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Definition of a Business and Previously Held Interests

Proposed Comment Letter

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

9 November 2016

Dear Mr Hoogervorst,

Re: Exposure Draft ED/2016/01 *Definition of a Business and Accounting for Previously Held Interests*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on Exposure Draft ED/2016/01 *Definition of a Business and Accounting for Previously Held Interests*, issued by the IASB on 28 June 2016 (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 in the European Union and European Economic Area.

Definition of a business

EFRAG welcomes the IASB's efforts to provide clarity on the definition of a business, and to help distinguish between a business and a group of assets. The proposals respond to concerns expressed by many stakeholders that the definition in IFRS 3 *Business Combinations* is too broad and lacks guidance on what should not be considered a business. This has resulted in a number of acquisitions being treated as business combinations which, in the view of the preparers, should have been treated as 'asset acquisitions'.

EFRAG appreciates the difficulties in drafting a screening test that is easy to apply, addresses concerns that the existing definition of a business captures some asset acquisitions and reaches the appropriate conclusion in every possible set of facts and circumstances. However, we are concerned that, as currently drafted, the screening test may, in some instances, result in inappropriate conclusions. EFRAG believes that the screening test should be retained as a determinative assessment only if its relative simplicity can be maintained while avoiding inappropriate outcomes. Should the IASB decide to retain the screening test in the proposed form, we state a number of concerns that we believe should be addressed.

In respect of the proposed guidance on evaluating whether an acquired process is substantive, we agree with having two different sets of criteria depending on whether the set of activities and assets has outputs. However, we have some concerns about the

presence of goodwill as an indicator, the guidance on acquired contracts and the role of an organised workforce.

We agree that examples are important in illustrating the application of the principles in the proposed guidance. However, we recommend that the examples focus more on the areas of the guidance that require significant judgement and we provide detailed comments on the proposed illustrative examples.

Further, EFRAG encourages the IASB and the FASB to reach converged solutions on their respective proposed amendments and use similar wording wherever possible in order to avoid divergence in practice.

Finally, while welcoming the IASB's efforts to provide clarity, EFRAG also observes that the tension arising from the distinction between business combinations and asset acquisitions originates to a significant degree from differences in the accounting. EFRAG therefore recommends that in due course the IASB should analyse whether or not these accounting differences are justified by differences in the economic substance of the two classes of transaction.

Accounting for previously held interests

EFRAG supports the IASB's proposal to clarify the accounting for previously held interests in the assets and liabilities of a joint operation when an entity *obtains control* over a joint operation that meets the definition of a business. We agree that the proposal is consistent with the existing principles in IFRS 3. We also support the proposed accounting for previously held interests in respect to the transactions described in paragraph B33C of the ED on the amendments to IFRS 11 *Joint Arrangements*. However, we make some suggestions to improve the understandability of the proposed amendments to both Standards IFRS 3 and IFRS 11.

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 Isabel Batista, Vincent van Caloen or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

APPENDIX

Question 1

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 (i.e. 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?

EFRAG's response

EFRAG welcomes the IASB's efforts to provide clarity on the definition of a business, and to help distinguish between a business and a group of assets.

We agree that a business must include, at a minimum, an input and a substantive process that together contribute to the creation of outputs, and we support the proposed change to the definition of output.

We appreciate the difficulties in drafting a screening test that is easy to apply, addresses concerns that the existing definition of a business captures some asset acquisitions and reaches the appropriate conclusion in every possible set of facts and circumstances. However, we are concerned that, as currently drafted, the screening test may sometimes result in inappropriate conclusions. EFRAG believes that a determinative screening test should be retained if its relative simplicity can be maintained while avoiding inappropriate outcomes. If this cannot be accomplished, EFRAG recommends that the IASB consider ways to take pressure off the test – for example by changing it into either an indicator or a rebuttable presumption. We also suggest that a screening test should not be required when it is clearly evident that the acquired set meets the general definition of a business. Should the IASB decide to retain the screening test, we state a number of concerns that, in our view, need to be addressed.

We agree with having two different sets of criteria when evaluating whether an acquired process is substantive, depending on whether the acquired set of activities and assets has outputs. However, we have some concerns about the presence of goodwill as an indicator, the guidance on acquired contracts and the role of an organised workforce.

We provide a number of suggestions for improving the application of the proposals to the definition of a business. In particular, we suggest to make the diagram in paragraph B8A more comprehensive so that it clearly illustrates the various steps in the assessment process.

