Summary of the comment letters received in response to EFRAG's Draft Comment Letter on IASB ED-2019-3

Structure of the paper

1 The purpose of this paper is to summarise the comment letters received in response to EFRAG's draft comment letter on IASB ED-2019-3 *Reference to the Conceptual Framework (Proposed amendments to IFRS 3)* ('the ED') and to provide the suggestions of the EFRAG Secretariat on how to reflect these comments in EFRAG's final comment letter.

2 This comment letter analysis contains:

(a) Summary of respondents;

(b) Summary of respondents' views;

(c) Additional comments provided to the IASB;

(d) Recommendations of the EFRAG Secretariat in response to the comments received; and

(e) Other amendments to EFRAG's draft comment letter.

Summary of respondents

3 At the time of writing, five comment letters have been received in response to the ED. The comment letters are from:

(a) CNC (Portuguese standard setter);

(b) OIC (Italian standard setter);

(c) ICAC (Spanish standard setter);

(d) ICAEW (association of chartered accountants); and

(e) DASC (Danish standard setter).

4 The letters are summarised below.

Summary of respondents' views

5 All respondents generally support the ED and hence the support for the ED as expressed in EFRAG's draft comment letter. Three respondents (CNC, OIC and ICAEW) have additional comments:

(a) The CNC considers that revision of IAS 37 to be urgent in order to avoid inconsistencies in IASB Standards;

(b) The OIC observes that a 'day 2 gain' may occur as liabilities in a business combination are measured at fair value at the acquisition date and subsequently measured in accordance with IAS 37. The OIC suggests the

IASB to consider whether this 'day 2 gain' would depict an economic gain or not and whether or not it should be reported in profit or loss.

(c) The OIC notes that in theory contingent assets would affect the consideration given by the acquirer as well as other assets and liabilities. The OIC therefore suggests that the IASB reconsiders whether an asymmetrical accounting treatment between contingent assets and contingent liabilities is justified for items being recognised at fair value.

(d) The ICAEW suggests that further consideration is given to how the proposals included in the ED interacts with current IFRS 3 requirements for 'indemnification assets'. The ICAEW considers that a tension could exist between the proposed requirement that would prohibit recognition of contingent assets in all circumstances in the case an indemnification asset relates to a contingent liability that is recognised in a business combination in accordance with paragraph 23 of IFRS 3.

Additional comments provided to the IASB

6 On 26 August, the EFRAG Secretariat examined the comment letters submitted to the IASB and published on the IASB's website in order to assess whether issues had been identified in the comment letters to the IASB, that had not been considered by EFRAG TEG. The comment letter from Deloitte included an additional issue. The comment letter from Deloitte notes that updating the reference to the revised Conceptual Framework may result in uncertain current tax assets and liabilities being recognised in a business combination, that would not be recognised under the current guidance. These current tax asset and liabilities would be measured at fair value under IFRS 3 (as IFRS 3 only includes an exception to its general recognition and measurement principles for *deferred* tax assets and liabilities arising from the assets acquired and liabilities assumed in a business combination). Subsequently, however, they would be measured in accordance with IFRIC 23 *Uncertainty over Income Tax Treatments* which could mean that they would be measured at a different amount than fair value. This could result in a 'day 2' gain or loss.

Recommendations of the EFRAG Secretariat in response to the comments received

7 In its draft comment letter in response to the ED, EFRAG noted that it could be argued that the approach suggested in the ED would not promote consistency in financial reporting. Although IFRS 3 would refer to the new definitions of assets and liabilities in the 2018 Conceptual Framework, the suggested exception to the recognition principles would mean that the new definitions would not be applied for the items that could be affected by the new definition. EFRAG, however, considered this to be a satisfactory solution in the short run as EFRAG considered that the exception would only be temporary. In that respect, EFRAG argued that one of the objectives of the IASB's project on provisions should be to align the IAS 37 liability definition and supporting guidance, including IFRIC 21, with those in the 2018 Conceptual Framework.

8 Although EFRAG's draft comment letter in response to the ED thus reflected that the IASB's project on provisions is important, it did not reflect that the project should be 'urgent' as in the comment letter of the CNC.

9 When discussing the ED, EFRAG TEG considered whether the purpose of the amendment should be to:

(a) Change the reference in IFRS 3 to the revised Conceptual Framework without introducing any changes; or

(b) Provide more useful information in the financial statements.

