
IASB[®] meeting

Date	April 2024
Project	Post-implementation Review of IFRS 15
Topic	Applying IFRS 15 with IFRS 3
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Purpose and structure

1. This paper provides a summary of the feedback and staff analysis of matters related to applying IFRS 15 *Revenue from Contracts with Customers* with IFRS 3 *Business Combinations* that were raised by respondents in response to question 9 *Applying IFRS 15 with other IFRS Accounting Standards* of [Request for Information: Post-implementation Review of IFRS 15 Revenue from Contracts with Customers](#) (the RFI).
2. At this meeting, the IASB will be asked to decide whether to take further action on application matters related to applying IFRS 15 with IFRS 3 and if so, how to prioritise those matters, applying its framework for responding to the matters identified in a post-implementation review (PIR).¹
3. This paper provides:
 - (a) [summary of staff recommendations](#); and
 - (b) [summary of the feedback and staff analysis of specific application matters](#).

¹ See Agenda Paper 6 for the framework.

Summary of staff recommendations

4. Based on the analysis in this paper, the staff recommend the IASB take no further action on the application matters related to:
 - (a) measurement of contract assets and contract liabilities acquired as part of a business combination; and
 - (b) other aspects of applying IFRS 15 with IFRS 3 described in Appendix A.

Summary of the feedback and staff analysis of specific application matters

5. In the RFI the IASB asked stakeholders to provide information about challenges in applying IFRS 15 with IFRS 3. Many respondents commented on the interaction between IFRS 15 and IFRS 3. In addition, we gathered feedback on this topic from users of financial statements in outreach meetings. A few respondents (mostly standard-setters) identified ‘applying IFRS 15 with IFRS 3’ as a major application matter.
6. Based on the feedback the staff have identified [measurement of contract assets and contract liabilities acquired as part of a business combination](#) as a main application matter.
7. This section analyses whether to take action in response to this application matter based on whether the feedback provides evidence that:
 - (a) there are fundamental questions about the clarity and suitability of the requirements;
 - (b) the benefits to users of financial statements of the information arising from applying the requirements are significantly lower than expected (for example, there is significant diversity in application); or

- (c) the costs of applying the requirements and auditing and enforcing their application are significantly greater than expected (or there is a significant market development since the requirements were issued for which it is costly to apply the requirements consistently).
8. In addition, [Appendix A](#) summarises feedback on other matters raised by one or a few respondents and provides our responses. The staff do not recommend acting on any of these matters because the feedback does not provide evidence of fundamental questions about the clarity and suitability of the principles in the requirements, of significant diversity in application or significant ongoing costs. The feedback received does not suggest that the matters are pervasive or have substantial consequences on revenue information provided in financial statements.

Measurement of contract assets and contract liabilities acquired as part of a business combination

Summary of IFRS 3 and IFRS 15 requirements

IFRS 15 defines:

- (a) contract asset as an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time; and
- (b) contract liability as an entity's obligation to transfer goods or services to a customer for which the entity has received consideration from the customer.²

Under IFRS 15, when either party to a contract has performed, contract assets and contract liabilities are presented depending on the relationship between the entity's performance and the customer's payment.³

² See Appendix A of IFRS 15.

³ See paragraph 105 of IFRS 15.

Summary of IFRS 3 and IFRS 15 requirements

Under IFRS 3, assets and liabilities acquired in a business combination are measured at fair value except for limited exceptions.⁴ No exception is provided for contract assets and contract liabilities.

Feedback

9. Some stakeholders reported challenges related to the difference in the measurement principles in IFRS 3 and in IFRS 15. Specifically:
- (a) some respondents (mostly standard-setters and preparers) and a few users in outreach raised concerns about fair value measurement of contract assets and contract liabilities on acquisition. They said an entity's performance is depicted differently depending on whether growth has occurred organically or via acquisition.⁵ A few respondents (mostly preparers) reported their experience of fair value adjustments that reduce contract liabilities which in their view distorts the depiction of an entity's post-acquisition financial performance and reduces comparability. A few respondents said these adjustments are pervasive in the software industry.
 - (b) some respondents (mostly standard-setters) said different measurement requirements in IFRS 15 and IFRS 3 are difficult to apply in practice in relation to initial recognition and initial fair value measurement of, and subsequent accounting for, contract assets and contract liabilities acquired in a business combination. For example:
 - (i) initial fair value measurement is difficult when a contract includes favourable or unfavourable terms;
 - (ii) it is unclear whether the unwinding of a fair value adjustment is revenue in the scope of IFRS 15; and

⁴ See paragraphs 18 and 21 of IFRS 3.

⁵ In outreach meetings, users often used the term 'deferred revenue' rather than 'contract liabilities'.

