

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

Feedback to constituents – EFRAG Final Comment Letter

November 2016

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Introduction

Objective of this feedback statement

EFRAG published its final comment letter on the Exposure Draft ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests* (‘the ED’) on 9 November 2016. This feedback statement summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s final comment letter.

November 2016

Background to the ED

On 28 June 2016, the IASB published the ED with comments due by 31 October 2016.

The amendments propose to clarify:

- (a) the definition of a business; and
- (b) the accounting for previously held interests when an entity obtains control of a business that is a joint operation and when it obtains joint control of a business that is a joint operation.

Further details are available on the EFRAG [website](#).

EFRAG’s draft comment letter

EFRAG published a [draft comment letter](#) on the proposals in the ED on 27 July 2016. In the draft comment letter, EFRAG welcomed the IASB’s objective of providing clearer application guidance to help determine when a set of assets and activities constitutes a business.

Overall, EFRAG considered that the proposals provide a more comprehensive framework for distinguishing business combinations from asset acquisitions compared to the current guidance in IFRS 3 *Business Combinations*, and should therefore help to reduce the workload for preparers in making this distinction especially in more problematic situations.

EFRAG agreed 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. EFRAG also supported the inclusion of a ‘screening test’ because it is intended to serve as a practical solution to allow entities to make the distinction relatively quickly in cases that are predominantly asset acquisitions, thereby limiting the need for further analysis. This

should result in cost savings for preparers in these cases. However, EFRAG suggested some improvements to the application of the proposed screening test in relation to more borderline cases. In respect of the proposed guidance on evaluating whether an acquired process is substantive, EFRAG agreed with having two different sets of criteria depending on whether the set of activities and assets has outputs.

EFRAG agreed that examples are important in illustrating the application of the principles in the proposed guidance. However, EFRAG recommended that the examples focus more on the areas of the guidance that require significant judgement.

Finally, EFRAG encouraged the IASB and the FASB to reach converged solutions on their respective proposed amendments.

In response to the amendments on accounting for previously held interests, EFRAG supported the IASB’s proposals to clarify the accounting for previously held interests in the assets and liabilities of a joint operation in the two types of transactions addressed in the ED.

Regarding the transition requirements, EFRAG agreed that the proposals should be applied prospectively.

Comments received from constituents

EFRAG received fourteen comment letters from constituents. The constituents are listed in the Appendix and the comment letters are available on the EFRAG [website](#).

The comment letters came from national standard setters, business associations, professional organisations, listed companies and EU authorities.

Overall constituents were supportive of the IASB’s efforts to clarify the definition of a business under IFRS 3.

Similar to EFRAG, constituents expressed several concerns with the proposed amendments to the guidance on the definition of a business and how they should be applied in practice. The degree of concern by constituents varied, with some constituents expressing additional concerns to those of EFRAG. The application of the concentration of the fair value (the screening test) was an area where a numbers of constituents questioned whether it would reach the appropriate conclusion in all cases. Constituents expressed different views on whether the screening test should play a decisive role in the assessment process.

Most constituents supported EFRAG’s tentative position to encourage the IASB and the FASB to reach converged solutions on their respective proposed amendments. Most of these constituents suggested using similar wording.

One constituent noted that the FASB’s project is being addressed in three phases, and considered that the issues that the IASB is not discussing in its project should also be considered as they affect the application of IFRS 3.

Like EFRAG, most constituents supported the proposed clarifications to the accounting for previously held interests. However, some constituents made suggestions to improve the guidance.

All constituents supported EFRAG’s tentative position that agreed that the proposals should be applied prospectively.

EFRAG’s final comment letter

EFRAG issued its final comment letter on 9 November 2016.

EFRAG noted 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, EFRAG is concerned that, as currently drafted, the screening test may, in some instances, result in inappropriate conclusions. EFRAG considers 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, EFRAG states a number of concerns that should be addressed.

In respect of the proposed guidance on evaluating whether an acquired process is substantive, EFRAG agreed with having two different sets of criteria depending on whether the set of activities and assets has outputs. However, EFRAG had some concerns about the presence of goodwill as an indicator, the guidance on acquired contracts and the role of an organised workforce.

EFRAG agreed that examples are important in illustrating the application of the principles in the proposed guidance. However, EFRAG recommended that the examples focus more on the areas of the guidance that require significant judgement and EFRAG provided detailed comments on the proposed illustrative examples.

Further, EFRAG encouraged 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 observed 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 recommended 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.

In response to the amendments on accounting for previously held interests, EFRAG supported the IASB’s proposals to clarify the accounting for previously held interests in the assets and liabilities of a joint operation in the two types of transactions addressed in the ED.

Finally, in relation to the transition requirements, EFRAG agreed that the proposals should be applied prospectively.

Detailed analysis of issues, comments received and changes made to EFRAG’s final comment letter

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

EFRAG’s response to constituents’ comments

General comments and cover letter

EFRAG’s tentative position

In relation to the proposed clarifications to the definition of a business, EFRAG considered that the proposals are pragmatic and should help to reduce the workload in making this distinction in various situations that can be problematic under the current guidance. However, EFRAG made several suggestions to clarify how the proposed guidance should be applied.