We recommend that the illustrative examples focus more on the areas of the guidance that require significant judgement and we provide detailed comments on the proposed illustrative examples.

Finally, we observe that the tension arising from the distinction between business combinations and asset acquisitions originates to a significant degree from differences in the accounting. In EFRAG's opinion, further consideration should be given by the IASB to whether these accounting differences are appropriate.

- 1 EFRAG's response is structured into four sections:
 - (a) a business consists of inputs and processes applied to those inputs that have the ability to contribute to the creation of outputs;
 - (b) the proposed assessment of concentration of fair value (screening test);
 - (c) evaluating whether an acquired process is substantive;
 - (d) the illustrative examples; and
 - (e) differences in the accounting for business combinations and asset acquisitions.

A business consists of inputs and processes that contribute to creating outputs

- 2 EFRAG agrees that a business must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs. We consider that these minimum requirements provide a helpful framework to help entities distinguish between an asset acquisition and a business combination. Absent these minimum requirements, the definition of a business would be so broad as to potentially include many transactions that economically are more in the nature of asset acquisitions.
- 3 EFRAG supports the proposed change to the definition of outputs to narrow the definition to focus on goods and services provided to customers. In our view, it is not always clear what the current definition of outputs in IFRS 3 represents.
- 4 The proposed definition of outputs is “the result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest) or other revenues”. This definition excludes returns in the form of lower costs and other economic benefits provided directly to investors or other owners, members or participants and defines output.
- 5 We understand that the reason for including ‘other revenues’ is that not all entities have revenues that are within the scope of IFRS 15 *Revenue from Contracts with Customers*. However, EFRAG is concerned that the term may be interpreted more broadly than intended and/or interpreted in different ways. We therefore recommend that the IASB clarify in paragraph 7(c) or in the Basis for Conclusions what is intended to be included in ‘other revenues’. We recognise that paragraph BC17 refers to circumstances where the output of the entity is sold to ‘internal’ customers (that is, other entities in the same group) in cases when an acquirer buys a supplier and subsequently consumes all the output from the supplier, which may indicate that ‘other revenues’ include intra-group revenue. We recommend that this be made clearer as other activities may also generate revenues outside the scope of IFRS 15, such as activities in the scope of IFRS 16 *Leases* or IFRS 4 *Insurance Contracts*.
- 6 Furthermore, EFRAG agrees with the deletion in paragraph B8 of IFRS 3 of the reference to the ‘market participant’s capability’ of replacing missing elements by integrating the acquired set of activities and assets into its own and continuing to produce outputs. We acknowledge that, as written, paragraph B8 is too broad. We support the IASB’s view that the assessment of whether an acquisition is a business should be based on what has been acquired, rather than whether some specific market participants could replace missing elements.
- 7 We note that the ED retains the reference to ‘market participant’ in paragraph B11 of IFRS 3. We understand this reference is to market participants in general. This is because it is used in the context of clarifying that, when assessing whether an acquired set of activities and assets is a business, it is not relevant whether the specific seller operated the set as a business or whether the specific acquirer intends to do so.

- 8 However, we understand that some may interpret the wording 'by a market participant' in paragraph B11 to be inconsistent with a definition of a business that focuses on the 'ability to contribute to the creation of outputs', irrespective of whether it is conducted or managed as a business by a particular market participant. We therefore suggest deleting the words 'by a market participant' in the first sentence of paragraph B11. This change would also highlight the importance of the fact-driven nature of this assessment, irrespective of the assessor's own circumstances (including those of a specific market participant).
- 9 Finally, we recommend the IASB to clarify whether an acquired 'integrated' set of assets and activities is intended to mean the same as an acquired set of assets and activities.

The proposed assessment of concentration of fair value (screening test)