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- (iii) significant differences in measurement could arise when contracts include variable consideration.
 - (c) a few users said that challenges related to fair value adjustments on acquisition relate not only to contract assets and contract liabilities, but also to other assets and liabilities, for example, inventory. A few users said that fair value adjustments on acquisition are difficult to understand because entities do not provide sufficient information to explain the reasons for those adjustments.
 - 10. Stakeholders expressed mixed views on resolving the matters:
 - (a) some stakeholders including a user (mostly standard-setters) suggested the IASB consider the changes the FASB made to its ASC Topic 805, Business Combinations, which require an entity to apply FASB ASC Topic 606, Revenue from Contracts with Customers, to recognise and measure contract assets and contract liabilities acquired in a business combination. A few said that this would:
 - (i) reduce the complexity associated with determining the fair value of contract liabilities as well as costs associated with post-acquisition accounting;
 - (ii) increase convergence with US GAAP; and
 - (iii) provide users with more useful information for projecting future cash flows and revenues.
 - (b) a few respondents suggested the IASB provide additional guidance or clarification on measurement and subsequent accounting, especially for contract liabilities.
 - (c) other stakeholders suggested retaining the fair value measurement principle on acquisition for all assets and liabilities:
 - (i) a few stakeholders, including users, said that fair value is the most appropriate basis for accounting for a business combination, and they see no difference between contract assets and liabilities and other assets or liabilities acquired in a business combination. A few respondents

said that the amount of goodwill would be distorted if contract assets and contract liabilities were measured at transaction-based prices rather than fair value when there is a difference between fair value measure and transaction-based amounts.

- (ii) a few users said that entities usually provide additional information and non-GAAP measures to help users adjust their valuation models for the effects of a business combination, including the effects of fair value adjustments.

Staff analysis

Clarity and suitability of the requirements

Initial recognition

11. IFRS 3 requires an entity to recognise identifiable assets and liabilities which meet the definitions of assets and liabilities in the *Conceptual Framework for Financial Reporting* as of the acquisition date.⁶
12. One of the reasons that the FASB amended Topic 805 to recognise contract assets and contract liabilities acquired in a business combination in accordance with Topic 606 was to address diversity in practice in recognition of acquired contract liabilities.⁷ That diversity was caused by a specific requirement in US GAAP that was superseded but often used in practice. The superseded requirement required an acquiring entity to recognise a liability related to the deferred revenue only if that deferred revenue represented a legal obligation. After the issuance of Topic 606, some argued that an entity should use the definition of a performance obligation in Topic 606 and others argued an entity should continue to use the legal obligation concept to determine whether to recognise contract liabilities.⁸ The FASB explained the amendment would resolve the difference in how the recognition criteria are applied between U.S. and

⁶ See paragraphs 10–11 of IFRS 3.

⁷ See Summary of [FASB ASU 2021-08](#) Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers.

⁸ See paragraph BC9 of ASU 2021-08.

international entities because the legal obligation concept does not exist in IFRS Standards and the performance obligation criteria are more consistent with the conceptual definition of a liability.⁹

13. The staff think although some judgement is required, the requirements for initial recognition in IFRS 3 are clear.

Initial measurement

14. Under IFRS 3, assets and liabilities acquired in a business combination are measured at fair value except for limited exceptions. No exception is provided for contract assets and contract liabilities.
15. Another reason for the FASB's amendment to Topic 805 was to address the issue that the timing of payment for an acquired revenue contract—for example, whether upfront payment is made before the acquisition—affects the subsequent amount of revenue recognised by the acquirer.¹⁰ By introducing an exception to the fair value measurement principle, the FASB also addressed the diversity in the fair value measurement techniques for contract liabilities arising in certain arrangements, such as licences of intellectual property. The FASB explained that there may be diversity in determining which direct, incremental costs are necessary to fulfil the remaining performance obligations, for example, in measuring fair value based on the fulfilment costs required to satisfy performance obligations, plus a reasonable profit on those costs.¹¹
16. However, the feedback to the RFI did not provide evidence of concerns related to the diversity in practice in fair value measurement. The staff think although the fair value measurement of revenue contracts is complex, the feedback provides insufficient evidence to suggest that there are fundamental questions about the fair value measurement of contract assets and contract liabilities.

⁹ See paragraph BC46 of ASU 2021-08.

¹⁰ See paragraph BC30 of ASU 2021-08.

¹¹ See paragraph BC47 of ASU 2021-08.

