unless the recognition of the resulting gain or loss is required in other comprehensive income in accordance with IFRS 9.

24. In order to address this issue, we propose the following wording for this paragraph which we have reflected in Appendices A and B. Changes to the text from the ED have been shown with double-strikethroughs or double-underlines to indicate removals and additions respectively:

(b) Other c~~C~~ontingent 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 at each reporting date, with any resulting gain or loss recognised ~~either~~ in profit or loss for the period. However, if the contingent consideration is a financial asset or a financial liability within the scope of IFRS 9 then the change in fair value must be recognised in other comprehensive income if that accounting treatment is required by IFRS 9.~~, unless the recognition of the resulting gain or loss is required~~ ~~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.~~

Summary and staff recommendation

25. We think that the proposed amendments are clear that contingent consideration can either be a financial instrument or a non-financial asset/liability.

26. However, in order to ensure that the amendments do not imply that contingent consideration can only be a financial instrument, we recommend amending the wording of paragraph 58(b). This amended wording is shown in paragraph 24 and Appendices A and B.

Subsequent measurement (Issue 2)

27. The amendments to IFRS 3 paragraph 58 proposed that contingent consideration that is not classified as equity shall be measured at fair value through profit or loss, unless the contingent consideration is a financial instrument and IFRS 9 requires the resulting gain or loss to be recognised in other comprehensive income.

Measurement of non-financial assets/liabilities

Views received

33. HKICPA disagreed with this approach, noting that:

(a) they were unclear what the appropriate measurement basis for non-financial asset/liability contingent consideration should be and how the resulting difference should be accounted for;

(b) they were unclear as to why the IASB believes that non-financial asset/liability and financial instrument contingent consideration should be accounted for in the same way; and

(c) they question whether subsequent measurement at fair value is appropriate for non-financial asset/liability contingent consideration.

They also noted that they did not find any discussion by the IASB of the above issues in the Basis for Conclusions for the proposed amendments.

Staff analysis

34. We think that paragraph 39 of IFRS 3 is clear that initial measurement is at fair value:

> … The acquirer shall recognise the acquisition-date **fair value** of contingent consideration as part of the consideration transferred in exchange for the acquiree. [emphasis added]

35. We also think that the proposed subsequent measurement requirements are clear in IFRS 3 paragraph 58 that:

 (a) equity is not required to be remeasured;

 (b) all other contingent consideration should be subsequently measured at fair value through profit or loss; and

 (c) that the fair value changes should be recognised in other comprehensive if required in accordance with IFRS 9.

36. Paragraph BC5 from the Basis for Conclusions to the amendments also noted that:

> … The proposal therefore maintains fair value as the subsequent measurement basis for all contingent consideration to which IFRS 3 applies. The Board thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

37. Paragraph BC355 of IFRS 3 says that:

> …for contingent payments that are liabilities but are not derivatives, the boards concluded that, in concept, all liabilities for contingent payments should be accounted for similarly. Therefore, liabilities for contingent payments that are not derivative instruments should also be remeasured at fair value after the acquisition date. The boards concluded that applying those provisions would faithfully represent the fair value of the liability for the contingent payment of consideration that remains a liability until settled.

38. We also understand from BC354 of IFRS 3 that the original intention of the IASB was that all contracts that otherwise would have been within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* should be subject to the

requirements of IAS 39 if issued in a business combination. When IFRS 9 was issued this was subsequently footnoted to note that some of requirements of IAS 39 were amended by the IASB and relocated to IFRS 9.

39. There paragraphs therefore indicate that the proposals both clarify the IASB's original intention for the subsequent accounting for liability contingent consideration and that this enhances consistency in accounting for contingent consideration.

Staff recommendation

40. As a result of the analysis above, we do not recommend providing different subsequent measurement requirements for non-financial asset/liability contingent consideration than for financial instrument contingent consideration as we think that the proposed subsequent measurement requirements are both clear and reflect the IASB's original intention.

Derivatives

41. The proposed consequential amendment to IFRS 9 stated that contingent consideration financial liabilities shall be presented in accordance with paragraph 5.7.7–5.7.8 as if they had been designated at fair value through profit or loss at initial recognition.

42. Paragraph 5.7.7 of IFRS 9 includes the requirement that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability shall be presented in other comprehensive income, with the remaining amount of change in the fair value being presented in profit or loss. This is required unless doing so creates or enlarges an accounting mismatch in profit or loss.

43. The proposed amendments therefore required fair value changes for all financial liability contingent consideration to be split between profit or loss and other comprehensive income, with changes in own credit risk being recognised in other comprehensive income.

Views received

44. Grant Thornton, Ernst & Young, KPMG, ASCG and ICAEW noted that the proposed amendments contradict the measurement requirements for derivatives in IFRS 9:

(a) ICAEW and Ernst and Young questioned if this was what the IASB intended with the proposed amendments, with the ICAEW questioning whether it merely short-cuts considering paragraph 4.3.5 for hybrid contracts.

(b) Ernst and Young said that they think that the accounting for derivatives that are contingent consideration should be consistent with the accounting for other derivative financial liabilities.

