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Updating reference in IFRS 3 to the revised Conceptual Framework
Issues Paper

Objective

1 The objective of this session is to receive the views of EFRAG CFSS and EFRAG TEG members on:

(a) Whether updating a reference in IFRS 3 from a previous version of the IASB's Conceptual Framework to the revised Conceptual Framework could result in additional unintended consequences than those identified by the IASB staff (and further presented below).

(b) How to deal with the possible unintended consequences identified.

Background and issues

2 Paragraph 11 of IFRS 3 *Business Combinations* states that "[t]o qualify for recognition as part of applying the acquisition method, the identifiable assets acquired and liabilities assumed must meet the definition of assets and liabilities in the *Framework for Preparation and Presentation of Financial Statements* at the acquisition date".

3 When issuing the revised *Conceptual Framework for Financial Reporting* in March 2018, the IASB updated many of the references to the Conceptual Framework in IFRS Standards to the revised Conceptual Framework. However, the reference to 'Framework for Preparation and Presentation of Financial Statements' in paragraph 11 of IFRS 3 was not updated as the IASB was concerned this could result in unintended consequences.

4 In previous versions of the Conceptual Framework an asset was defined as "a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity". A liability was defined as "a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits".

5 The revised Conceptual Framework (for Financial Reporting) defines an asset as "a present economic resource controlled by the entity as a result of past events". An economic resource is defined as "a right that has the potential to produce economic benefits". A liability is defined as "a present obligation of the entity to transfer an economic resource as a result of past events". In the supporting guidance it is mentioned that the obligation must have the potential to require the entity to transfer an economic resource to another party (or parties).

6 Based on its own analyses and consultation with ASAF members and auditors, the IASB staff concludes that updating the IFRS 3 reference to the revised Conceptual

Framework would not create significant unintended consequences. The IASB has, however, identified the following two potential issues that could result from updating the reference:

(a) The new definition of a liability would in some cases result in levies being recognised earlier than under IFRIC 21 *Levies*. Accordingly, an entity might have to recognise a liability in relation to a levy in a business combination, but would have to derecognise this on day 2 as the levy cannot be recognised according to IFRIC 21.

(b) According to the new definition, an asset should have 'the potential' to produce economic benefits. According to paragraph 67 of IAS 16 *Property, Plant and Equipment,* the carrying amount of an item of property, plant and equipment shall be derecognised when no future economic benefits are 'expected' from its use or disposal. Different interpretations of 'expected' exists. If 'expected' is interpreted to mean a higher probability-threshold than 'has the potential to', then a piece of property, plant or equipment could be recognised in a business combination but would have to be derecognised on day 2 – if it would not be 'expected' to result in future cash flows flowing to the entity. This issue did not exist under the previous definition of an asset as it also required that future economic benefits should be 'expected' to flow to the entity from an asset. Accordingly, a piece of property, plant and equipment could only be recognised in a business combination if it was 'expected' that future economic benefits would flow to the entity.

7 The IASB staff and the ASAF member highlighting the issue mentioned in paragraph 6(b) above noted that the issue might arise infrequently in practice. It would normally be expected that any property, plant or equipment assigned a significant fair value on acquisition would produce future economic benefits in one way or another.

8 The IASB staff has accordingly focused on how the issue mentioned in paragraph 6(a) could be addressed. The IASB staff has developed some alternatives. It could:

(a) Update IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (and IFRIC 21) to align the IAS 37 definition of a liability and IAS 37 requirements for identifying liabilities with the liability definition and supporting concepts in the revised Conceptual Framework. Updating the IFRS 3 reference to the revised Conceptual Framework would then not create any conflicts. As it would take time to update IAS 37 (and IFRIC 21), this approach would mean that the reference in IFRS 3 could not be updated for some time.

(b) Add another exception to IFRS 3 for liabilities within the scope of IAS 37, so that liabilities recognised on acquisition would be the same as those recognised applying IAS 37 or IFRIC 21 (and not those identified applying the revised Conceptual Framework). Such an exception could be similar to the exception already in IFRS 3 for income taxes.

(c) Add requirements to IFRS 3 for subsequent recognition and measurement of liabilities within the scope of IAS 37 or IFRIC 21, so that the liabilities recognised on acquisition applying the revised Conceptual Framework would not be derecognised on day 2. Such a requirement could be similar to those already in IFRS 3 for contingent liabilities within the scope of IAS 37.

9 The IASB staff notes that if there is a risk of other conflicts between IFRS 3 and other IFRS Standards, an option would be to change IFRS 3, so instead of requiring the identifiable assets acquired and liabilities assumed that would meet the definition of assets and liabilities in the revised Conceptual Framework, they should meet the definition in a Standard that specifically assesses those assets or liabilities. It would follow that, the definitions in the revised Conceptual Framework would only be used in the absence of any such Standard.

Questions for EFRAG CFSS and EFRAG TEG

10 Does EFRAG TEG and EFRAG CFSS agree with the conclusion of the IASB staff that updating the IFRS 3 reference to the revised Conceptual Framework would not create significant new conflicts between IFRS 3 and requirements in IFRS Standards (other than those mentioned in paragraph 6)?

11 What are the views of EFRAG CFSS and EFRAG TEG on whether, when and how the IASB should update the IFRS 3 reference to the revised Conceptual Framework?

12 Does EFRAG TEG and EFRAG CFSS have any suggestions for solutions other than those discussed in paragraphs 8 - 9 above?

Agenda papers

13 In addition to this issues paper, Agenda paper 07-02, which is the agenda paper for the ASAF meeting for the session, has been made available for background.