STAFF PAPER

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IASB® Meeting

Project	**Updating a reference to the *Conceptual Framework* (Amendments to IFRS 3)**
Paper topic	Contingent liabilities, contingent assets, transition and due process

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Overview of paper

1. Paragraph 11 of IFRS 3 *Business Combinations* refers to the *Framework for the Preparation and Presentation of Financial Statements* issued by the International Accounting Standards Committee in 1989 and adopted by the International Accounting Standards Board (Board) in 2001 (2001 *Framework*).

2. In March 2018, the Board issued a revised *Conceptual Framework for Financial Reporting* (2018 *Conceptual Framework*).

Decisions to date

3. At its November 2018 meeting, the Board tentatively decided:

   (a) to update IFRS 3 so that it refers to the 2018 *Conceptual Framework* instead of the 2001 *Framework*; and

   (b) to avoid any resulting conflicts between IFRS 3 and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (as interpreted by IFRIC 21 *Levies*) by adding an exception to the recognition requirements in IFRS 3. The exception would specify that levies within the scope of IFRIC 21 and other obligations within the scope of IAS 37 should be recognised in a business combination only if they would be identified as liabilities applying IFRIC 21 or IAS 37 respectively.[1]

4. The Board concluded that updating the IFRS 3 reference to the *Conceptual Framework* would have significant practical implications only for recognition of levies within the scope of IFRIC 21 and other obligations within the scope of IAS 37. So, adding an exception for these items would allow the Board to update the reference to the *Conceptual Framework* in IFRS 3 without significantly changing the population of assets and liabilities recognised in a business combination.

Content of this paper

5. This paper discusses:
   (a) remaining technical matters:
      (i) harmonising the proposed exception with existing IFRS 3 requirements for contingent liabilities (paragraphs 7– 12);
      (ii) clarifying IFRS 3 requirements for contingent assets (paragraphs 13–18);
      (iii) transition arrangements and early application (paragraphs 19–32); and
   (b) due process matters (paragraphs 33–44).

Permission to prepare an Exposure Draft for balloting

6. If the Board reaches decisions on the technical matters, Board members will be asked to confirm that:
   (a) they are satisfied that the Board has complied with applicable due process steps for developing an Exposure Draft, and
   (b) the staff should prepare an Exposure Draft for balloting.

1 November 2018 IASB meeting Agenda Paper 10 *Updating a reference to the Conceptual Framework (Amendments to IFRS 3)—When and how to update the reference* and November 2018 IASB *Update.*

Harmonising proposed exception with existing IFRS 3 requirements for contingent liabilities

7. IFRS 3 contains specific recognition requirements for contingent liabilities within the scope of IAS 37. The Board will need to ensure that any new exception for obligations within the scope of IAS 37 work in harmony with those existing requirements.

Background

8. IAS 37 identifies, and prohibits recognition of, three types of contingent liability—present obligations that arise from past events ('present obligations') that are not recognised because outflows are not probable; present obligations that are not recognised because they cannot be measured reliably; and possible obligations (obligations whose existence is uncertain).

9. Paragraph 23 of IFRS 3 requires recognition in a business combination of one of those three types of contingent liability—namely present obligations that are classified as contingent liabilities only because there is a low probability of future outflows.

Staff analysis and conclusions

10. If an exception in IFRS 3 stated that obligations within the scope of IAS 37 should be recognised on acquisition only if they would be identified as liabilities applying IAS 37, that exception could be viewed as inconsistent with the existing requirement in IFRS 3 to recognise some items that IAS 37 classifies as contingent liabilities (not liabilities).

11. To avoid any inconsistency, the staff think that the new exception should state that obligations within the scope of IFRIC 21 or IAS 37 should be recognised on the acquisition of a business only if they would be identified as *present obligations* applying IFRIC 21 or IAS 37. Referring only to present obligations (instead of liabilities) would be sufficient to avoid problems from updating the IFRS 3 reference to the *Conceptual Framework* because those problems stem from changes to the description of a present obligation, not from changes to other aspects of the liability

definition. And the staff think the exception would then work for both liabilities and contingent liabilities—Appendix A shows how we think it would interact with existing IFRS 3 requirements.

Staff recommendation and question for the Board

12. The staff recommend specifying that levies within the scope of IFRIC 21 and other obligations within the scope of IAS 37 should be recognised on the acquisition of a business only if they would be identified as present obligations applying IFRIC 21 or IAS 37.