(c) Grant Thornton also noted that the extent of this issue depends on the extent to which these contracts are considered to be (or include) derivatives. They said that this can be a complex matter and may require judgment in some arrangements.

Staff analysis & recommendation

45. In IFRS 9 all held for trading financial liabilities (which includes derivatives) are required to be measured at fair value through profit or loss. However, as noted in paragraphs 41–43, the proposed amendments state that all financial liability contingent consideration must be accounted for as if the fair value option has been applied, therefore meaning that fair value changes attributable to the credit risk of that contingent consideration would be recognised in other comprehensive income.

46. The proposed amendments therefore contradict the held for trading financial liability subsequent measurement requirements in IFRS 9. We do not think that it is appropriate for the contingent consideration subsequent measurement requirements to contradict the held for trading financial liability subsequent measurement requirements because this would result in a different accounting compared with any other held for trading financial liabilities accounted for in accordance with IFRS 9.

47. Therefore we recommend that held for trading contingent consideration (which includes derivatives) shall be subsequently measured at fair value through profit or loss. An entity should not be required to apply the fair value option for financial liabilities to held for trading contingent consideration.

48. The proposed wording amendments to IFRS 9 paragraph 4.2.1(e) is shown in Appendices A and B.

49. We think it is appropriate for financial liability contingent consideration–other than held for trading financial liabilities–to be required to apply the fair value option in IFRS 9. This is because an entity would be deemed to be applying the fair value option to contingent consideration financial liabilities (other than held for trading financial liabilities), in order to achieve fair value subsequent measurement accounting that is required by IFRS 3 paragraph 58.

Financial asset contingent consideration

50. We think that the proposed amendments to IFRS 3 and IFRS 9 are clear that fair value is the subsequent measurement requirement for financial asset contingent consideration. This is because IFRS 9 paragraph 5.2.1 requires that an entity shall measure a financial asset at fair value or amortised cost (in accordance with paragraph 4.1.1–4.1.5) and the ED proposed an amendment to paragraph 4.1.2 to ensure that a financial asset cannot be measured at amortised cost.

51. However, we do not think that a contingent consideration financial asset could meet the requirements to be measured at amortised cost in IFRS 9 paragraph 4.1.2. We think that contingent consideration financial assets do not give rise to contractual cash flows that are solely principal and interest (ie the cash flows are linked to performance or another factor).

52. Therefore, we recommend that the amendment proposed in the ED to IFRS 9 paragraph 4.1.2 should be deleted because it is not needed.

53. The proposed amendment to IFRS 3 paragraph 58(b) requires that changes in fair value are recognised in profit or loss for the period, unless IFRS 9 requires the gain or loss to be recognised in other comprehensive income.

54. However, we think that it is highly unlikely that a contingent consideration financial asset could be an equity instrument that qualifies for the irrevocable election in IFRS 9 to present gains or losses in other comprehensive income (paragraph 5.7.5).

55. Additionally, we note that contingent consideration assets likely would not qualify to be subsequently measured using the proposed fair value through other comprehensive income measurement category that was proposed in the Exposure Draft *Classification and Measurement: Limited amendments to IFRS 9*. That is because contingent

consideration does not give rise to contractual cash flows that are solely principal and interest (ie the cash flows are linked to performance or another factor).

56. Therefore, we do not think that any further amendments are required.

Summary

57. Therefore, we recommend that the proposed amendments in the ED be confirmed, subject to the additional amendment relating to held for trading financial liabilities, as noted in paragraph 47 and the removal of the amendment to IFRS 9 paragraph 4.1.2.

Own credit risk

Views received

58. SAICA, AcSB, Grant Thornton, Deloitte, The Hundred Group and KPMG thought that it was not appropriate to split out the fair value changes attributable to changes in own credit risk and recognise them instead in other comprehensive income. Their reasons include:

(a) the requirement to split the 'own credit risk' portion into other comprehensive income is too onerous and unduly complex. It was also noted that contingent consideration contracts often have features such as variable cash flows that may increase the complexity of separating the own credit risk portion;

(b) it is unclear to them what the benefit of bifurcating changes in the fair value of contingent consideration is;

(c) IFRS 3 **requires** fair value measurement, so it is inappropriate to account for the contingent consideration as if it had been **designated** at fair value through profit or loss on initial recognition. This is inconsistent with the presentation principle in IFRS 9;

(d) fair value measurement of contingent consideration is not analogous to the use of the fair value option for financial liabilities;

(e) they question the conceptual basis for this requirement, because a liability for contingent consideration is frequently more akin to a free-standing derivative for which all changes in fair value are recognised in profit or loss under IFRS 9 than a debt instrument for which fair value measurement has been elected.

59. IDW also noted that the original intention of the IASB was that liabilities for contingent payments should be accounted for similarly, however the ED proposals require the split between profit or loss and other comprehensive income for fair value changes.

60. KPMG, Deloitte and SAICA all recommended removing contingent consideration from the scope of IFRS 9 and instead dealing with this in IFRS 3 and also recommended that it should be measured at fair value through profit or loss. Grant Thornton also suggested that contingent consideration should be measured at fair value through profit or loss.

