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IASB
30 Cannon Street
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October 28, 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,

We are pleased to take the opportunity to comment on the proposals of the document in reference (the ED). We think that the proposals in the ED are good step in the right direction, that is, towards a more pragmatic approach than that of the current IFRS 3 and which will, we hope, restrict the application of IFRS 3 to those transactions which are clearly business combinations.

Indeed, we would like to reiterate the view we stated in our response to the Post Implementation Review (PIR): "*we believe that such a standard which is so complex and expensive to implement should be restricted to transactions that significantly impact the business and the structure of a reporting entity. Today, however, because of the very broad definition of a business, especially since 2008 with the notion of "capable of", and the very literal interpretation of this standard made by some stakeholders, companies are forced to apply it to acquisitions that should be treated much more simply (e.g. an acquisition of property through a legal entity which is accompanied by a maintenance contract).*

Having said that, we believe that the Board should undertake further work to improve the following issues:

- Improve the definition of a substantive process and consider whether focusing so much on the presence of a workforce will always be relevant in an economic environment which is becoming more and more dematerialized.
- Compare accounting differences between the acquisition of a business and that of the purchase of an asset and then justify or eliminate some or all of them (see our "other comments");

- Clarify the accounting treatment that should be applied when an entity acquires or sells part or all of an individual asset(s) other than a business, directly or through participating interests in another entity (see our “other comments”);

We think that these aspects should be dealt with as soon as possible but their resolution must not delay or prevent the timely finalisation of the current proposals.

Our detailed comments and responses to the questions asked are laid out in the Appendix.

Please do not hesitate to contact us if you require any further information about our response.

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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 in particular, we agree with the focusing of the nature of "output" on revenues and the elimination of the references to elements missing from the transaction which could be provided by "market participants". We support the principle that the analysis should concentrate on what has actually been acquired and not consider how a hypothetical third party might deal with the activities and assets that have been purchased.

However, we note that the phrase "is capable of being conducted and managed as a business by a market participant" persists in paragraph B11 as the basis for the determination of whether a business exists. The Board argues in BC14 that this is necessary to ensure that the assessment continues to be a "fact-driven assessment". We agree that the assessment must be fact-driven but think the reference to the market participant is at odds with the proposed amendments and we think this paragraph should either be eliminated altogether or redrafted to reflect the new approach.

In addition, in order to create a consistent set of definitions and principles, we think that it would be helpful to rename the second element of a business as a "substantive process" rather than just a "process" throughout paragraph B7 and wherever relevant thereafter.

In a similar vein, we note that there is no proposal to amend the definition of a business included in Appendix A to IFRS 3. We assume that this definition will be modified to conform with the proposals once the Board has finalised the amendments.

Assessment of the concentration of fair value (concentration test)

First of all, we welcome the development of a concentration test which allows entities to assess and exclude rapidly straightforward instances of asset purchases which must not be dealt with within the scope of IFRS 3. We think that when the transaction is essentially aimed at the acquisition of an asset or group of assets the existence of a small number of ancillary contracts or the transfer of some personnel should not automatically lead this transaction to be treated as a business combination.

We have nonetheless some questions about how this assessment should be applied. It is important that it should not be difficult to implement or interpret in practice:

- Some might think that the performance of this assessment will require that a purchase price allocation be carried out, that is, identify and value at fair value all the elements acquired, including liabilities and non-controlling interests. In this case the sought-after simplification would not be achieved. It might be helpful if the IASB were to state that the objective is not to produce a proxy for the PPA, but rather to arrive at an estimation of the relative fair value of the assets or group of assets compared with the whole of the elements acquired, and that it is not necessary to calculate deferred taxes, for example. [This could be likened to the exercise required by paragraph 2(b) of IFRS 3 to allocate values in an asset purchase.] Although this assessment is a mandatory step, it would be a helpful simplification if the standard were to state that if it is clear without any detailed analysis that this test will not result in a determination that the transaction is an asset purchase, then it should be possible to proceed directly to the detailed evaluation required by paragraphs B12-B12C.

