International Accounting Standards Board
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

[XX September 2019]

Dear Mr Hoogervorst,

Re: Exposure Draft *Reference to the* Conceptual Framework *(Proposed amendments to IFRS 3)*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft *Reference to the* Conceptual Framework *(Proposed amendments to IFRS 3),* issued by the IASB on 30 May 2019 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS Standards in the European Union and European Economic Area.

EFRAG agrees with the proposals in the ED.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Rasmus Sommer or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

Appendix - EFRAG's responses to the questions raised in the ED

Question 1

The IASB proposes to:

(a) Update IFRS 3 so it refers to the 2018 *Conceptual Framework* instead of the 1989 *Framework*.

(b) Add to IFRS 3 an exception to its recognition principle. For liabilities and contingent liabilities that would be within the scope of IAS 37 or IFRIC 21 if incurred separately, an acquirer should apply IAS 37 or IFRIC 21 respectively, instead of the *Conceptual Framework*, to identify the obligations it has assumed in a business combination.

(c) Add to IFRS 3 an explicit statement that an acquirer should not recognise contingent assets acquired in a business combination.

Do you agree with these proposals? If not, why not, and what do you recommend instead?

EFRAG's response

EFRAG agrees with the proposals.

Updating IFRS 3 to refer to the 2018 Conceptual Framework

2 EFRAG supports updating IFRS 3 so that it refers to the 2018 *Conceptual Framework* instead of the 1989 *Framework*. EFRAG agrees with the intention of the IASB, as noted in paragraph BC2 of the ED, to update and align the references to the *Conceptual Framework* in Standards to promote consistency in financial reporting and avoid the confusion that could result from having more than one version of the *Conceptual Framework* in use. EFRAG believes that the consistent application of IFRS Standards requires the use of consistent terms and concepts in all the IFRS Standards.

3 EFRAG acknowledges that in order to avoid having more than one version of the *Conceptual Framework* in use, the reference to the 1989 *Framework* in IFRS 3 could have been replaced by the definitions of assets and liabilities in the 1989 *Framework*. Such an approach would not have resulted in any unintended consequences. However, the approach would not promote consistency in financial reporting.

4 It could be argued that the approach suggested in the ED would also 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. While this is true, EFRAG considers that the exception will only be temporary. The IASB has added a project on provisions to its work plan. IASB stakeholders, including EFRAG, have supported that one of the objectives of the project should be to align the IAS 37 liability definition and supporting guidance, including IFRIC 21, with those in the 2018 *Conceptual Framework*.

Adding an exception to the IFRS 3 recognition principle

5 EFRAG has considered whether the primary objective of the project of updating the reference in IFRS 3 to the 2018 *Conceptual Framework* should be to:

(a) Change the reference in IFRS 3 to the 2018 *Conceptual Framework* in a manner that would not have any unintended consequences to avoid having two conceptual frameworks in issue; or

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

6 EFRAG is of the view that the primary objective of this particular project should be to change the reference in IFRS 3 to the 2018 *Conceptual Framework* in a manner that would not have any unintended consequences. However, if it would be possible to also have more useful information in the financial statements without compromising the primary objective, that opportunity should not be missed.

7 The proposals in the ED to require an acquirer to apply IAS 37 or IFRIC 21, instead of the 2018 *Conceptual Framework*, to identify whether the obligations it has assumed in a business combination would meet the primary objective. This is because it is unlikely to result in any significant changes in accounting. This, however, also means that the proposals would not result in more useful information.

8 EFRAG considers that more useful information could be provided if liabilities in certain circumstances are recognised earlier than under the current Standards. EFRAG has previously considered that the IFRIC 21 interpretation of IAS 37 results in a liability, under certain circumstances, being identified too late. This is because under IFRIC 21, the obligating event that gives rise to a liability is the activity that triggers the payment of the levy. For example, a coal fired power plant might have to pay a levy on 31/3 20X1, if it has been operating in the first month of 20X1, based on the amount of CO_2 it has emitted in 20X0. Under IFRIC 21, there would not be a liability for the amount of CO_2 emitted in 20X0 on 31/12 20X0, as the triggering event would be that the plant has been operating in the first part of 20X1. EFRAG considers that it would result in more useful information if a liability is identified as of 31/12 20X0 if the entity has no practical ability to avoid paying the levy arising from its emission in 20X0.