61. The Hundred Group instead believed that IFRS 9 should be consequentially amended to reflect that contingent consideration should be measured at fair value through profit or loss and the reference to other comprehensive income in paragraph 58(b) of IFRS 3 should be deleted.

62. Although they did not mention own credit risk, PwC also recommended specifying that contingent consideration financial liabilities are designated at fair value through profit or loss, removing the requirement to link IFRS 3 to IFRS 9. They thought that it was the IASB's original intention when IFRS 3(2008) was issued that financial liabilities should be measured at fair value through profit or loss.

63. KPMG did not agree with the proposed amendments to paragraph 58 and the proposed consequential amendment to IFRS 9 paragraph 4.2.1. They pointed out that the requirement to present fair value changes attributable to changes in own credit risk in other comprehensive income did not exist when IFRS 3 was issued. They noted that it would therefore be outside the scope of Annual Improvements to amend IFRS 3/IFRS 9 so that the own credit risk element of the financial liability would be recognised through other comprehensive income, because this would change the IASB's original intention.

Staff analysis & recommendation

64. Regarding the point raised in paragraph 63, although we agree that IFRS 9 did not exist when IFRS 3 was issued, the IASB concluded that the subsequent measurement of contingent consideration within the scope of IAS 39 should be accounted for in accordance with IAS 39 (this is reflected in paragraph BC354 of IFRS 3). We note that paragraph 58 of IFRS 3 was consequentially amended during the IFRS 9 (2010) project by replacing the reference to IAS 39 with IFRS 9.

65. Consequently, we disagree that the amendments proposed in the ED change the IASB's intention.

66. We do not agree that all contingent consideration should be subsequently measured at fair value through profit or loss or that the proposed amendments should not reference IFRS 9.

67. We note BC5 of the proposed amendments, which said

> The Board considered removing from IFRS 3 all the references to other IFRSs (which would have included the references to IFRS 9) and instead including in IFRS 3 a requirement to measure all contingent consideration at fair value through profit and loss. However, the Board noted that this would not be a clarification, but would instead be a change to the intended requirements of IFRS 3. As explained in paragraph BC354, the Board's original intention for contingent consideration was that the fair value gains and losses should be presented in accordance with IAS 39 (now IFRS 9). …

68. We agree with the above explanation in the Basis for Conclusions on the ED and think that requiring only fair value through profit or loss subsequent measurement would be a departure from the IASB's original intention. We note that BC4 specifically references that IFRS 9 requires some fair value changes to be recognised through other comprehensive income. Therefore, we think it is appropriate that the subsequent measurement requirements for contingent consideration are that fair value changes should be recognised in profit or loss except when IFRS 9 requires (part of) that change to be recognised in other comprehensive income.

Disclosures (Issue 3)

69. The proposed amendments did not amend the disclosure requirements for contingent consideration.

Views received

70. Deloitte pointed out that the proposed amendments make no reference to disclosure requirements, specifically those of IFRS 7. They recommended that an amendment should be made to IFRS 3 or IFRS 7 to specify which disclosures should be made in respect of contingent consideration that meets the definition of a financial instrument.

Staff analysis and recommendation

71. We think that it is clear that an entity is required to make the disclosures in IFRS 7 for financial instrument contingent consideration, because the scope of IFRS 7 is for all types of financial instruments, with some exceptions, of which contingent consideration is not one.

72. We also think that the proposed Basis for Conclusions shows that the IASB thought about this and concluded that IFRS 7 disclosures are required, as shown in BC6:

> …The Board think that is it appropriate for the disclosure requirements of IFRS 7 to apply to contingent consideration that is a financial instrument within the scope of IFRS 7. Consequently, the Board is not proposing any changes to the scope of IFRS 7.

73. We agree with the above conclusion.

74. We also note that it would be outside the scope of this project to specify which particular disclosures in IFRS 7 should be required for financial instrument contingent consideration. Consequently, we do not recommend amending the disclosure requirements for contingent consideration.

Other points raised by respondents

IAS 39—consequential amendment

75. No consequential amendment was proposed to IAS 39 in the ED. Only a consequential amendment to IFRS 9 was proposed.

Views received

76. ESMA, Volkswagen, EFRAG, RSM International Limited, AASB, ICAC, ICPAS, VMEBF, ASCG and The Linde Group also wanted a consequential amendment made to IAS 39. Reasons given include:

    (a) Entities that do not apply IFRS 9 early will encounter the same issues.

    (b) Entities that do not apply IFRS 9 early should, on this issue, have comparable reporting with those that do.

    (c) The effective date of IFRS 9 within the EU is still open.

    (d) If a consequential amendment is made to IAS 39, then the effective date of the proposed amendments could be made earlier.

    (e) The issue on accounting for contingent consideration also exists in IAS 39.

77. FAR also suggested that the improvement should be allowed to be applied earlier together with IAS 39 and not be dependent on applying IFRS 9.

Staff analysis and recommendation

78. We disagree that a consequential amendment is also required to IAS 39. We note that the effective date of the proposed amendments is 1 January 2015, which is also the effective date of IFRS 9. Consequently, an entity would be required to apply IFRS 9 at the same time as the proposed amendments.

