Hans Hoogervorst, Chairman
International Accounting Standards Board
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Paris, 3 november 2016

Ref: Exposure Draft ED/2016/1 Definition of a Business and Accounting for Previously Held Interests Proposed amendments to IFRS 3 and IFRS 11

Dear Mr Hoogervorst,

ENGIE appreciates the opportunity to comment on the proposed Exposure Draft ("ED") "Definition of a Business and Accounting for Previously Held Interests".

We regret that the ED does only address the definition of a business. We are indeed concerned that there are differences between the accounting for a business versus an asset. The models are currently not identical on several areas including goodwill, contingent consideration, direct acquisition costs, deferred taxes. We believe that those differences do not rely on strong conceptual basis (we refer to the Engie Comment Letter we have sent earlier on the IFRS 3 PIR).

When referring specifically to the ED, we believe that the guidance does not sufficiently help to determine whether a transaction is a business or an asset acquisition (see our example page 4).

While the expectations are that the proposed ED will lead to less acquisitions being classified as business acquisitions, we are concerned that it will also result in an increased diversity in accounting for asset acquisitions, due to the lack of clear guidance thereon (see our example page 4).

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Finally, we do not support the piecemeal changes approach undertaken on the topic. The accounting approach for joint operations (both purchases and sales of interests, that do constitute or not businesses) should rather be performed through a revision of IFRS 11, the necessity of which could be highlighted during the upcoming IFRS 11 PIR. This is important as we believe the features of a joint operation are quite specific and we question whether, for example, accounting for business under IFRS 3 best depicts the intrinsic nature of joint operations in case the latter is a business (which is also questionable).

Please do not hesitate to contact us if you require any further information about our comments and proposed example.
Best regards

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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 (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?*

Definition of a business
Overall, we agree with the proposed amendments to the definition of a business and mainly with the Board's proposal:

- to revise the definition of outputs to focus on goods and services provided to customers,
- to remove the statement that a set of activities and assets is a business if market participants can replace the missing elements and continue to produce outputs.

We would insist on the need that, for being considered as a business, an acquired set of assets must include an input and a process, that should be substantive, that together have the ability to contribute to the creation of output. The existence of a **substantive** process should be added throughout paragraph B7, and wherever relevant thereafter, with an appropriate definition of what is considered as a substantive process. We believe that clear examples should be added to distinguish processes that are substantive or not, highlighting also which facts and circumstances in these examples are used to reach the conclusion. We agree with the conclusion of example J "Acquisition of oil and gas operations", but it would be helpful to specifically identify the operational processes related to extracting and transporting oil and gas. We are nevertheless concerned that the replacement of those processes would require replacement of the equipment and infrastructure, while these are generally viewed as inputs and not processes.

Assessment of the concentration of fair value (concentration test)
We generally agree that adding the proposed screening (assessment of concentrated fair value) would provide a practical indicator to determine whether some sets of assets do not constitute a business.
However, the overall approach seems quite "checklist-based" and the result of the concentration test is conclusive. To support a principle-based approach, we believe that this test should rather be considered as one indicator amongst others and could therefore be mitigated with other elements, such as the existence of a substantive process acquired.

Importance of the workforce in the analysis
The Board believes that it will be possible, only in some limited circumstances, to conclude that the set of activities and assets is a business when an organised workforce is not acquired (BC26).
In particular, an organised workforce able to perform a process is :

- required if outputs are not present (B12A),
- one factor if outputs are present (B12B).

According to the Board, an acquired contract is not a substantive process. But it confirms that the organised workforce could be outsourced through a contractual agreement (B12C).
It is difficult to rationalise the proposed guidance and it would be helpful to add some further explanations to the BC and to bring them into the body of the standard to ensure a proper understanding. Indeed, there may be some situations where the outsourced process / contracts are sufficiently key and substantive to provide evidence that, together with inputs, the acquisition is a business acquisition rather than an asset acquisition.

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Purchase/ Sale of a subsidiary which does not contain a business.
Paragraph 2(b) of IFRS 3 makes clear that the acquisition of an asset is not in the scope of IFRS 3 and provides limited reference to how to account for such transactions. While it is expected that the proposed ED will lead to less acquisitions being classified as business acquisitions, we are concerned that few practical guidance exist for these transactions and this may lead to a diversity in practice. The areas of concerns mainly relate to the following: recognition of an "overpayment" allocated to identifiable assets (as no goodwill is recognized) that could increase the risk of an immediate depreciation, presentation of the purchase price in the statement of cashflows, presentation of the other acquired elements (intangible assets, cash, debt....)....