Question 1— Harmonising proposed exception with existing IFRS 3 requirements for contingent liabilities
Do you agree with the staff recommendation in paragraph 12?

Clarifying IFRS 3 requirements for contingent assets

Background

13. To help the Board identify problems that might arise from updating the IFRS 3 reference to the *Conceptual Framework*, the staff requested assistance from members of its Accounting Standards Advisory Forum (ASAF) and large accounting firms.

14. Several of those who replied asked the Board to consider whether updating the reference would create a conflict between IFRS 3 and IAS 37 requirements for contingent assets. They were unsure about the answer because:

(a) IFRS 3 explicitly clarifies its requirements for contingent liabilities but not its requirements for contingent assets; and

(b) although the Basis for Conclusions accompanying IFRS 3 states the Board’s conclusion that contingent assets should not be recognised on acquisition, the explanation refers to assets being 'unconditional rights' and the 2018 *Conceptual Framework* definition of an asset does not require rights to be unconditional.

15. At its November 2018 meeting, the Board considered this matter. It concluded that there would not be a conflict:

(a) IAS 37 defines contingent assets as possible assets whose existence will be confirmed only by one or more uncertain future events not wholly within the control of the entity. IAS 37 prohibits recognition of contingent assets.[2]

(b) IFRS 3 also prohibits recognition of contingent assets. Although this prohibition is not stated explicitly in IFRS 3, it can be inferred from the IFRS 3 recognition principle and is referred to in the Basis for Conclusions accompanying IFRS 3:

> BC276 … the IASB observed that the definition of a contingent asset in IAS 37 includes only 'possible assets'. A contingent asset arises when it is uncertain whether an entity has an asset at the end of the reporting period, but it is expected that some future event will confirm whether the entity has an asset. Accordingly, the IASB concluded that *contingent assets should not be recognised*, even if it is virtually certain that they will become unconditional or non-contingent. If an entity determines that an asset exists at the acquisition date (ie that it has an unconditional right at the acquisition date), that asset is not a contingent asset and should be accounted for in accordance with the appropriate IFRS. [emphasis added]

(c) the existing IFRS 3 requirements for contingent assets would not be overridden by updating the reference to the *Conceptual Framework*. The 2018 *Conceptual Framework* is clear that *if* an entity has a right, that right can meet the definition of an asset even if there is only a low probability that the right will produce economic benefits. But it is also clear that if there is uncertainty about

2 Paragraph 31 of IAS 37.

whether an entity has a right, it is uncertain whether an asset exists.[3] And it envisages that if there is uncertainty about the existence of an asset, an entity might not recognise the possible asset in its financial statements.[4] [5]

Staff analysis

16. The staff understand why respondents to the request for assistance raised questions on this matter. Although we can explain why updating the reference to the *Conceptual Framework* would not require acquirers to recognise contingent assets, this conclusion might not be obvious to readers of IFRS 3—especially because the IFRS 3 requirements for contingent assets are explicitly referred to only in the Basis for Conclusions, not in the Standard itself.

Staff recommendation and question for the Board

17. For the avoidance of doubt, the staff recommend clarifying in IFRS 3 that, in applying that Standard's recognition principle, an acquirer does not recognise contingent assets.

18. We think that the clarification could be located immediately below the requirements for contingent liabilities, which are in paragraphs 22–23 of IFRS 3.

Question 2—Clarifying IFRS 3 requirements for contingent assets
The staff recommend clarifying in IFRS 3 that, in applying that Standard's recognition principle, an acquirer does not recognise contingent assets. Do you agree?

3 Paragraph 4.13 of the 2018 *Conceptual Framework*.

4 Paragraph 5.14 of the 2018 *Conceptual Framework*.

5 For a more detailed staff analysis, see paragraphs 26–35 of November 2018 IASB meeting Agenda Paper 10 *Updating a reference to the Conceptual Framework (Amendments to IFRS 3)—When and how to update the reference.*

Transition arrangements and early application

Background

19. When the Board issued the 2018 *Conceptual Framework*, it also updated most references to the *Conceptual Framework* in IFRS Standards and Interpretations.