79. It also does not seem appropriate to consequentially amend IAS 39 for a short period of application.

Convergence

Views received

80. Both AFME and KPMG mentioned that IFRS 3 was a converged Standard, undertaken jointly with the US Financial Accounting Standards Board (FASB) and that:

    (a) "the proposal which would result in a bifurcation of the credit-risk component from the remainder of the fair value change…would result in divergence from US GAAP on a standard that was the result of a convergence effort between the IASB and US FASB."—KPMG

    (b) "the IASB should work with the FASB with a view to getting these amendments also incorporated in Accounting Standards Codification ('ASC') 805, the equivalent FASB standard on business combinations."—AFME

Staff analysis

81. There is currently divergence between IFRS and US GAAP for the subsequent measurement of contingent consideration because:

    (a) US GAAP requires all non-equity contingent consideration to be subsequently measured at fair value with changes recognised in earnings unless the contingent consideration is a hedging instrument; whereas

    (b) IFRS requires contingent consideration to be subsequently measured based on the applicable Standard, which might not require subsequent measurement at fair value through profit or loss.

82. The US GAAP requirements are reproduced in Appendix C.

83. Consequently, under the proposed amendments convergence with US GAAP will be furthered, because it will be clarified that the subsequent measurement of non-equity contingent consideration is fair value—which is the same as US GAAP requires, unless the contingent consideration is a hedging instrument.

84. Accordingly, we do not think that further work regarding these amendments needs to be undertaken with the FASB in order that similar amendments can be made to US GAAP.

85. We do note that US GAAP has not been amended to remove the references to other GAAP from the classification guidance for contingent consideration, whereas the proposed amendments to IFRS 3 have (ie, the proposed amendments to paragraph 40). However, as noted above, the accounting requirements are more converged.

Credit risk—IAS 39

Views received

86. ACTEO/AFEP/MEDEF, Business Europe, EFRAG and ICAEW all suggested that an amendment should be made to IAS 39 to align its requirements with IFRS 9 regarding credit risk (as in IFRS 9 paragraph 5.7.7–5.7.9).

Staff analysis

87. We think that it is outside the scope of this project to make that amendment. We therefore do not recommend any amendment to IAS 39 for own-credit risk in this project.

Seller's perspective

Views received

88. BP requested that the accounting for contingent consideration from the seller's perspective should also be clarified—although not necessarily in IFRS 3, whether it should be accounted for as a financial instrument, in accordance with the revenue Standard or in another way.

Staff analysis

89. Although we note BP's suggestion, it is outside the scope of this project to address accounting for contingent consideration from the seller's perspective. It is also outside the scope of IFRS 3 to deal with this issue as IFRS 3 deals with accounting for the acquisition of a business from the acquirer's perspective.

Contingent liabilities

Views received

90. ESMA pointed out that different measurement requirements apply for the subsequent measurement of contingent liabilities acquired in a business combination, for example IAS 37 or IAS 18 *Revenue* compared with those for contingent consideration. They queried whether this was intentional.

Staff analysis

91. We note that the comment that ESMA raises is correct and based on our knowledge of the development of the standard we understand that this difference in the accounting for contingent assets and liabilities of the acquiree and the accounting for contingent consideration is intentional. Nevertheless in our view the question of accounting for the contingent assets and liabilities of the acquiree is outside the scope of this project and should instead be referred to the post-implementation review of IFRS 3.

Consequential amendment to IAS 37

Views received

92. BDO noted that they think that a consequential amendment is needed to IAS 37 to state specifically that it does not apply to contingent consideration arising from a business combination within the scope of IFRS 3. They noted this would be similar to the exclusion of financial instruments within the scope of IAS 39, which is covered by IAS 37 paragraph 2.

Staff analysis

93. We note BDO's comment, but we point out that paragraph 5 of IAS 37 says that when another Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. This paragraph then gives some examples of when this is the case.

94. Consequently, we do not think that a consequential amendment to IAS 37 is needed, because we think it is clear from the scope paragraphs of that Standard that the Standard will not apply to contingent consideration in a business combination.

Classification of contingent consideration assets

95. Paragraph 40, the classification requirements for contingent consideration, say:

> …The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

Views received

96. Grant Thornton and ICAEW noted that the wording in paragraph 40 could be read to imply that there are conditions which need to be met in order for such contingent consideration to be recognised as an asset.

97. AIA said that a cross-reference to the specified conditions that need to be met in paragraph 40 would be helpful.

Staff analysis and recommendation

98. We note that these views received are outside of the scope of this project. We will refer these comments to the post-implementation review of IFRS 3.

Question 2—Do you agree with the proposed transitional provisions and effective date for the issue as described in the exposure draft? If not, why and what alternative do you propose?

99. The majority of respondents agreed with the proposed transition provisions and effective date.

Wording issue

Views received

100. The AcSB highlighted that, as currently worded, the amendments could be applied without IFRS 9 being applied. The noted this issue arises from the interaction between the wording of the effective date paragraph and the effective date of IFRS 9:

(a) The amendment shall be applied to **business combinations for which the acquisition date** is on or after 1 January 2015;

(b) whereas IFRS 9 has an effective date of **annual periods beginning** on or after 1 January 2015.