Additional guidance on sales transactions should also be considered. Examples of issues are the following when having to recognize the loss of control of an entity that is not a business (i.e. being considered as a sale of an asset):

- how to measure the gains/losses at derecognition: (i) does it include a revaluation of retained interests (accounting approach in accordance with IFRS 10) or (ii) does it only include the result on the portion effectively sold (accounting approach in accordance with IAS 16/IAS 38 or similarly to the accounting treatment of a contribution of a non-monetary asset that is not a business in accordance with IAS 28)?
- how to account for the retained interest : (i) is it an instrument consolidated using the equity method of accounting under IAS 28 (and then, referring to the first issue, measured at fair value ?) or (ii) is it an asset that is the outcome of a proportionate "deconsolidation" of the initial asset measured at 100% (i.e. applying then a sort of proportional consolidation in accordance with IFRS 11)?

In short, we strongly believe that changing the definition of a business without having clear answers to these questions may lead to an increased diversity in the accounting of those transactions. Therefore, the point needs to be considered first before issuing a new definition of a business.

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?*

We understand that a feedback is requested from ASAF members on whether the wording differences between the IASB and FASB ED will lead to converged outcomes for the same transaction. When the outcome is different, a more detailed effect analysis should be undertaken and the reasons for having those differences should be further explained as they would probably have few conceptual grounds.

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?*

We do not support a piecemeal changes approach undertaken on joint operations. The accounting approach for joint operations (both purchases and sales of interests, that do constitute or not businesses) should rather be performed through a revision of IFRS 11, the necessity of which could be highlighted during the upcoming IFRS 11 PIR. This is important as we believe the features of a joint operation are quite specific and we question whether for example accounting for business under IFRS 3 depicts the best the intrinsic nature of joint operations in case the latter is a business (which is also questionable).

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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?*

We agree.

Other comments : Illustrative examples
The use of examples is important in illustrating the application of the principles in the proposed guidance. But the examples proposed by the ED are not specifying which fact(s) (or change in fact(s)) affect(s) the accounting outcome.

Appendix A

Context :
When the Group invests in renewable projects (like a solar farm), the structure is usually that a separate legal entity (SPV) is created for each of the projects undertaken. When the bid (e.g. auctions are organised) is won, the SPV develops the project (consisting in receiving land permits, grid connection…), finds external project financing (usually the project is financed on a non-recourse basis when a long-term sale contract is signed) and negotiates sale contracts with an offtaker. The construction of the farm is then done with an EPC (engineering, procurement and construction) contractor.
When the solar plant reaches the commercial operation date (i.e. at that date, the plant is running and generating cash flows), the Group usually sells a partial stake of the SPV and this transaction involves the loss of control of the Group over the SPV. The operation and maintenance remains being done by the Group or another supplier thereafter. They will only act on behalf and under the supervision of the SPV holding the asset.

Current treatment :
The SPV is considered as a business. Indeed, the existence of a sale contract with an offtaker (i.e. the assurance to obtain future cash flows) is one of the strong argument used to qualify the transaction as affecting a business. Using that business qualification, the loss of control generates a gain/loss on sale which is based on the equity stake effectively sold as well as on the remeasurement of the retained interest.

Applying the ED :
- ***1st step** : is all of the fair value of the gross asset acquired concentrated in a single identifiable asset ?*
Yes, the assets (solar farm + sale contract) are a single identifiable asset as they are not separable (usually in a price purchase allocation exercise, the value of the contract is subsumed into the value of the PP&E as the contract is inextricably linked to the PP&E). According to the proposal of the ED, the analysis would end there, concluding that the sale is a sale of an asset and not a sale of a business.
We think that this conclusion does not reflect the intrinsic substance of the transaction. The existence of a sale contract is a major element of the transaction. The deal would not be valued in a similar way if there was a sale contract or not. The fact of having the sale contract at a floating or a fixed price will also affect its fair value (and therefore the proposed price) since the risk inherent to the project is not identical in both cases.

➔ While the analysis would stop under the proposed ED, let's consider the other elements in the ED.

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- ***2nd step** : as the assets are generating outputs, do they include a substantive process, an organized workforce ?*
The SPV usually has no workforce or very few.
Regarding the processes relative to the operation and maintenance, it may be questioned whether they are to be considered as scarce or unique. We would not consider that they are according to the ED (. B12B (a)). We would then have to assess whether the sale contract is considered under the ED to be a substantive process.
The reading of the ED does not make the answer very clear:

- We understand from the proposed ED (B12C) that it is not one. It seems to be confirmed by example A where the building and in-place lease are considered as a single asset (IE75). Other companies having similar deals consider the contrary, they do not read B12C the same way.
- In the example J, the existence of processes (operational process in place) linked to the asset seems relevant to consider that the set of assets is a business.

Based on the above, we think that the ED should be clarified. We believe that sale contracts could constitute substantive processes and would then indicate that the acquisition is a business acquisition (cfr our example above). Furthermore, as we also said, should it not be the case, we would then be concerned that the accounting treatment of such partial sale is not clarified in IFRS (see page 3).