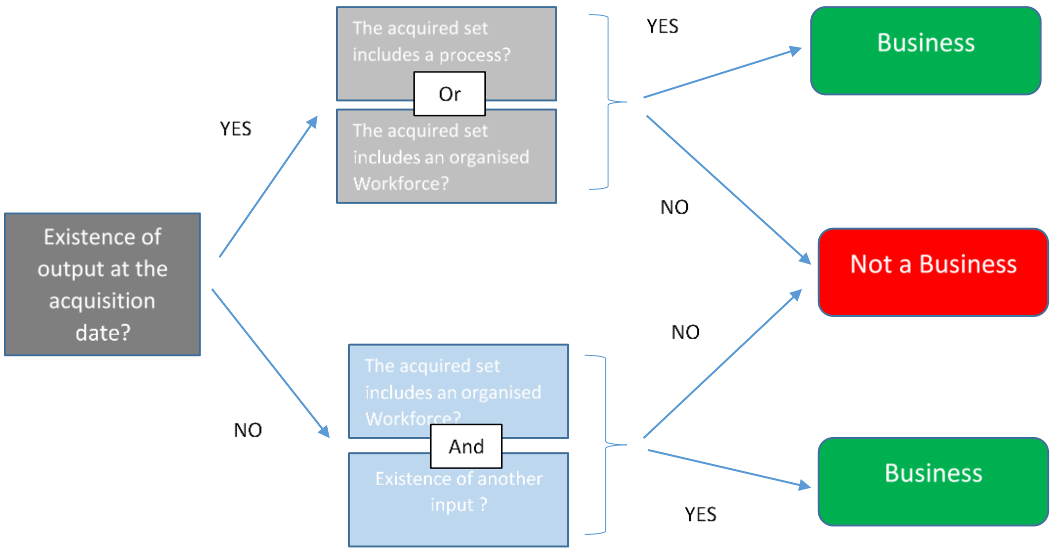
- The notion of « similar assets » appears to be crucial to the application of this test. We understand that this notion requires the use of judgement and we think that no further specific guidance be provided.

  However, if the IASB were to be pressed for such guidance, we think that, as a general principle for the proposed test, the notion of similar assets should be linked to the presentation in the balance sheet or in the notes, so that if the assets are aggregated in one line they qualify as assets of similar nature for the purposes of the test. As an example, major oil and gas companies transfer mineral licences and exploration evaluation expenditure into Property, Plant and Equipment once the property is approved for development. It would be onerous to require these entities to generate the detail listed in Example J of the ED.

  Conversely, we are not in favour of the FASB's proposal to incorporate a characteristic of similar risks into the test ["*Identifiable assets within the same major asset class that have significantly different risk characteristics should not be considered similar assets*"]. Indeed, we think that this might lead to endless debates about whether risks are similar or not. As an example of the questions which could arise, there is the question of whether a building in one area of a city can be grouped with a building in a different neighbourhood.

Evaluation of whether an acquired process is substantive.

We think that the use of a "decision-tree" diagram can help to give a clear overall view of the assessment of whether a business has been acquired.
However, we believe that the diagram provided in paragraph B8A should be improved by including all the steps described in paragraphs B12A and B12B. For example, the second step in the proposed diagram refers only to the complete analysis required to conclude on whether the main definition of a Business has been satisfied, and this, in our view, is not very helpful.



__The workforce__

Paragraph B12A [where the acquired set does not have outputs] specifies that, for the set of activities to be a business, the acquired organised workforce must have the necessary skills, knowledge, or experience to perform an acquired __substantive__ process which must itself __be critical__ to the ability to produce outputs. We wonder what distinction is to be drawn between the "substantive" and "critical" natures of a process. In contrast, in paragraph B12B [where the acquired set has outputs] the process is referred to without the characteristic of its being substantive. Does the difference in drafting imply a different approach to assessment?

Moreover, we think that the distinction between principles behind paragraph B12B(a) and B12B(b) is not sufficiently clear. We think that the principle is that where an organised workforce is acquired it is sufficient that it has the necessary competence to perform the acquired critical process, whereas in the absence of an acquired workforce the acquired critical process must be scarce in nature. We are not sure that the justification for this difference in threshold is sufficiently explained in the Basis for Conclusions (BC) paragraph B26. We think it would be helpful therefore to add some further explanation to the BC and to bring some of this into the body of the standard to ensure comprehension and application.

On a related point of drafting: the first sentence of paragraph BC26 is slightly misleading. If our understanding of what it means is correct, then it would be clearer to draft it as follows:

"The Board believe 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."

On another point of drafting, given that the paragraphs B12-B12C are intended to give guidance about evaluating whether a process is substantive, we wonder whether the references to substantive processes within the section are necessary or should be removed since they result in a circular definition which is confusing.