For example, a business combination could occur in February 2015 (therefore not applying the amendment early), but the entities annual period does not begin until 1 April 2015.

Staff analysis and recommendation

101. We agree with the comment raised and therefore recommend that the wording of the transition and effective date paragraph should be changed to address this issue. This recommended wording is shown in Appendices A and B.

Earlier effective date

View received

102. ESMA, BDO, PwC, Deloitte, ASCG, IACVA, ICGN and The Hundred Group commented that they would prefer/the IASB should or could consider an earlier effective date. Some recommended that this should be 1 January 2014, with one respondent recommending that this should be the first fiscal year beginning in 2013. As noted by some respondents, this could either be as a result of a consequential amendment to IAS 39 or necessitate an amendment to IAS 39.

Staff analysis

103. The proposed amendments include amendments to IFRS 9. As such, it would not be possible to make the effective date earlier than 1 January 2015, as 1 January 2015 is the effective date of IFRS 9. We also, as noted in paragraphs 78–79, do not recommend a consequential amendment to IAS 39.

104. Therefore, we do not recommend that the effective date of these amendments be made earlier.

105. We do note that earlier application of the proposed amendments is permitted, albeit with a requirement to apply IFRS 9 at the same time.

This amendment as an annual improvement

Views received

106. The Volkswagen Group, ACTEO/AFEP/MEDEF, British American Tobacco, Business Europe, HKICPA, Roche Group, Sanofi-Aventis, SwissHoldings, ICAEW. VMEBF, KPMG, ASCG and ANC thought/questioned that the proposed amendments should not be addressed at this time/go through Annual Improvements because, for example:

    (a) It is an important issue that affects many transactions, not only Business Combinations

    (b) A wider study of accounting for contingent consideration should be undertaken before making amendments

    (c) They are unconvinced that a minor amendment represents the best way forward

    (d) If the IASB doesn't remove the link IFRS 9, they should deliberate and expose for comments those changes as part of its redeliberations on other selected aspects of the classification and measurement model in IFRS 9.

    (e) The proposed amendments are more than editorial/maintenance

    (f) The 2008 revisions to IFRS 3 were controversial and contingent consideration has been discussed by the IFRIC before without final resolution

    (g) the proposed consequential amendments to IFRS 9 in this annual improvement cycle may give rise to unexpected confusion in relation to the limited amendments to IFRS9, particularly with regard to the proposed effective date

107. Respondents recommendations instead included:

    (a) these issues/the entire concept of contingent consideration should be addressed in the post-implementation review of IFRS 3 or await the results of the post-implementation review

    (b) a wider study should be undertaken into contingent consideration

(c) this amendment should be addressed simultaneously with the Exposure Draft of the limited amendments to IFRS 9 or in an annual improvement project cycle in the future

(d) the IASB should re-examine the whole issue across all Standards dealing with contingent payments (they noted that the Interpretations Committee is currently working on one such issue – in connection with the purchase of tangible assets and is faced with several existing accounting models across the whole of IFRS.)

Staff analysis

108. We note that the proposed amendments clarify the classification requirements in IFRS 3 in that ‘other applicable IFRSs’ are no longer referred to and that the subsequent measurement requirements clarify the IASB’s original intentions. As such, the proposals are merely clarifying in nature.

109. We think that our staff recommendations, as summarised in paragraph 111 below, also clarify the IASB’s original intention. We think that the proposed amendment to require held for trading contingent consideration financial liabilities to be measured at fair value through profit or loss ensure that the contingent consideration subsequent measurement requirements do not contradict the requirements for similar financial liabilities in IFRS 9.

110. As such, we do not think that the amendments we recommend mean that the proposals are no longer an annual improvement.

Summary of staff recommendations

111. We recommend that:

(a) the wording in paragraph 58(b) of IFRS 3 should be amended to ensure that it does not imply that contingent consideration can only be a financial instrument;

(b) held for trading contingent consideration (which includes derivatives) shall be subsequently measured at fair value through profit or loss. An entity should not be required to apply the fair value option for financial liabilities to held for trading contingent consideration;

(c) that the amendment proposed in the ED to IFRS 9 paragraph 4.1.2 should be deleted; and

(d) the wording of the transition and effective date paragraph should be amended to address the issue in paragraph 100.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendations as shown in paragraphs 111?
2. Does the Interpretations Committee agree with the proposed edits to paragraph 40 and 58 of IFRS 3 and paragraph and 4.2.1 of IFRS 9, and to the Basis for Conclusions for both Standards, based on our discussion above and to recommend to the IASB that it should proceed with the amendments to those paragraphs?

Appendix A—Changes for finalising the amendment

A1. The proposed amendments are presented below.

The acquisition method

...

Consideration transferred

...