Subsequent accounting

17. IFRS 3 requires an acquirer to subsequently measure and account for assets and liabilities in accordance with other applicable IFRS Accounting Standards for those items, depending on their nature except for specific exceptions.¹²
18. The staff think subsequent accounting might be complex especially when the measurement base of other applicable IFRS Accounting Standards is not fair value. However, the feedback to the RFI did not indicate any specific issues and provides insufficient evidence to suggest that there are fundamental questions about the subsequent accounting of contract assets and contract liabilities.
19. For the reasons discussed in paragraphs 11–18, the staff think that the feedback to the RFI provides insufficient evidence to suggest that there are fundamental questions about the clarity and suitability of the requirements for measuring contract assets and contract liabilities acquired in a business combination at fair value, or that the requirements are not working as intended.

Benefits to users of financial statements

20. As mentioned in paragraphs 9–10, there was a mix of views on the usefulness of fair value measurement in a business combination in our feedback:
 - (a) some stakeholders raised concerns about the usefulness of fair value measurement of contract assets and contract liabilities.
 - (b) a few users were against fair value measurement not just specifically for contract assets and contract liabilities, arguing that fair value adjustments distort post-acquisition performance.
 - (c) some stakeholders said fair value is the most appropriate basis. A few said an exception to the fair value measurement principle could negatively affect the usefulness of information about goodwill.

¹² See paragraph 54 of IFRS 3.

- (d) a few users said they usually get additional information they need from disclosures.
21. The matter is not new, and the relevance of fair value measurement was considered in the PIR of IFRS 3 and Business Combination—Disclosures, Goodwill and Impairment projects. In response to the Discussion Paper *Business Combinations—Disclosures, Goodwill and Impairment*, a few respondents said fair value adjustments made to assets acquired and liabilities assumed in a business combination affect the financial performance of the reporting entity in future periods, for example due to the upward adjustment of the carrying amount of inventory. One respondent to that PIR highlighted a conflict between the measurement principles in IFRS 3 and in IFRS 15.¹³
22. The IASB decided not to address the matter, given that in the [Report and Feedback Statement](#) on the PIR of IFRS 3 the IASB acknowledged it is difficult to compare companies that grow organically and those that grow through acquisitions but, based on the comments received in the PIR of IFRS 3, concluded that fair value remains the best approach for measuring the assets acquired and the liabilities assumed in a business combination.
23. For the reasons discussed in paragraphs 20–22, the staff think that the feedback does not indicate that the benefits to users of financial statements of the information resulting from measurement of contract assets and contract liabilities acquired as part of a business combination are significantly lower than expected.

Costs of applying the requirements

24. As mentioned in paragraph 10(a)(i), a few respondents said measuring contract assets and liabilities acquired in a business combination applying the FASB’s amended requirements would reduce the complexity associated with determining the fair value

¹³ See December 2022 [Agenda Paper 18D Goodwill and impairment—Other topics](#).

of contract assets and contract liabilities and the costs associated with post-acquisition accounting.

25. The staff acknowledge that applying the IFRS 3 fair value requirements might be more costly than it would be applying requirements similar to the FASB's amended requirements. However, the information gathered on the RFI did not provide any new evidence related to the increased costs of applying the requirements.
26. For the reasons discussed in paragraphs 24–25, the staff think that the feedback provides insufficient evidence that the costs of applying the requirements are significantly greater than expected.

Staff recommendation and question for the IASB

27. Based on the analysis in paragraphs 11–26, the staff think the findings from the RFI provide insufficient evidence that the characteristics to take further action described in the PIR framework are present. Therefore, the staff recommend the IASB take no further action on application matters raised by respondents in relation to measurement of contract assets and contract liabilities acquired as part of a business combination.

Question 1 for the IASB

Do IASB members agree with the staff recommendation in paragraph 27 of this paper?

Question 2 for the IASB

As explained in paragraph 8, the staff recommend taking no action in relation to the matters discussed in Appendix A. Do you agree with the staff recommendation?

Appendix A—Other application matters raised by a few respondents

	Application matter	Staff response
1	A few respondents said the subsequent accounting for favourable and unfavourable contract terms recognised in a business combination is unclear. For example, a favourable contract term of a remaining performance obligation is generally recognised as an intangible asset and amortised on a straight-line basis; whereas an unfavourable contract term is recognised as a contract liability and reversed as additional revenue.	The staff suggest no action because the feedback does not suggest that the matter is widespread. Paragraph 54 of IFRS 3 states that subsequent accounting is determined depending on the nature of assets and liabilities.
2	A few respondents said the classification of contract assets acquired as a result of a business combination is unclear because the assets do not relate to goods or services the acquiring group has transferred to a customer.	The staff suggest no action because the feedback does not suggest that the matter is widespread. Paragraph 54 of IFRS 3 states that subsequent accounting is determined depending on the nature of assets and liabilities.
3	A standard-setter said the allocation of consideration in a business combination is unclear when the acquired entity has contracts with customers.	The staff suggest no action because the feedback does not suggest that the matter is widespread.