- 10 The ED proposes a screening test designed to simplify the assessment of whether an acquired set of activities and assets constitutes a business. We understand that the proposal is intended as a first step in order to provide a practical solution that simplifies the assessment in some cases.
- 11 We appreciate the difficulties in drafting a practical solution that is easy to apply, addresses concerns that the existing definition of a business captures some asset acquisitions and reaches the appropriate conclusion in every possible set of facts and circumstances. However, we are concerned that a determinative screening test as currently drafted may in some instances result in inappropriate conclusions. In particular, we consider that there may be instances in which an acquired set meets the requirements of the screening test such that the transaction is treated as an asset purchase, even though other evidence indicates that the acquired set meets the definition of a business based on the general definition. In other words, the fair value of the acquired assets could be concentrated in a single asset (or group of similar assets) in some situations when the acquired set is nonetheless a business.
- 12 EFRAG believes that the screening test should be retained as a determinative assessment only if its relative simplicity can be maintained while avoiding inappropriate outcomes. If this cannot be accomplished, EFRAG recommends that the IASB consider ways to take pressure off the test – for example by changing it into either an indicator or a rebuttable presumption. EFRAG also suggests that the screening test should not be required in cases where it is clearly evident that the acquired set meets the general definition of a business.
- 13 Should the IASB decide to retain the screening test in its current form, we consider that the following concerns should be addressed in order to ensure that the test is operational and applied in a consistent manner:
 - (a) *Impact of deferred tax on the screening test:* EFRAG observes that when applying the screening test, the identifiable assets are those which would qualify for recognition in accordance with IFRS 3, and that paragraph 25 of IFRS 3 requires recognition of deferred tax assets and liabilities for temporary differences on the acquired assets and liabilities. In EFRAG's opinion the IASB should consider excluding the effects of deferred tax from the screening test, on the basis that the tax attributes of the acquired assets and liabilities should not influence the outcome of the test. Accordingly, in EFRAG's view the gross assets acquired should exclude deferred tax asset for the purpose of the screening test. Also, when calculating fair value of the acquired assets as the sum of the fair values of the consideration and the liabilities assumed, deferred tax liabilities should be excluded from the latter. We understand that the FASB has tentatively decided to exclude deferred tax effects from the calculation.

- (b) *Structure of the guidance on the screening test:* EFRAG believes that it is confusing to have the definition of fair value in paragraph B11A when this paragraph intends to explain when a transaction is not a business. We suggest moving this part of paragraph B11A to a separate paragraph. In addition, we consider it may improve the understandability of the guidance if the guidance on a single and similar identifiable asset(s) were to be moved under a subheading 'Single or similar identifiable asset(s)' and the guidance on determining the fair value of the gross assets under a subheading 'Fair value of gross assets'.
- (c) *Measurement of fair value of gross assets:* the ED presents the measurement of the fair value of the gross assets by adding the fair value of the liabilities acquired to the transaction price as one solution amongst others. We believe this solution is a pragmatic way to determine fair value, making the screening test a straightforward assessment. For the avoidance of doubt, we recommend the IASB to clarify whether they have other solutions in mind on how the fair value of gross assets could be determined.
- (d) *Similar identifiable assets:* The ED does not define the term 'similar', and only indicates in paragraph B11C assets that shall not be combined into a single identifiable asset or considered a group of similar identifiable assets. In order to ensure that the screening test is applied consistently, we recommend that the IASB articulate in a more principle-based manner when assets can be deemed similar for this purpose. This should clarify which factors play a role in the assessment (for example, that the nature, risks and characteristics of the assets should be similar) without broadening the scope of the proposed screening test. We understand that the FASB has tentatively decided to provide such a clarification.
- (e) *Interactions with existing guidance:* EFRAG recommends the IASB to explain the interactions with existing guidance, including the guidance on similar assets (paragraph 36 of IAS 38 *Intangible Assets*) and on the term 'class' (paragraphs 37 and 73 of IAS 16 *Property, Plant and Equipment*, 6 of IFRS 7 *Financial Instruments: Disclosures*, 119 of IAS 38).

Evaluating whether an acquired process is substantive

- 14 The proposed amendments include two different sets of criteria in determining whether a substantive process has been acquired, depending on whether the acquired set of activities and assets has outputs. We comment below on three issues:
- (a) the role of an organised workforce;
 - (b) different sets of indicators; and
 - (c) goodwill as an indicator of an acquired substantive process.

The role of an organised workforce (including acquired contracts)

- 15 EFRAG understands that different sets of criteria are proposed because more persuasive evidence is required when the acquired set of activities and assets has no outputs. In such cases, the acquired set is a business only if it includes both (i) an organised workforce that performs a process that is critical to the creation of outputs; and (ii) another input (or inputs) that is (are) intended to be developed into outputs.
- 16 We understand that the guidance in paragraph B12A implies that if an acquired set of assets and activities has no outputs, the absence of an organised workforce would mean that the set cannot meet the definition of a business. Accordingly, the absence of an organised workforce seems decisive in these cases. For the avoidance of doubt, we recommend that the IASB includes a paragraph in the

section on the definition of a business (paragraphs B7-B10) that addresses the concept of an organised workforce and clarifies that if an acquired set of assets and activities has no outputs, the absence of an organised workforce would mean that the set cannot meet the definition of a business under paragraphs B7 and B8 of the ED. In addition, in order to mitigate the room for structuring opportunities, we also recommend the IASB to consider whether amendments are needed to the guidance on determining what forms part of the business combination transaction (paragraph B50 of IFRS 3).