Contingent consideration

…

40 The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial 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.

Subsequent measurement and accounting

…

Contingent consideration

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) Other c~~C~~ontingent 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 at each reporting date, with any resulting gain or loss recognised ~~either~~ in profit or loss for the period. However, if the contingent consideration is a financial asset or a financial liability within the scope of IFRS 9 then the change in fair value must be recognised in other comprehensive income if that accounting treatment is required by IFRS 9.~~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.~~

Effective date and transition

Effective date

…

64G *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraphs 40 and 58. An entity shall apply that amendment to those paragraphs prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2015. Earlier application is permitted. If an entity applies that amendment earlier, it shall disclose that fact and at the same time apply IFRS 9 *Financial Instruments* (as amended by *Annual Improvements to IFRSs 2010–2012 Cycle*).

Proposed consequential amendment to IFRS 9 *Financial Instruments*

4.2 Classification of financial liabilities

4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost using the *effective interest method*, except for:

(a) ...

(e) contingent consideration in a business combination (see IFRS 3 *Business Combinations*). Contingent consideration that meets the definition of held for trading (which includes derivatives) shall be subsequently measured at fair value through profit or loss. All other contingent consideration in a business combination that is a financial liability shall apply paragraphs 5.7.7–5.7.9 of this Standard.

7.1 Effective date

…

7.1.4 *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraph 4.2.1. An entity shall apply that amendment prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2015. Earlier application is permitted. If an entity applies that amendment earlier, it shall disclose that fact and at the same time apply IFRS 3 *Business Combinations* (as amended by *Annual Improvements to IFRSs 2010–2012 Cycle*).

Basis for Conclusions on the proposed amendment to IFRS 3 *Business Combinations*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Accounting for contingent consideration in a business combination

BC360A The Board proposed to clarify the accounting for contingent consideration arising from business combinations.

Classification of contingent consideration in a business combination

BC360B The Board noted that the classification requirements in paragraph 40 were unclear as to when, if ever, 'other applicable IFRSs' would need to be used to determine the classification of contingent consideration as a financial liability or as an equity instrument. Consequently, the Board deleted the reference to 'other applicable IFRSs' in paragraph 40.

Subsequent measurement of contingent consideration in a business combination

BC360C In addition, the Board noted that the requirements on subsequent measurement in paragraph 58 for contingent consideration that is a financial instrument within the scope of IFRS 9 *Financial Instruments* were inconsistent with the accounting requirements of IFRS 9. Because paragraph 58 referred to IFRS 9, which allows amortised cost measurement in certain circumstances, contingent consideration that is a financial liability might be classified as at amortised cost. This would conflict with the requirement in paragraph 58 that such contingent consideration should be subsequently measured at fair value. Consequently, the Board amended the classification requirements of IFRS 9 so that the subsequent measurement requirements of IFRS 9 that do not require the use of fair value do not apply to contingent consideration that arises from a business combination. The Board thinks that this will make clear that subsequent measurement of contingent consideration is required to be at fair value in accordance with paragraph 58. The Board thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

BC360D The Board considered removing from IFRS 3 all the references to other IFRSs (which would have included the references to IFRS 9) and instead including in IFRS 3 a requirement to measure all contingent consideration at fair value through profit and loss. However, the Board noted that this would not be a clarification, but would instead be a change to the intended requirements of IFRS 3. As explained in paragraph BC354, the Board's original intention for contingent consideration was that the fair value gains and losses should be presented in accordance with IAS 39 (now IFRS 9). IFRS 9 requires some changes in fair value to be recognised through other comprehensive income (for example changes in an entity's credit risk for certain types of financial liabilities). Consequently, the Board thinks that measuring the changes in fair value in accordance with IFRS 9 by reference to this Standard is the best way of clarifying the original intention of IFRS 3 with respect to contingent consideration.

BC360E In making this clarification to the accounting for contingent consideration that is a financial liability, the Board has made clear that all changes in the fair value of contingent consideration that is a financial liability held for trading (and therefore including derivatives) should be recognised in profit or loss. The Board decided that it would not be appropriate to recognise the credit risk component of changes in the fair value of held for trading financial liabilities in other comprehensive income. This maintains consistency with the accounting for held for trading financial liabilities that are not contingent consideration.

BC360F The Board also noted that the subsequent measurement requirements in paragraph 58(b) for contingent consideration that is not a financial instrument conflicted with the measurement requirements in other applicable IFRSs. The conflict arises because paragraph 58 refers to changes in the fair value of contingent consideration but paragraph 58(b) requires contingent consideration to be measured in accordance with Standards that do not require fair value as a measurement basis, for example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Consequently, the Board deleted the reference to 'IAS 37 or other IFRSs as appropriate' from paragraph 58(b). This therefore maintains fair value as the subsequent measurement basis for all contingent consideration to which IFRS 3 applies. The Board thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

BC360G In redeliberating the issue, the Board decided that it would not be possible for a contingent consideration financial asset to meet the requirements in IFRS 9 to be subsequently measured at amortised cost. Consequently, the Board deleted the Exposure Draft's proposed amendments to IFRS 9 paragraph 4.1.2.

Disclosure

BC360H Some stakeholders had questioned whether the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* are intended to apply to contingent consideration because there are disclosure requirements for contingent consideration in IFRS 3. The Board thinks that it is appropriate for the disclosure requirements of IFRS 7 to apply to contingent consideration that is a financial instrument within the scope of IFRS 7. Consequently, the Board did not propose any changes to the scope of IFRS 7 to exclude such instruments.