Acquired contracts

The proposed amendments do not make it clear how acquired contracts should be taken into account in the determination of the existence of a business. It seems to us that the current drafting of paragraph B12C implies that that all acquired contracts, except those giving access to an organised workforce, should be disregarded in determining the existence of a business. However, other elements of the proposals appear to be contradictory. For example, IE91 states that in accordance with paragraph B12C, "the customer contracts and the supply contract are excluded from the determination of whether a process is present, whereas in IE94, access to raw material under the acquired supply contracts contributes to the ability to continue producing outputs. Although we agree that an acquired contract is not in itself a substantive process, we believe that an acquired contract may provide access to a workforce or other input, or to a critical process, and as such must be considered in the analysis of the presence of a business. If the Board agrees, then the final amendment should specify that an "an acquired contract may give access to an organised workforce, critical process or input".

Illustrative examples

Although in general we find examples to be useful in standards, we wonder whether the large number of examples propose is not an indication that the proposed new principles are perhaps weak or unclear. Moreover, the conclusions reached in some of the examples seem to us to be debatable in view of the stated fact pattern. Moreover, some of the examples either do not include sufficient relevant elements to enable one to come to a clear and acceptable conclusion or the necessary elements seem to be introduced only in the discussion of the conclusion.

For example, in Example D we are not convinced by the conclusion that this is not a business. The inputs acquired include a facility, the equipment and an organised workforce (which presumably has the necessary skills, knowledge, or experience to perform the critical process). What is stated to be missing is "another acquired input that the workforce could develop or convert into outputs" and wonder what this should be: the raw material alone, the raw material, an order book or a client portfolio or a combination of two or all of these?

When compared with Example E which is determined to be a business, the only difference appears to be that Entity Biotech has "in-process research and development projects" which are inputs deemed sufficient to pass the test of being a business, even in the absence of any order book or client portfolio. We think that this aspect requires further explanation.

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?*

Any difference in wording can result in a difference in interpretation. It would be helpful to have access to the comparative study of all the differences and an explanation of the reasons for these that the Board has carried out, in order to have an opinion on the potential effect.

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?*

Although we agree on the principles as resumed in Question 3, we believe that the drafting should be simplified. Thus, while the proposals as described above are very clear, their translation into paragraphs 42A and B33C is much less understandable, in particular because of the very long description of the various entities involved (joint operator or party to the JO). We think it should be possible to strip out some of the superfluous language in these paragraphs and make them clearer.

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

Difference in accounting treatment between business combinations and asset purchases

In developing our response to the PIR we asked whether it was appropriate that such important differences should existed between the accounting for the acquisition of a business and that of the purchase of an asset. Although some of these differences seem justified, (such as, for example fair value measurement, the accounting treatment of non-controlling interests and the calculation of any goodwill / negative goodwill …) others appear less justifiable and contribute to the evident tension around the definition of a business (see our section "other comments").We reiterate what we stated in our response to the PIR: "*We believe that specific treatments for business combinations are justified, provided that the scope of IFRS 3 is set appropriately. These include provisions relating to the identification of the acquiree's assets and liabilities, their fair value measurement, the accounting treatment of non-controlling interests and the calculation of any goodwill / negative goodwill. Indeed, these provisions are clearly specific to business acquisitions in which the Group acquires a set of identified assets and liabilities but also synergies for its future business. However, one may wonder about the relevance of other commonly observed differences between the accounting treatment of business acquisitions and the acquisition of a single asset. Our objective is not to comment at this stage on the comparative merits of these differences but only to point out that such differences as, for example, the treatment of acquisition costs, deferred taxes, and contingent payments, contingent liabilities …) seem not justified. The IASB should deal with all of these "cross cutting issues" during this review of IFRS 3 in conjunction with the current revision of the conceptual framework."* We could add to the list cited above contingent liabilities and the accounting for favourable/unfavourable operating lease terms, for example.

We understand that the IASB has decided that it will not deal with these topics. However, recent decisions in the area of "sale or Contribution of Assets" will produce very different accounting treatments depending upon the determination of whether the object of the transaction is a business or not. The tension between the two outcomes remains high and we think the Board ought perhaps to remain open to reconsidering its decision in the light of the responses to this ED.

Specific requirements in the case of the purchase of a subsidiary which does not contain a business [and its subsequent total or partial sale]

We think that it is likely that the result of the proposals of the ED being finalised will probably be not only a reduction in the number of transactions treated as business combinations but also an increase in the number of acquisitions of subsidiaries not classified as businesses. Paragraph 2(b) of IFRS 3 provides some guidance for this but we think the IASB ought to consider further guidance for the accounting for such purchases.

Areas where we think additional guidance would be useful include, for example, presentation of the purchase in the Cash-flow Statement, presentation of the other acquired elements (intangible assets, cash, finance debt etc.) recognition of acquisition costs and accounting for whole or partial sales. This guidance should cover the case where the initial purchase is carried out directly and the case where it is carried out via participating interests.