Business combinations: Post-acquisition payments to sellers

The IFRIC issued an agenda decision on the accounting treatment of payments to the sellers of a business that are contingent on their continued involvement. The decision is consistent with previous guidance. The question, however, highlights some of the complexities that may arise from these types of payments.

IFRS 3 Business Combinations ('IFRS 3') governs how entities account for the acquisition of businesses. One element of this is identifying the consideration paid for the acquired business. The IFRS Interpretations Committee ('IFRIC') recently issued a decision on the accounting treatment of payments made to sellers of a business. This article briefly considers the agenda decision.

Nature of the post-acquisition payments

The IFRIC considered whether payments to the sellers contingent on employment should be accounted for as part of the acquisition cost or post-combination employee compensation expenses. The payments in question are contingent on the sellers' continued employment during a post-acquisition handover period, except in circumstances such as death or disability. The sellers' continued involvement facilitated knowledge transfer. The sellers' compensation was at the same level as other management executives.

Analysis

The IFRIC staff referred to existing guidance under IFRS 3. In particular, they considered a 2013 agenda decision. This guidance suggests that such payments are employee compensation rather than additional consideration for the acquisition. The key criterion for this classification is whether the payments are contingent on the sellers remaining employed. If so, such charges typically represent remuneration for post-combination services and, therefore, expensed. The staff found minimal diversity in how entities applied this guidance globally.

Despite the general agreement, some stakeholders raised concerns that this accounting treatment may not always reflect the true economic substance of the transaction. Treating all such payments as employee compensation could overlook scenarios where part of the payment may represent additional consideration for the business itself, particularly in complex acquisitions involving strategic handovers of crucial knowledge or relationships. They suggested a more nuanced approach. This would entail a split between compensation for services and consideration for the business to capture the economic reality of certain transactions better. However, this would require revisiting the conclusive language in IFRS 3, specifically paragraph B55(a). This paragraph currently conclusively states that such payments should be treated as remuneration if forfeiture occurs upon termination of employment.

Agenda decision

The IFRIC concluded that the existing guidance remains unchanged. The payments should be expensed unless the service condition is not substantive. The committee acknowledged the concerns about economic substance but concluded that the existing rules, in most cases, adequately reflect the nature of these transactions. While this decision does not change any existing guidance, it highlights some of the complexities, especially around substance, that one may encounter when considering arrangements between parties to the sale of a business.

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