- 17 In contrast, if the set has outputs, the guidance in paragraph B12B (a) implies that an organised workforce is not required if the set includes a process (or processes) that is (are) unique or scarce or cannot be replaced without significant cost, effort or delay in the ability to continue to produce outputs.
- 18 We note that the relevance to the assessment of the presence or absence of an organised workforce as a criterion could become increasingly less determinative as the trend towards automation of certain business processes continues. We therefore believe this aspect of the guidance might need to be revisited in due course. Nonetheless, we consider this aspect of the guidance to be appropriate and helpful for the time being.
- 19 Finally, EFRAG welcomes the introduction of guidance provided in paragraph B12C of the ED on how to determine whether an acquired set of activities and assets is a business, in cases when an acquired contract gives access to an organised workforce. However, EFRAG understands that this is a difficult area of judgement, where diversity in practice is observed and we are concerned that the guidance may not be sufficient to allow entities to exercise their judgement. EFRAG therefore recommends the IASB to provide additional guidance to help entities assess whether an acquired contract gives access to an organised workforce.

Different sets of indicators

- 20 More generally, we agree that having different sets of indicators is helpful when evaluating whether an acquired process is substantive. We also consider the criteria to be appropriate indicators that a substantive process has been acquired, in cases when the acquired set of activities and assets has outputs and when it does not.
- 21 In particular, we consider that it is helpful to have a set of criteria to assess a substantive process when an acquired set of activities and assets has no outputs on the grounds that these cases have generally proved to be more problematic under existing guidance. Notwithstanding the above, EFRAG acknowledges that the use of output as a distinguishing factor may appear to be inconsistent with the guidance in paragraphs B7 and B8, which does not require the presence of output in order to meet the definition of a business. EFRAG recommends the IASB to address this comment in the Basis for Conclusions of the ED.
- 22 To determine which set of criteria should be used, paragraphs B12A and B12B of the ED refer to the presence of outputs at the acquisition date. However, paragraph BC17 of the ED refers to the capability of generating outputs. We understand this difference to be intentional in that paragraphs B12A and B12B are referring to the presence or absence of actual outputs at the acquisition date. However, to mitigate any potential inconsistency, EFRAG recommends that the IASB reviews paragraph BC17 of the ED to ensure that there is no confusion on the meaning of 'has outputs' when determining which set of criteria should be applied.

Goodwill as an indicator of an acquired substantive process

- 23 EFRAG also agrees that the presence of more than an insignificant amount of goodwill may indicate that an acquired process is substantive. However, we consider that the discussion of the presence of goodwill may cause confusion if considered as a separate indicator in addition to the two sets of indicators. It could

also lead to a counterintuitive outcome, for example when the presence of goodwill arises primarily from deferred tax liabilities. EFRAG therefore recommends that the first two sentences of paragraph B12 are moved to the Basis for Conclusions.

Illustrative examples

- 24 EFRAG considers that examples are helpful to illustrate the application of the proposed guidance. However, we also consider that the examples should focus more on the areas of the guidance where significant judgement is required.
- 25 In addition, in EFRAG's opinion, some of the proposed examples do not clearly illustrate the application of the principles and may lead to confusion. We provide our detailed comments on the examples below.
- 26 Furthermore, EFRAG considers that the linkage between the guidance and the illustrative examples should be improved so that it is clearer which example is illustrating a particular part of the guidance. EFRAG therefore recommends that the IASB include a flowchart at the beginning of the section that highlights which parts of the guidance are illustrated by each of the examples.
- 27 Finally, EFRAG observes that the examples should clarify further the following areas of judgement when applying the indicators set out in paragraphs B12A and B12B of whether an acquired process is substantive:
- (a) Can processes be considered as "critical" if they can be easily sourced from market participants? Or should only "unique" processes that are critical to the ability to continue producing outputs be considered to be substantive?
 - (b) How many inputs and/or processes would have to be included in the set of activities and assets to constitute a business, since the replacement of missing elements is no longer needed?
 - (c) To what extent should the acquired set of activities and assets be "capable" of producing outputs? Should the output be comparable to the output generated by the acquiree prior to the acquisition? Should the output consist of similar goods and/or services?
 - (d) Should the assessment of the organised workforce limit its focus on the criticality of the individuals which cannot be easily replaced or should it be performed on the complete organised workforce (including those that are easily replaceable).
- 28 In EFRAG's view, some of the proposed examples are confusing in the sense that they do not always clearly illustrate how the proposed requirements should be applied, or they illustrate that the proposed guidance is not sufficiently clear, as in some cases a different conclusion would be reached. This is primarily the case in relation to the examples in relation to the screening test and the application of the criteria for determining whether a process is substantive.
- 29 In particular, should the IASB retain the screening test as currently drafted, we have the following suggestions to improve the understanding and application of the screening test.
- (a) Example A (Acquisition of single family homes): It is unclear which factors should be considered to determine whether a group of assets is similar. Example H refers to a broad class of tangible assets (any 'office building', therefore irrespective of age, lease term, location or nature of the office space), whilst example A refers to similar characteristics ('all single-family homes', therefore referring to a specific category of residential homes).
 - (b) Example E (Acquisition of a biotech entity): EFRAG understands that in the pharmaceutical industry, biotech acquisitions can be performed with no significant tangible fixed assets being transferred. Therefore, the acquisition