20. In each case, the Board specified the same effective date and similar transition requirements. Typical wording was:

> *Amendments to References to the Conceptual Framework in IFRS Standards*, issued in 2018, amended [paragraph number or footnote reference]. An entity shall apply that amendment for annual periods beginning on or after 1 January 2020. Earlier application is permitted if at the same time an entity also applies all other amendments made by *Amendments to References to the Conceptual Framework in IFRS Standards.* An entity shall apply the amendment to [name of Standard or Interpretation] retrospectively [subject to transitional provisions in paragraphs x–y of this Standard] in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity determines that retrospective application would be impracticable or would involve undue cost or effort, it shall apply the amendment to [name of Standard or Interpretation] by reference to paragraphs 23–28, 50–53 and 54F of IAS 8.

21. The Board has previously required retrospective application for some amendments to IFRS 3, but typically for amendments made either:
    (a) soon after IFRS 3 was issued (and without requiring restatement of assets and liabilities arising from business combinations that preceded the application of IFRS 3); [6] or
    (b) as a consequence of amendments to another Standard and effective at the same time as the amendments to that other Standard. [7]

[6] See paragraphs 64B and 64C of IFRS 3.

[7] See paragraphs 64E, 64F, 64G, 64K, 64L, 64M and 64N of IFRS 3.

22. Since 2013, four amendments have been made specifically to IFRS 3 (in other words, not as a consequence of amendments to other Standards). They were made by *Annual Improvements Cycle 2010–2011*, *Annual Improvements Cycle 2011–2013*, *Annual Improvements Cycle 2015–2017* and *Definition of a Business* (Amendments to IFRS 3). In each case, entities were required to apply the amendments prospectively. In the two most recent cases, the Board has not used the term prospectively—it has instead explained what prospectively means:

> 64O *Annual Improvements to IFRS Standards 2015–2017 Cycle*, issued in December 2017, added paragraph 42A. An entity shall apply those amendments 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 2019. Earlier application is permitted. If an entity applies those amendments earlier, it shall disclose that fact.
>
> 64P *Definition of a Business*, issued in October 2018, added paragraphs B7A–B7C, B8A and B12A–B12D, amended the definition of the term 'business' in Appendix A, amended paragraphs 3, B7–B9, B11 and B12 and deleted paragraph B10. An entity shall apply these amendments 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 2020 and to asset acquisitions that occur on or after the beginning of that period. Earlier application of these amendments is permitted. If an entity applies these amendments for an earlier period, it shall disclose that fact.

23. The Board has required prospective application of recent amendments to IFRS 3 because, for business acquisitions:

    (a) application of new requirements on a retrospective basis may involve the use of hindsight in determining acquisition-date fair values; and

    (b) the Board did not think that the benefits of applying new requirements on a retrospective basis would outweigh the cost and effort required.

Staff analysis and conclusions

Transition arrangements for entities that already apply IFRS Standards

24. The Staff do not think there would be significant benefits from requiring entities to apply retrospectively the amendments proposed in this project. As noted in paragraph 4, the amendments should not significantly change the population of assets and liabilities recognised in a business combination. So, applying the amendments should not require significant adjustments to assets and liabilities previously recognised.

25. Although this conclusion would also mean that preparers of financial statements may not incur substantial costs in applying the amendments to past business combinations, preparers would have to incur some costs even if only to prove that no adjustments were required.

26. For this reason, the staff think that the amendments proposed in this project should apply only to business combinations occurring on or after the effective date. Because those transition arrangements would be the same as those for the two most recent amendments to IFRS 3 (paragraphs 64O and 64P of IFRS 3), the staff think they should use the same wording.

Further transition arrangements for entities adopting IFRS Standards

27. Applying paragraph C1 of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, a first-time adopter is not required to apply IFRS 3 retrospectively. Consequently, a first-time adopter would not apply retrospectively the amendments to IFRS 3 proposed in this project. This means that no further transitional relief would be needed for first-time adopters.

Early application

28. The Board typically permits early application of new requirements and the staff see no reason not to permit early application of the amendments to IFRS 3—especially because the amendments should not significantly change the population of assets and liabilities recognised in a business combination. Furthermore, permitting early application of the updated reference in IFRS 3 could simplify procedures for preparers of financial statements who are already applying the updated references in other IFRS Standards.

29. *Amendments to References to the Conceptual Framework in IFRS Standards* permits early application of its amendments (that is, application before annual periods beginning on or after 1 January 2020) if the entity applies all the amendments at the same time.

