ED/2016/1 Definition of a Business and Accounting for Previously Held Interests

ICAEW welcomes the opportunity to comment on the ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests*, published by the IASB on 28 June 2016, a copy of which is available from this link.

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MAJOR POINTS

We would prefer a principles-based approach to distinguishing between business combinations and asset purchases

1. We are supportive of the board's efforts to provide clarity in this area as under current guidance it can be difficult to distinguish between a business and a group of assets, which can result in entities accounting for similar transactions in markedly different ways. We are, however, concerned that the board is proposing what appears to be a rules-based approach to determining whether or not what is being acquired is or is not a business.

2. While in many cases the proposed 'asset concentration' test will help to identify transactions which are asset purchases rather than business combinations, we are concerned that as currently drafted it may – in some instances – result in inappropriate conclusions being drawn. We believe that this test should not be a hard and fast rule and that rather than having primacy it should be just one of many factors that should be considered when determining whether or not a business exists.

3. However, as the 'substantially all' threshold is likely to provide the 'right' answer in the majority of cases, it could – perhaps – be retained as a 'rebuttable presumption' that can only be overcome where there is clear evidence that what is being acquired is, in fact, a business. This would be a better solution as it is more principles-based and allows preparers to exercise their professional judgement.

Some of the illustrative examples could be clearer

4. We appreciate the board's efforts to give practical examples of how to assess whether or not what is being acquired meets the definition of a business. However, while many of the examples provided are helpful, others could be clearer.

5. We are particularly concerned about example D. It is difficult to support the conclusion that the set of activities and assets purchased is not a business just because the facility is temporarily closed down. Although the facility is 'not currently producing outputs' it nonetheless presumably retains 'the ability to contribute to the creation of outputs' as it seems that it could be reopened at any time. Moreover, we are concerned that the conclusion reached in this example could encourage entities to arrange for a temporary shutdown of soon to be acquired facilities immediately before concluding the acquisition in order to ensure that the transaction is accounted for as an asset purchase rather than a business combination.

Every effort should be made to find a common solution

6. It is pleasing to note that the IASB and the FASB have reached the same tentative conclusions on how to clarify and amend the definition of a business. However, it is disappointing that the two boards have been unable to agree on the same wording. If the intention is that the same principles should be applied and same conclusions reached then it is essential that – wherever possible – the same wording is used in both standards. We encourage the boards to make every effort to find a common solution.

A fundamental review of accounting for changes in stake is needed

7. Although we agree with the proposed amendments to paragraph 42A to IFRS 3 and paragraph B33C of IFRS 11, we are concerned that the board is adopting something of a piecemeal approach to updating its guidance on changes in stake. In our view, the whole area of how to account for such transactions needs addressing more fundamentally.

RESPONSES TO SPECIFIC QUESTIONS

Question 1

Do you agree that the IASB should seek to address these concerns? Why or why not?

The Board is proposing to amend IFRS 3 to clarify the guidance on the definition of a business (see paragraphs B7–B12C and BC5–BC31). Do you agree with these proposed amendments to IFRS 3?

In particular, do you agree with the Board's conclusion that if substantially all the fair value of the gross assets acquired (ie the identifiable assets and non-identifiable assets) is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of activities and assets is not a business (see paragraphs B11A–B11C)?

Why or why not? If not, what alternative would you propose, if any, and why?

8. We are supportive of the board's efforts to provide clarity in this area as under current guidance it can be difficult to distinguish between a business and a group of assets, which can result in entities accounting for similar transactions in markedly different ways. Having said that, we do have some concerns about some elements of the board's proposals, which are not always clearly drafted or easy to understand.

9. In particular, we are uncomfortable with the 'asset concentration' test proposed in paragraph B8A and expanded upon in paragraphs B11A-B11C. While in many cases this 'filtering' test will help to identify asset purchases, it may as currently drafted – in some instances – result in inappropriate conclusions being drawn.

10. For example, substantially all of the fair value of an acquired set of activities and assets previously held by an entity that invests in property may be concentrated in a single asset or group of similar assets but that alone does not necessarily mean that what is being acquired is not a business ie, the set of activities and assets acquired may well come with inputs and substantive processes that together contribute to the ability to create outputs even though much of its value is concentrated in a single asset or a group of similar assets.