of a set of activities and assets can encompass the transfer of a R&D team and a single asset (or combination of similar assets / drug candidates). We question whether applying the screening test to this type of transaction would permit accounting for the acquisition as a business combination, even though the transfer of the R&D team is key to complete successfully the development, and therefore would be considered as an acquired substantive process.

- (c) Examples H and I (Acquisition of investment properties): We refer to our comment on example A in relation to the application of the concept of similar identifiable assets. The example (in paragraph IE99) implies that the entity has measured the value of its organised workforce and has concluded that there is significant fair value associated with the acquired workforce. This seems inconsistent with the last sentence of paragraph B11A, which implies that this is not required in order to apply the proposed screening test. In addition, in our view, it would be helpful to further explain the importance of the fact that employees are being transferred in the context of this activity (leasing of buildings).

Finally, we note that having a large difference between examples H and I because of the workforce may seem artificial because, in relation to this type of transactions, we understand that the majority of the value of the acquired set of activities and assets lies in the properties, not in the value of the employees and the processes. It would be more helpful to provide examples of borderline cases between what constitutes and what does not constitute a business (for example when applied to sets of activities and assets where the organised workforce is provided through outsourcing contracts).

30 Furthermore, we think that the examples that illustrate the application of the criteria for determining whether a process is substantive, in particular the role of the workforce, could be improved in relation to the following:

- (a) Example B (Acquisition of a drug candidate): Example B refers to an in-process research and development project. In our view the reasons should be further articulated for not considering separately the existence of the outsourcing contracts, the know-how, formula protocols, designs and procedures which could be considered as substantive processes.
- (b) Example C (Acquisition of a television station): Example C refers to an acquisition of a television station but states that the set of activities and assets does not have outputs. In our view, the mere fact that it is a television station could imply the presence of some form of output such as transmission of content. We recommend that the title of the example is changed to acquisition of 'broadcasting assets' to avoid confusion.
- (c) Example D (Acquisition of a closed-down manufacturing facility): The example concludes that the transaction is not a business relying on the fact that although the transaction includes the transfer of an organised workforce, it does not include any other acquired input that the workforce could convert into outputs. EFRAG considers that the facts and circumstances presented in the example are not sufficiently detailed to be able to conclude. For example, would the conclusion be different if some raw material inventories were transferred together with the facility? We also believe that the IASB should clarify how the conclusion interacts with the principle in paragraph B8 that a business need not include all of the inputs or processes that the seller used in operating that business.

EFRAG also observes that the analysis in the example appears to contradict the guidance in paragraph BC17, which indicates that the assessment of a business must focus on "capable of generating outputs". Furthermore,

example D does not provide the basis for determining that there is an organised workforce. As the factory was closed down, employees no longer work in the facility. One interpretation could be that the acquirer hires former employees on an individual basis.

- (d) Example J (Acquisition of oil and gas operations): The analysis in example J concludes that the transaction is a business. This may appear to be inconsistent with the strict definition of a process as mentioned in paragraph B7 of the ED, as the definition does not specify that a specific asset can in some instances become or be integrated in a substantive process. Assets are only described as inputs.
- (e) Example K (Acquisition of mortgage loan portfolio): It is unclear why the acquirer in example K is paying a significant amount to acquire an organised workforce that does not seem to be involved in the development of new business.