9 The IASB seems to have a similar view. When revising the *Conceptual Framework*, the IASB specifically stated that the interpretation of IAS 37 included in IFRIC 21 results in excluding “information that many users of financial statements would find useful” (paragraph BC4.52 of the 2018 *Conceptual Framework*).

10 When the IASB revised the *Conceptual Framework*, the IASB therefore thought it would result in more useful information to consider that a present obligation to transfer an economic resource has arisen when an entity has no practical ability to avoid the future transfer.

11 The alternatives to the proposals in the ED, that would both result in an update of the reference in IFRS 3 in a manner that would not result in a day 2 gain and result in liabilities being identified when an entity has no practical ability to avoid the future transfer, would therefore be to:

(a) Amend the requirements in IAS 37 for identifying liabilities (including the requirements in IFRIC 21) to align these requirements with the 2018 *Conceptual Framework* guidance on the definition of a liability; or

(b) Include additional requirements in IFRS 3 for the subsequent measurement of liabilities accounted for after the acquisition date by applying IAS 37 or IFRIC 21.

12 The solution mentioned in paragraph 11(a) would introduce the improvement for the relevant liabilities no matter how they have arisen. As mentioned above, the IASB has added a project on provisions to its work plan which may result in an alignment of the IAS 37 liability definition and supporting guidance with that in the 2018 *Conceptual Framework*. However, it would take some time to amend IAS 37 and during that time the IASB would not be able to withdraw the 1989 *Framework* as the

reference in paragraph 11 of IFRS 3 to the *Conceptual Framework* could not be updated without resulting in unintended consequences. Accordingly, there would have to be two conceptual frameworks in issue (for some time) and EFRAG would therefore not support such an approach.

13 The solution mentioned in paragraph 11(b) would only introduce the improvement for the relevant duties and responsibilities that are transferred to an entity as part of a business combination. This would result in some duties and responsibilities being accounted for differently depending on whether they are assumed in a business combination or not. In the first case they could be identified as liabilities while they would not be so in the latter case. This would reduce comparability. Nevertheless, it would result in more relevant information for the obligations assumed in a business combination. Because relevance is a fundamental qualitative characteristics and comparability is "only" an enhancing qualitative characteristics, EFRAG assesses that the solution mentioned in paragraph 11(b) would result in more useful information.

14 However, the Basis for Conclusions accompanying the ED notes that an approach such as the one described in paragraph 11(b) would require more time and resources than the approach suggested in the ED. It also notes that there may be calls for further requirements to help entities apply the new liability definition and supporting concepts consistently.

15 EFRAG agrees that there may be calls for further requirements to help entities apply the new liability definition and supporting concepts consistently. EFRAG has thus observed that the guidance supporting the definition of a liability in the 2018 *Conceptual Framework* is interpreted differently. In order to avoid divergence in practice and unnecessary discussions in the future on how to interpret the guidance, it would be necessary for the IASB to clarify the guidance. This could take time and the solution mentioned in paragraph 11(b) would therefore in the short term result in the objective mentioned in paragraph 5(a) not being met.

16 EFRAG therefore assesses that it would not be possible in the short term to meet both objectives stated in paragraph 5 above. That is, it would not be possible to both update the reference in IFRS 3 in a manner that would not result in a day 2 gain and have liabilities being identified when an entity has no practical ability to avoid the future transfer.

17 EFRAG accordingly considers that in the short term it would only be possible to update the reference in IFRS 3 in a manner that would not result in any (new) unintended consequences. EFRAG assesses that the proposals in the ED would meet that objective, and EFRAG therefore agrees with the proposals.

Adding an explicit statement that an acquirer should not recognise contingent assets acquired in a business combination

18 EFRAG supports adding an explicit statement that an acquirer should not recognise contingent assets acquired in a business combination. Such a statement could clarify the Standard and hence prevent potential diversity in practice.

Question 2

Do you have any other comments on the proposals in this Exposure Draft?

EFRAG's response

EFRAG supports that the amendments should be applied prospectively.

19 The IASB states in paragraph BC35 of the Basis for Conclusions of the ED that it does not expect the amendments to change significantly the population of assets

and liabilities recognised in a business combination. EFRAG therefore assesses that the amendments are close to being of editorial nature. Although EFRAG normally favours retrospective application, it therefore agrees with paragraph BC35 of the ED that the costs preparers of financial statements would have to incur to apply the amendments retrospectively, even if only to prove that no material adjustments were required, would not be justified.