11. While examples H and I seek to illustrate the thought processes that should be applied when addressing acquisitions involving investment properties, there is unfortunately still room for doubt and confusion. It is unclear whether what is being acquired in the scenario described in example I would or would not be considered to be a business if 90% or more of the value of the purchased set of activities and assets was concentrated in the office buildings acquired. As many would consider this to be 'substantially all' of the value they may conclude that the acquisition should be treated as an asset purchase even though all the other evidence points to this being the acquisition of a business.

12. Similar situations may arise, for example, where much of a business's value is concentrated in a small number of established trademarks or in high value parcels of land containing minerals or other natural resources. Again, the concentration in value does not in itself necessarily mean that what is being acquired is not a business.

13. We therefore urge the board to reconsider what appears to be a rules-based approach to determining whether or not what is being acquired is or is not a business. That is not to say that the 'filtering' test and the proposed 'substantially all' threshold do not have some value. However, we believe that it should not be a hard and fast rule and that rather than having primacy this test should be just one of many factors that should be considered when determining whether or not a business exists. Ultimately determining whether what is being acquired is or isn't a business will always be – and should always be – a matter of judgement.

14. As the 'substantially all' threshold is likely to provide the 'right' answer in the majority of cases, it could – perhaps – be retained as a 'rebuttable presumption' that can only be overcome where there is clear evidence that what is being acquired is, in fact, a business. This would be a better solution as it is more principles-based and allows preparers to exercise their professional judgement.

15. We appreciate the board's efforts to give practical examples of how to assess whether or not what is being acquired meets the definition of a business. However, while many of the examples provided are helpful, others could be clearer.

16. We are particularly concerned with example D. It is difficult to support the conclusion that the set of activities and assets purchased is not a business just because the facility is temporarily closed down. Although the facility is 'not currently producing outputs' it nonetheless presumably retains the 'the ability to contribute to the creation of outputs' as it seems that it could be reopened at any time. Moreover, we are concerned that the conclusion reached in this example could encourage entities to arrange for a temporary shutdown of soon to be acquired facilities immediately before concluding the acquisition in order to ensure that the transaction is accounted for as an asset purchase rather than a business combination.

17. One consequence of the proposed amendments is that more transactions are likely to be accounted for as asset purchases. There is, however, little guidance on how to account for such transactions. The board may find that although it has 'fixed' one problem, in doing so it has only succeeded in throwing the spotlight on another one. A more holistic approach is, perhaps, needed.

Question 2

The Board and the FASB reached substantially converged tentative conclusions on how to clarify and amend the definition of a business. However, the wording of the Board's proposals is not fully aligned with the FASB's proposals.

Do you have any comments regarding the differences in the proposals, including any differences in practice that could emerge as a result of the different wording?

18. It is pleasing to note that the IASB and the FASB have reached the same tentative conclusions on how to clarify and amend the definition of a business. However, it is disappointing that the two boards have been unable to agree on the same wording. If the intention is that the same principles should be applied and same conclusions reached then it is essential that – wherever possible – the same wording is used in both standards. We encourage the boards to make every effort to find a common solution.

Question 3

To address diversity of practice regarding acquisitions of interests in businesses that are joint operations, the Board is proposing to add paragraph 42A to IFRS 3 and amend paragraph B33C of IFRS 11 to clarify that:

(a) on obtaining control, an entity should remeasure previously held interests in the assets and liabilities of the joint operation in the manner described in paragraph 42 of IFRS 3; and

(b) on obtaining joint control, an entity should not remeasure previously held interests in the assets and liabilities of the joint operation.

Do you agree with these proposed amendments to IFRS 3 and IFRS 11? If not, what alternative would you propose, if any, and why?

19. We agree with the proposed amendments as they add clarity and should therefore reduce diversity in practice. However, as noted in paragraph 7 above, we believe that the whole area of accounting for changes in stake needs addressing more fundamentally.

Question 4

The Board is proposing the amendments to IFRS 3 and IFRS 11 to clarify the guidance on the definition of a business and the accounting for previously held interests be applied prospectively with early application permitted.

Do you agree with these proposed transition requirements? Why or why not?

20. We agree with the proposed transition requirements as the costs of requiring full retrospective application are likely to outweigh the benefits.