10 Had EFRAG TEG thought that amending IAS 37 was 'urgent', the EFRAG Secretariat would have expected EFRAG TEG to select option (b) in paragraph 9 above. Instead, most EFRAG TEG members considered that the purpose should be to change the reference in IFRS 3 without introducing any changes. One of the arguments made in favour of this position was that it would be the most efficient use of the IASB's resources.

11 The EFRAG Secretariat thus expects that although EFRAG TEG considers the project on IAS 37 to be important, the IASB has also other important projects that it needs to consider. Amending IAS 37 should therefore not be prioritised above all other projects.

12 Based on this, the EFRAG Secretariat suggests not including in EFRAG's comment letter that the revision of IAS 37 is urgent.

13 The EFRAG Secretariat agrees with the comment of the OIC that a 'day 2' gain may occur as a result of differences in the measurement requirements, because certain liabilities are measured at fair value at the acquisition date and are subsequently measured in accordance with IAS 37. IFRS 3 includes particular requirements for the subsequent measurement of contingent liabilities. A 'day 2' gain would accordingly not arise on these liabilities. However, IAS 37 also applies to liabilities that would not meet the definition of contingent liabilities and the issue could arise for those liabilities. The EFRAG Secretariat, however, notes that the issue does not arise as a result of the ED. The EFRAG Secretariat would therefore suggest not including the comment in EFRAG's comment letter in response to the ED.

14 Similarly, the EFRAG Secretariat considers the OIC's comment on contingent assets to be relevant, but this issue also does not arise as a result of the ED. The ED results in IFRS 3 stating that contingent assets are not recognised by an acquirer. This is currently not stated explicitly. However, it would currently follow from an interpretation of IFRS 3 taking into account paragraph BC276 of the Basis for Conclusions accompanying IFRS 3. The EFRAG Secretariat would therefore suggest not including the comment in EFRAG's comment letter in response to the ED.

15 The comment of the ICAEW, that a tension could exist between the guidance in IFRS 3 on indemnification assets and the proposed requirement that an acquirer shall not recognise a contingent asset at the acquisition date, seems to assume that an indemnification asset could be a contingent asset. The EFRAG Secretariat questions this. According to IFRS 3, an acquirer has an indemnification asset as a result of the seller guaranteeing that the acquirer's liability will not exceed a specified amount. As it also seems to follow from IFRS 3 that the guarantee is contractual, the EFRAG Secretariat would be of the view that the existence of this guarantee is not subject to the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. This applies even if the indemnification asset relates to a contingent liability.

16 The EFRAG Secretariat acknowledges that there may be different views on this topic. It is therefore useful to inform the IASB about the issue. However, as the issue is also mentioned in the ICAEW's comment letter to the IASB, the IASB will be informed about the issue in this manner. The EFRAG Secretariat accordingly recommends not including the comment in EFRAG's comment letter to the IASB.

17 The EFRAG Secretariat agrees with the comment included in Deloitte's comment letter to the IASB. The EFRAG Secretariat, however, notes that current guidance also includes a risk of entities having to recognise a 'day 2' gain or loss in a business combination. This is because the current tax assets and liabilities would have to be measured at fair value on day one and then subsequently be measured in

accordance with IFRIC 23 to the extent there is uncertainty over the tax treatments. When the current tax asset or liability is measured at fair value, the uncertainty would be reflected in the measurement. Measurement in accordance with IFRIC 23 may be at an amount (most likely amount) that would not reflect the uncertainty. The EFRAG Secretariat thus considers that the issue should be considered more broadly and not only in relation to those additional current tax assets and liabilities that might be recognised following the update of the reference to the Conceptual Framework.

Other amendments to EFRAG's draft comment letter

18 When considering EFRAG's draft comment letter, it was noted by an EFRAG TEG member, that the draft comment letter was long. The reason for this was that it was considered useful to inform EFRAG's constituents about EFRAG's thought process in order to stimulate the thought process of constituents. As this purpose has now been achieved, it could be argued that EFRAG's final comment letter could be shortened significantly by only stating that EFRAG agrees with the.

19 There would be benefits of such an approach. The EFRAG Secretariat, however, also considers that it could give the impression that EFRAG has changed its mind on issues it has not changed its mind on. On balance, the EFRAG Secretariat thus suggests not shortening the comment letter.

Question to EFRAG TEG

20 Does EFRAG TEG agree with EFRAG Secretariat's recommendations included in paragraphs 7 - 19 above?

21 Does EFRAG TEG agree with the draft final comment letter included as Paper 07-03?

22 Does EFRAG TEG agree with the drafted feedback statement included as Paper 07-04?