30. The Board might issue the amendments proposed in this project before 1 January 2020. If it does so, the staff think the conditions for early application of those amendments should be consistent with the conditions for early application of the amendments to references to the *Conceptual Framework* in other IFRS Standards. To achieve consistency, entities should be permitted to apply the amendments to IFRS 3 for annual accounting periods beginning before 1 January 2020 if at the same time they also apply all the amendments made by *Amendments to References to the Conceptual Framework in IFRS Standards*.

31. Some IFRS Standards require entities that apply amendments early to disclose the fact that they have done so. However, the Board has not required disclosure of early application of the amendments made by *Amendments to References to the Conceptual Framework in IFRS Standards*. The staff think there is similarly no need to require disclosure of early application of the amendments proposed in this project, because those amendments should not significantly change the population of assets and liabilities recognised in a business combination.

Staff recommendations and questions for the Board

32. The staff recommend that:

(a) the Board requires entities to apply the amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after [date to be decided after exposure].

(b) the Board permits earlier application, without requiring entities that apply the amendments early to disclose that they have done so.

(c) if the Board issues the amendments before 1 January 2020, it permits entities to apply the amendments for annual periods beginning before 1 January 2020 if at the same time they also apply all the amendments made by *Amendments to References to the Conceptual Framework in IFRS Standards.*

Question 3—Transition arrangements and early application
Do you agree with the staff recommendations in paragraph 32?

Due process

Review of due process steps and recommendation for comment period

Due process requirements

33. If the Board reaches decisions on the matters discussed earlier in this paper, it will have reached agreement on all the technical matters in the project. It has also considered the likely effects of its proposals—as noted in paragraph 4, the proposals would allow the Board to update the reference to the *Conceptual Framework* in IFRS 3 without significantly changing the population of assets and liabilities recognised in a business combination.

34. The IFRS Foundation *Due Process Handbook* (*Due Process Handbook*) states that:

6.6 When the IASB has reached general agreement on the technical matters in the project and has considered the likely effects of the proposals, the technical staff present a paper to the IASB:

(a) summarising the steps the IASB has taken in developing the proposals, including a summary of when the IASB discussed this project in public meetings, the public hearings held, outreach activities, meetings of consultative groups and consultation with the Advisory Council;

(b) if applicable, reaffirming why the IASB has decided that it was not necessary to have a consultative group or conduct fieldwork; and

(c) recommending a comment period for the Exposure Draft.

Steps taken, consultative group and fieldwork

35. The Board has reached all decisions on this project in public meetings. It has discussed the project at two meetings before this one:

(a) in January 2017, when it decided to start a project to make a narrow-scope amendment to IFRS 3 to allow the replacement of the reference to the 2001 *Framework* in a way that would prevent unintended consequences. See January 2017 IASB meeting *Agenda Paper 10E Conceptual Framework—Updating References Exposure Draft—proposed amendments*.

(b) in November 2018, when it decided how to prevent unintended consequences. See November 2018 IASB meeting Agenda Paper 10 *Updating a reference to the Conceptual Framework (Amendments to IFRS 3)—When and how to update the reference* and November 2018 IASB *Update*.

36. To help identify potential unintended consequences, the Board requested assistance from large accounting firms and members of its Accounting Standards Advisory Forum (ASAF). The feedback from the accounting firms and ASAF members was reported and analysed in the paper for the Board's November 2018 meeting.

37. The ASAF has acted as the Board's consultative group for the *Conceptual Framework* project. Before reaching decisions on this project, the Board consulted the ASAF for advice on:

(a) its conclusions about the unintended consequences of updating the IFRS 3 reference to the *Conceptual Framework*; and

(b) four alternative ways of avoiding those consequences.[8]

38. The ASAF members' feedback was reported in the agenda paper for the Board's November 2018 meeting. The feedback informed the staff recommendations and Board decisions at that meeting.

39. The feedback supported the Board's conclusion that adding an exception to IFRS 3 would not only avoid any significant unintended consequences of updating the reference to the *Conceptual Framework*, but also avoid any changes to the existing requirements of IFRS 3. For this reason, the staff do not think the Board needs to do further fieldwork at this stage to understand how the proposals are likely to affect those who use and apply IFRS.

40. Appendix B to this paper lists the due process steps that have been or will be completed on this project.

Comment period

41. The *Due Process Handbook* states that:

> 6.7 The IASB normally allows a minimum period of 120 days for comment on an Exposure Draft. If the matter is narrow in scope and urgent, the IASB may consider a comment period of no less than 30 days, but it will only set a period of less than 120 days after consulting, and obtaining approval from, the [Due Process Oversight Committee].

