September 10th 2019

International Accounting Standards Board

7 Westferry Circus

Canary Wharf

London E14 4HD

United Kingdom

Dear IASB members,

<u>Exposure Draft ED/2019/3 – *Reference to the Conceptual Framework* – Proposed amendments to IFRS 3</u>

The Israel Accounting Standard Board welcomes the opportunity to comment on the IASB's Exposure Draft, ED/2019/3, *Reference to the Conceptual Framework* – Proposed amendments to IFRS 3. This letter sets out the views that were raised in the Israel Accounting Standards Board's discussion.

Please find below our detailed comment for the question raised in the ED:

Question 1
The Board 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? Paragraphs BC21-BC29 describe alternative approaches considered by the Board and explain why the Board is not proposing them.

We agree with the Board's proposals. However, we believe that an additional amendment is required. We would mention that the amendment is not a consequence of replacing the reference to the 1989 Framework with a reference to the 2018 Conceptual Framework, but that the amendment would also prevent day 2 gains/losses on liabilities in the scope of IAS 37.

The Board proposes an exception to the recognition principle in IFRS 3, but not an exception to the measurement principle of <u>provisions</u> which is also necessary to prevent day 2 gains/losses on liabilities in the scope of IAS 37.

According to paragraph 10 of IFRS 3, the acquirer shall recognise the identifiable assets acquired and liabilities assumed as of the acquisition date. According to paragraph 15 of IFRS 3 the acquirer shall measure the identifiable assets acquired and liabilities assumed at their acquisition-date fair values.

The exception proposed by the Board excludes provisions and contingent liabilities from the recognition principle, but paragraph 56 of IFRS 3 refers only to the subsequent measurement of contingent liabilities and not to the subsequent measurement of provisions. As a consequence, liabilities within the scope of IAS 37 would be recognised on the acquisition date and measured at their acquisition-date fair value (the liabilities meet the recognition criteria). Subsequently, in the absence of any other provision, these liabilities would be measured in accordance with IAS 37. Since IAS 37's measurement model is not fair value, day 2 gain or loss would arise at subsequent measurement of these liabilities.

For example, assume there is a lawsuit against the acquiree and the recognition criteria in paragraph 14 of IAS 37 for provisions are met. The acquiree estimates that there is a probability of 70% that it would be required to pay 1,000 CU. According to IAS 37, the acquiree would measure the provision at 1,000 CU. However, the acquirer would measure the provision at its fair value (approximately 700 CU) on the acquisition date. Subsequently, the acquirer would measure that provision in accordance with IAS 37, since paragraph 56 of

IFRS 3 does not apply to provisions (applies only to contingent liabilities). Assuming the best estimate remains 1,000 CU, a day 2 loss would be recognised by the acquirer.

Although this additional amendment is not a consequence of replacing the reference to the 1989 Framework with a reference to the 2018 Conceptual Framework, we believe that the Board should also address the above-mentioned issue in order to prevent day 2 loss/gain.

We appreciate the opportunity to provide our comments.

Sincerely,

Dov Sapir, CPA, Chairman

Israel Accounting Standards Board