IFRS INTERPRETATIONS COMMITTEE REJECTIONS – INCLUDING CONTINGENT CONSIDERATION WITH CONTINUING EMPLOYMENT

THE IFRS INTERPRETATIONS COMMITTEE OF THE INTERNATIONAL ACCOUNTING STANDARDS BOARD (IASB) MET IN LONDON ON 22 AND 23 JANUARY 2013 AND MADE THE FOLLOWING AGENDA DECISIONS (WHICH ARE EFFECTIVELY REJECTIONS BECAUSE THESE ITEMS HAVE NOT BEEN TAKEN ONTO THEIR AGENDA FOR FUTURE INTERPRETATIONS).

As part of this rejection process, the Interpretations Committee published their rationale for not taking items onto their agenda and this is useful because it often clarifies what their views are regarding appropriate accounting treatments.

At the January 2013 meeting, the Interpretations Committee published agenda decisions on the following topics:

- IFRS 3 *Business Combinations* – Continuing employment
- IAS 27 *Consolidated and Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements* – Non-cash acquisition of a non-controlling interest by a controlling shareholder in the consolidated financial statements
- IAS 28 *Investments in Associates* – Impairment of investments in associates in separate financial statements.

IFRS 3 *Business Combinations* – Continuing employment

Issue:

Whether paragraph B55(a) of IFRS 3 is **conclusive** in determining that payments to an employee (vendor) that are forfeited upon termination of employment are remuneration for post-combination services (i.e. not part of purchase consideration).

Paragraph B55 says that "if it is not clear whether an arrangement for payments to employees or selling shareholders is part of the exchange for the acquiree, or is a transaction separate from the business combination, the acquirer should consider the following indicators…".

Paragraph B55(a) then goes on to say (key words have been underlined):

> ***"Continuing employment***
>
> The terms of continuing employment by the selling shareholders who become key employees <u>may</u> be an indicator of the substance of a contingent consideration arrangement. …A contingent consideration arrangement in which the payments are <u>automatically forfeited</u> if employment terminates <u>is</u> remuneration for post-combination services. Arrangements in which the contingent payments are not affected by employment termination may indicate that the contingent payments are additional consideration rather than remuneration."

Committee conclusion:

The Committee concluded that arrangements 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 purchase consideration.

Their rationale for this decision was the conclusive language used in paragraph B55(a) – refer above extract.

Example:

Big Co Limited bought all the shares in Small Co Pty Limited from its owner, Mr Sellout. The purchase consideration was agreed at $3 million but if the sales revenue of Small Co Pty Limited reached $10 million within three years after acquisition date, Mr Sellout would receive an additional $500,000.

A condition of the sale agreement was that Mr Sellout would remain employed in the Small Co Pty Limited business for a period of three years. Even if the target sales revenue is achieved, if Mr Sellout leaves the company prior to the end of the three year period, he will automatically forfeit his right to the additional $500,000 payment.

The IFRS Interpretations Committee agenda decision appears to confirm, based on the conclusive language used in paragraph B55(a), that the $500,000 will form part of the post-combination expense for employee services rather than part of the purchase consideration (and therefore part of goodwill/intangible assets).

The issue will be revisited after the US Financial Accounting Standards Board completes their post-implementation review of their equivalent Standard, FAS 141R *Business Combinations*.

IAS 27 *Consolidated and Separate Financial Statements* and IFRS 10 *Consolidated Financial Statements* – Non-cash acquisition of a non-controlling interest by a controlling shareholder in the consolidated financial statements

Issue:

Paragraph 31 of IAS 27 (paragraph B96 of IFRS 10) requires that where a parent entity buys out the non-controlling interest (NCI) in a subsidiary, any changes in the parent entity's interest is recognised directly in equity. Any difference between the adjustment to NCI and the fair value of the consideration is recognised directly in equity and attributed to the parent.

Where the consideration is not cash, the issue was raised whether the following **difference** should be recognised in **profit or loss** or **equity** because applying IFRIC 17 *Distributions of Non-cash Assets to Owners* by analogy means that the difference should be recognised in profit or loss.

Fair value of consideration given (non-cash assets)	Less	Carrying amount of consideration given (non-cash assets)

Committee conclusion:

The Committee noted that paragraph 31 of IAS 27 (and B96 of IFRS 10) only deals with the difference between the carrying amount of NCI and the fair value of the consideration. It does not deal with the difference between the fair value and carrying value of the consideration given (as illustrated above).

Where the consideration is a non-cash asset, the difference between its fair value and carrying value on derecognition is generally recognised in profit or loss.

The Committee therefore concluded that an interpretation or amendment to Standards was not required and the issue was therefore not added to its agenda.

Example

On 31 December 2013 Parent D has 60% ownership interest in Sub E. Investor A holds the remaining 40% ownership interest. The carrying value of Sub E's net assets is $1m. (Parent D's share of Sub E's net assets is $0.6M.)

On 1 January 2014 Parent D transfers to Investor A a piece of land in exchange for Investor A's 40% ownership interest. The land has a carrying value of $1m and a fair value of $10m.

Parent D would recognise the following entries:

DR	Investment in Sub E	$10m	
CR	Fair value gain P/L		$9m
CR	Land		$1m

Being the derecognition of the land at fair value and recognition of additional 40% ownership interest in Sub E

On consolidation, the group would recognise the following entries:

DR	Non-controlling interest	$0.4m	
DR	Equity	$9.6m	
CR	Investment in Sub E		$10m

Being the derecognition of the NCI (Investor A's) share of net assets in equity [40%$1m] and the difference between the carrying amount of NCI [$0.4M] and the fair value of the consideration [$10m] = $9.6m being recognised in equity*

IAS 28 *Investments in Associates* – Impairment of investments in associates in separate financial statements.

Issue:
In its separate financial statements, what is the appropriate Standard for an investor to use to determine whether impairment is required for investments in subsidiaries, joint ventures and associates carried at cost less impairment? Is it:

- IAS 36 *Impairment of Assets*
- IAS 39 *Financial Instruments: Recognition and Measurement*?

Committee conclusion:
IAS 36, paragraph 4, and IAS 39, paragraph 2(a), require that investments in subsidiaries, associates and joint ventures (that are accounted for at cost) are within the scope of IAS 36 for impairment purposes.

The Committee therefore concluded that an interpretation or amendment to Standards was not required and the issue was therefore not added to its agenda.