[8] October 2018 ASAF meeting Agenda Paper 2 *Updating a reference to the Conceptual Framework (Amendments to IFRS 3)—Possible problems and ways of addressing them*.

42. The staff think that the amendments that the IASB has decided to make as part of this project are sufficiently limited in overall effect and narrow in scope that 90 days could be enough time for comment. However, we have concluded that the amendments are not urgent enough to merit consulting the Due Process Oversight Committee for approval to set a comment period less than the standard minimum period of 120 days.

Staff recommendation

43. The staff recommend that the Board allows 120 days for comment on the proposed amendments.

Permission to prepare an Exposure Draft for balloting

44. The *Due Process Handbook* states that:

> 6.9 If the IASB is satisfied that it has addressed all of these matters, it votes to have the technical staff prepare the Exposure Draft for balloting. IASB members who intend to dissent from the proposals in the Exposure Draft must make their intentions known at this time.

Questions for the Board

Question 4—Due process
(a) Do you agree that the Board should allow 120 days for comment on the proposed amendments?
(b) Are you satisfied that the Board has complied with applicable due process steps for developing an Exposure Draft and that the staff should prepare an Exposure Draft for balloting?
(c) Do you intend to dissent from the proposals in the Exposure Draft?

Appendix A—IFRS 3—Applying proposed new exception with existing IFRS 3 recognition requirements for contingent liabilities

	Provisions	Contingent liabilities			
	Scenario 1	**Scenario 2**	**Scenario 3**	**Scenario 4**	**Scenario 5**
At date of acquisition					
Step 1—apply proposed new exception. Apply IAS 37 or IFRIC 21 to decide whether entity has a present obligation as a result of a past event ('present obligation').	Present obligation applying IAS 37 / IFRIC 21.	Present obligation applying IAS 37 / IFRIC 21.	Present obligation applying IAS 37 / IFRIC 21.	Possible obligation applying IAS 37/IFRIC 21.	No present obligation applying IAS 37/IFRIC 21.
Step 2—apply existing recognition requirements for contingent liabilities (paragraph 23 of IFRS 3) (a) Decide whether fair value can be measured reliably	Fair value can be measured reliably.	Fair value can be measured reliably.	Fair value cannot be measured reliably. (Extremely rare.)		
(b) Decide whether outflow is probable.	Outflow probable.	Outflow not probable.			
	Apply paragraph 10 of IFRS 3 (recognition principle) to recognise provision.	Apply paragraph 23 of IFRS 3 (contingent liability requirements) to recognise contingent liability.	Apply paragraph 23 of IFRS 3. Do not recognise contingent liability. (Disclose information.)	Apply paragraph 23 of IFRS 3. Do not recognise contingent liability. (Disclose information.)	Nothing to recognise.
Subsequently					
IFRS 3 principle: recognise and measure liabilities in accordance with applicable IFRS Standard (paragraph 54).	Apply IAS 37 / IFRIC 21 to recognise and measure provision.		Apply IAS 37. Do not recognise contingent liability. (Disclose information.)	Apply IAS 37. Do not recognise contingent liability. (Disclose information.)	Nothing to recognise.
IFRS 3 requirements for contingent liabilities recognised on acquisition (paragraph 56).		Apply paragraph 56 of IFRS 3 to measure contingent liability.			

Appendix B—Due Process steps

Step	***Actions***
Board meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Yes - see paragraph 35 of this paper.
Consultation with the Trustees and the Advisory Council	The Trustees and the Advisory Council will be informed about the proposed amendments to IFRS 3 as part of the regular reporting to them.
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or ongoing associated costs.	Yes – see paragraph 33 of this paper.
Finalisation	
Due process steps are reviewed by the Board.	This step will be met by this Agenda Paper.
The Exposure Draft has an appropriate comment period	The comment period is being considered by the Board at this meeting—see paragraphs 41–43 of this paper.
Drafting	
Drafting quality assurance steps are adequate.	The translations, taxonomy and editorial teams will review drafts during the balloting process. We will perform an editorial review of the pre-ballot draft with some external parties. The pre-ballot draft will be made available to members of the International Forum of Accounting Standard Setters.
Publication	
Press release to announce publication of the Exposure Draft.	A press release will be published with the Exposure Draft.
Publication of the Exposure Draft	The Exposure Draft will be made available on our website when issued.