Effective date and transition

BC360I The Board also considered whether the transitional provisions of paragraph 19 in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should apply, which require retrospective application. The Board considered that the amendments required fair value measurement, and that some entities might not have previously applied fair value measurement for the subsequent measurement of contingent consideration. Therefore, retrospective application might require the determination of fair value for contingent consideration which might not have been previously subsequently measured at fair value. Consequently, the Board decided to require prospective application to avoid the risk of hindsight being applied. In addition, the Board thinks that the proposed amendments should not be applied before IFRS 9 (2010) because of the proposed consequential amendment to that IFRS.

Appendix B—Changes from the Exposure Draft published in May 2012 following our recommendations in this paper

B1 The amendments are presented below. New text that is proposed to be added on the basis of the comment letter analysis, arising from the proposed amendment included in the ED (May 2012), is shown with a double-underline. Text that is proposed to be deleted with respect to the proposed amendment included in the ED (May 2012), is shown with a double-strike-through.

The acquisition method

...

Consideration transferred

...

Contingent consideration

…

40 The acquirer shall classify an obligation to pay contingent consideration that meets the definition of a financial instrument as a financial 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.

Subsequent measurement and accounting

…

Contingent consideration

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) Other c~~C~~ontingent 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 at each reporting date, with any resulting gain or loss recognised ~~either~~ in profit or loss for the period. However, if the contingent consideration is a financial asset or a financial liability within the scope of IFRS 9 then the change in fair value must be recognised in other comprehensive income if that accounting treatment is required by IFRS 9.~~, unless the recognition of the resulting gain or loss is required 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.~~

Effective date and transition

Effective date

…

64G *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraphs 40 and 58. An entity shall apply that amendment to those paragraphs prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2015. Earlier application is permitted. If an entity applies that amendment earlier, it shall disclose that fact and at the same time apply IFRS 9 *Financial Instruments* (as amended by *Annual Improvements to IFRSs 2010–2012 Cycle*).

Proposed consequential amendment to IFRS 9 *Financial Instruments*

4.1 Classification of financial assets

…

4.1.2 A financial asset shall be measured at amortised cost if ~~all~~ ~~both~~ of the following conditions are met:

(a) The asset is held within a business model whose objective is to hold assets in order to collect contractual cash flows.

(b) The contractual terms of the financial asset give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding.

~~(c) The asset is not a contingent consideration to which IFRS 3 *Business Combinations* applies.~~

Paragraphs B4.1.1–B4.1.26 provide guidance on how to apply ~~these conditions~~ ~~the conditions in (a) and (b)~~.

4.2 Classification of financial liabilities

4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost using the *effective interest method*, except for:

(a) ...

(e) contingent consideration in a business combination (see IFRS 3 *Business Combinations*). Contingent consideration that meets the definition of held for trading (which includes derivatives) shall be subsequently measured at fair value through profit or loss. All other contingent consideration in a business combination that is a financial liability shall apply paragraphs 5.7.7–5.7.9 of this Standard.~~ Such financial liabilities shall be subsequently measured at fair value with changes in the fair value of the financial liabilities being presented in accordance with paragraphs 5.7.7–5.7.8 as if they had been designated at fair value through profit or loss at initial recognition.~~

7.1 Effective date

…

7.1.4 *Annual Improvements to IFRSs 2010–2012 Cycle* issued in [date] amended paragraph~~s~~ ~~4.1.2 and~~ 4.2.1. An entity shall apply that amendment prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 1 January 2015. Earlier application is permitted. If an entity applies that amendment earlier, it shall disclose that fact and at the same time apply IFRS 3 *Business Combinations* (as amended by *Annual Improvements to IFRSs 2010–2012 Cycle*).

Basis for Conclusions on the proposed amendment to IFRS 3 *Business Combinations*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Accounting for contingent consideration in a business combination

BC360A~~1~~ The Board propose~~s~~d to clarify the accounting for contingent consideration arising from business combinations.

Classification of contingent consideration in a business combination

BC360B~~2~~ The Board noted that the classification requirements in paragraph 40 ~~are~~were unclear as to when, if ever, 'other applicable IFRSs' would need to be used to determine the classification of contingent consideration as a financial liability or as an equity instrument. Consequently, the Board ~~proposes to~~ deleted the reference to 'other applicable IFRSs' in paragraph 40.

Subsequent measurement of contingent consideration in a business combination

BC360C In addition, the Board noted that the requirements on subsequent measurement in paragraph 58 for contingent consideration that is a financial instrument within the scope of IFRS 9 *Financial Instruments* ~~are~~were inconsistent with the accounting requirements of IFRS 9. Because paragraph 58 referred~~s~~ to IFRS 9, which allows amortised cost measurement in certain circumstances, contingent consideration that is a financial liability might be classified as at amortised cost. This would conflict with the requirement in paragraph 58 that such contingent consideration should be subsequently measured at fair value. Consequently, the Board ~~proposes to~~ amended the classification requirements of IFRS 9 so that the subsequent measurement requirements of IFRS 9 that do not require the use of fair value do not apply to contingent consideration that arises from a business combination. The Board thinks that this will make clear that subsequent measurement of contingent consideration is required to be at fair value in accordance with paragraph 58. The Board thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