Differences in the accounting for business combinations and asset acquisitions

- 31 EFRAG notes that the tension arising from the distinction between business combinations and asset acquisitions originates to a significant degree from differences in the accounting for business combinations and asset acquisitions. Some of the more important areas of difference include acquisition expenses, contingent consideration and deferred taxes. In EFRAG's opinion, further consideration should be given in due course to whether these accounting differences are appropriate (i.e. whether or not these accounting differences are justified by differences in the economic substance of the two classes of transaction).
- 32 EFRAG however acknowledges that such a project (or projects) would require a considerable period of time to complete. EFRAG therefore supports proceeding with clarifying the definition of a business and supporting guidance in the meantime.

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?

EFRAG's response

EFRAG encourages the IASB and the FASB to reach converged solutions on their respective proposed amendments and use similar wording wherever possible in order to avoid divergence in practice.

- 33 EFRAG understands that the IASB's proposed amendments to IFRS 3 and the FASB's Proposed Accounting Standards Update *Clarifying the Definition of a Business* are based on substantially converged tentative conclusions.
- 34 We also understand that the objective of FASB's Proposed Accounting Standards Update was to narrow the application of the definition of a business in US GAAP so that practice under US GAAP and IFRS may be more closely aligned. However, we acknowledge that the FASB has already considered the comments received on its proposals and made tentative decisions on how to address them. This may limit the possibility of the FASB making substantive changes in order to align with the IASB's tentative decisions.

- 35 Notwithstanding the above, EFRAG wishes to highlight the potential differences that may arise between the IASB's proposed amendments and the FASB's Proposed Accounting Standards Update due to the FASB's tentative decisions to amend their proposals in order to address the comments the FASB received on its proposals.
- 36 We encourage the IASB and the FASB to reach converged solutions on their respective proposed amendments and use similar wording wherever possible in order to avoid divergence in practice.

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?

EFRAG's response

EFRAG agrees with the proposed amendments. We make some suggestions to improve the understandability of the proposed guidance.

- 37 EFRAG supports the IASB's proposal to clarify the accounting for previously held interests in the assets and liabilities of a joint operation when an entity *obtains control* over a joint operation that meets the definition of a business. We agree that the proposal is consistent with the existing principles in IFRS 3.
- 38 However, to improve the clarity of the guidance, we recommend to clarify directly in paragraph 42A of IFRS 3, rather than in the Basis for Conclusions, that the remeasurement applies to the investor's previously held interests in the individual assets and liabilities of the joint operation.
- 39 We also support the proposed accounting for previously held interests in respect to the transactions described in paragraph B33C of the ED (amendments to IFRS 11). We agree that the proposals are consistent with existing principles that no remeasurement of a previously held interest is required when the underlying transaction does not result in a change in the group boundaries or the method of accounting for previously held interests in the joint operation.
- 40 We also agree that the proposal to amend paragraph B33C of IFRS 11 is consistent with the principle in paragraph 24 of IAS 28 *Investments in Associates and Joint Ventures*. This states that when an investment in an associate becomes an investment in a joint venture (or vice versa), the entity does not remeasure the previously held interest because the entity continues to apply the equity method before and after the transaction.
- 41 We observe that paragraph BC3 of the Basis for Conclusions on the *Proposed Amendment to IFRS 11* could imply a wider scope than the proposed change to paragraph B33C. Paragraph BC3 refers to cases when "an investor obtains joint control of a business that is a joint operation". We believe the proposals intend to capture only transactions for which the previously held interests were accounted for under IFRS 11 both before and after the transaction (in other words, cases in which the reporting entity was previously a party to the joint operation in question and had

rights to the assets, and obligations for the liabilities, relating to the joint operation). We therefore recommend that the IASB reviews paragraph BC3 and clarifies this wording if necessary.

- 42 EFRAG also recommends that the IASB include in the Basis for Conclusions the more comprehensive analysis that the IFRS Interpretations Committee performed to identify those transactions for which the guidance needed to be improved, in order to improve the understandability of the guidance and to address the concern that the proposed amendments may seem to address only a part of the issues related to remeasuring previously held interests.

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?

EFRAG's response

EFRAG agrees with the proposed transition requirements.

- 43 EFRAG generally supports retrospective application of new, or amendments to existing, Standards and Interpretations.
- 44 However, in this case, EFRAG agrees that the proposals should be applied prospectively (on or after the effective date of the amendments) as the costs for preparers of retrospective application are expected to outweigh the benefits to users in the way of decision-useful information.