BC~~4~~360D The Board considered removing from IFRS 3 all the references to other IFRSs (which would have included the references to IFRS 9) and instead including in IFRS 3 a requirement to measure all contingent consideration at fair value through profit and loss. However, the Board noted that this would not be a clarification, but would instead be a change to the intended requirements of IFRS 3. As explained in paragraph BC354, the Board's original intention for contingent consideration was that the fair value gains and losses should be presented in accordance with IAS 39 (now IFRS 9). IFRS 9 requires some changes in fair value to be recognised through other comprehensive income (for example changes in an entity's credit risk for certain types of financial liabilities). Consequently, the Board thinks that measuring the changes in fair value in accordance with IFRS 9 by reference to this Standard is the best way of clarifying the original intention of IFRS 3 with respect to contingent consideration.

BC360E In making this clarification to the accounting for contingent consideration that is a financial liability, the Board has made clear that all changes in the fair value of contingent consideration that is a financial liability held for trading (and therefore including derivatives) should be recognised in profit or loss. The Board decided that it would not be appropriate to recognise the credit risk component of changes in the fair value of held for trading financial liabilities in other comprehensive income. This maintains consistency with the accounting for held for trading financial liabilities that are not contingent consideration.

BC~~5~~360F The Board also noted that the subsequent measurement requirements in paragraph 58(b) for contingent consideration that is not a financial instrument conflicted with the measurement requirements in other applicable IFRSs. The conflict arises because paragraph 58 refers to changes in the fair value of contingent consideration but paragraph 58(b) requires contingent consideration to be measured in accordance with Standards that do not require fair value as a measurement basis, for example, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. Consequently, the Board ~~proposes to~~ deleted the reference to 'IAS 37 or other IFRSs as appropriate' from paragraph 58(b). Th~~e proposal~~is therefore maintains fair value as the subsequent measurement basis for all contingent consideration to which IFRS 3 applies. The Board thinks that this clarifies the original intention for subsequent measurement of contingent consideration as explained in paragraph BC355.

BC360G In redeliberating the issue, the Board decided that it would not be possible for a contingent consideration financial asset to meet the requirements in IFRS 9 to be subsequently measured at amortised cost. Consequently, the Board deleted the Exposure Draft's proposed amendments to IFRS 9 paragraph 4.1.2.

Disclosure

BC~~6~~360H Some ~~have~~stakeholders had questioned whether the disclosure requirements in IFRS 7 *Financial Instruments: Disclosures* are intended to apply to contingent consideration because there are disclosure requirements for contingent consideration in IFRS 3. The Board thinks that it is appropriate for the disclosure requirements of IFRS 7 to apply to contingent consideration that is a financial instrument within the scope of IFRS 7. Consequently, the Board ~~is~~did not propose~~ing~~ any changes to the scope of IFRS 7 to exclude such instruments.

Effective date and transition

BC~~7~~360I The Board also considered whether the transitional provisions of paragraph 19 in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* should apply, which require retrospective application. The Board considered that the amendments required fair value measurement, and that some entities might not have previously applied fair value measurement for the subsequent measurement of contingent consideration. Therefore, retrospective application might require the determination of fair value for contingent consideration which might not have been previously subsequently measured at fair value. Consequently, the Board decided to require prospective application to avoid the risk of hindsight being applied. ~~However, given the potential impact of the change, the Board thinks that the proposed amendments to IFRS 3 and IFRS 9 should be applied prospectively.~~ In addition, the Board thinks that the proposed amendments should not be applied before IFRS 9 (2010) because of the proposed consequential amendment to that IFRS.

Appendix C—US GAAP requirements for contingent consideration

Initial recognition in Topic 805-30-25-5/6/7

25-5 The consideration the acquirer transfers in exchange for the acquiree includes any asset or liability resulting from a contingent consideration arrangement. The acquirer shall recognize the acquisition-date fair value of contingent consideration as part of the consideration transferred in exchange for the acquiree.

25-6 The acquirer shall classify an obligation to pay contingent consideration as a liability or as equity in accordance with Subtopics 480-10 and 815-40 or other applicable generally accepted accounting principles (GAAP). For example, Subtopic 480-10 provides guidance on whether to classify as a liability a contingent consideration arrangement that is, in substance, a put option written by the acquirer on the market price of the acquirer's shares issued in the business combination.

25-7 The acquirer shall classify as an asset a right to the return of previously transferred consideration if specified conditions are met.

Subsequent measurement in Topic 805-30-35-1

35-1 Some changes in the fair value of contingent consideration that the acquirer recognizes after the acquisition date may be the result of additional information about facts and circumstances that existed at the acquisition date that the acquirer obtained after that date. Such changes are measurement period adjustments in accordance with paragraphs 805-10-25-13 through 25-18 and Section 805-10-30. 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 shall be remeasured to fair value at each reporting date until the contingency is resolved. The changes in fair value shall be recognized in earnings unless the arrangement is a hedging instrument for which Topic 815 requires the changes to be initially recognized in other comprehensive income.