In relation to the proposals on the accounting for previously held interests, EFRAG agreed with the proposed amendments.

Constituents’ comments

Overall constituents were supportive of the IASB’s efforts to clarify the definition of a business under IFRS 3, but supported EFRAG’s call for improvements to the proposed guidance.

Like EFRAG, all constituents supported the proposed clarifications to the accounting for previously held interests.

EFRAG’s final position

In light of the feedback received by constituents, EFRAG retained most tentative positions on the proposed guidance.

However, considering the concerns expressed by many constituents, EFRAG stated in its final comment letter that the screening test should be retained as a determinative assessment only if its relative simplicity could be maintained while avoiding inappropriate outcomes.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Clarifications to the definition of a business

Proposals in the ED

The ED proposed to clarify the guidance on the definition of a business by amending the definitions of a business and output; introducing a screening test; introducing two sets of criteria to determine whether an acquired set of activities and assets contains an input and a substantive process that together contribute to the ability to create outputs; and including illustrative examples.

EFRAG’s tentative position

EFRAG supported the proposals, but made some suggestions to improve their application.

Constituents’ comments

All constituents supported the IASB’s proposal to narrow the definition of a business to state that a business must include, as a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs. Those constituents that commented on the proposed change to the definition of outputs, supported the change to the definition of outputs, but, similar to EFRAG’s tentative position, a few constituents considered that the meaning of ‘other revenues’ should be clarified. Four constituents asked for clarification on the presence of goodwill as an indicator.

Constituents generally supported the IASB’s efforts to develop a test that would facilitate the identification of situations where the integrated set of activities and assets is not a business. However, many constituents expressed concerns that the screening test may not achieve its purpose when applied to certain facts and circumstances. Three constituents suggested changing the screening test

EFRAG’s response to constituents’ comments

EFRAG’s final position

Considering the broad range of views expressed by constituents on the screening test, EFRAG stated in its final comment letter that it considered that the screening test should be retained as a determinative assessment only if its relative simplicity could be maintained while avoiding inappropriate outcomes.

In light of the request made by constituents for the IASB to consider whether the difference in accounting for business combinations and asset purchases is appropriate, EFRAG included this comment in its final comment letter.

With regard to the remaining proposals on the definition of a business, EFRAG notes that the majority of constituents broadly agreed with EFRAG’s tentative views. Constituents provided several recommendations to clarify the application of the proposed guidance, in particular determining when an acquired process is substantive and the role of the work force in making the assessment. Constituents also provided some additional recommendations, compared to EFRAG’s initial position, on how the illustrative examples might better illustrate the proposals to ensure that entities apply the definition correctly and uniformly, some of which are different to the recommendations made by EFRAG’s in its initial position. EFRAG included these additional recommendations in its final comment letter.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

into a rebuttable presumption. Two constituents suggested changing the screening test into an indicator. One constituent suggested to focus on the acquirer’s calculation used to determine the purchase price, instead of the fair value concentration.

Most constituents supported the inclusion of two sets of criteria to assess when an acquired process is substantive. However, many constituents supported EFRAG’s tentative position that the IASB should further clarify the proposed guidance. In particular, constituents referred to the role of the ‘organised workforce’.

Many constituents asked the IASB to consider whether the difference in accounting for business combinations and asset purchases is appropriate.

In response to EFRAG’s specific question to constituents on whether the proposed illustrative examples are sufficient to illustrate how the proposed guidance on what is considered a business should be applied, constituents provided detailed comments on the proposed illustrative examples, noting that in some instances the examples may be misleading or blur the understanding of the amendments.

EFRAG’s response to constituents’ comments

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Convergence between IFRS and US GAAP

Proposals in the ED

Whilst the IASB and the FASB reached substantially converged conclusions on how to clarify and amend the definition of a business, the wording of the ED and the FASB proposals were not fully aligned.

EFRAG’s tentative position

EFRAG encouraged 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.

Constituents’ comments

Most constituents supported EFRAG’s tentative position to encourage the IASB and the FASB to reach converged solutions on their respective proposed amendments. Many constituents also supported EFRAG’s suggestion to use similar wording. Two constituents asked for a comparative study of the differences and an explanation of the reasons for these in order to have an opinion on the potential effect.

One constituent noted that the FASB’s project is being addressed in three phases, and considered that the issues not being discussed by the IASB in its project should also be considered as they affect the application of IFRS 3.

One constituent observed that the ordering of the steps is different as the FASB’s proposals did not require the application of the screening test prior to evaluating whether an acquired process is substantive.

EFRAG’s response to constituents’ comments

EFRAG’s final position

Considering the feedback received by constituents, EFRAG maintained its tentative position on the proposed guidance.

In response to the comments made on the FASB’s project, EFRAG included the observation in its final comment letter that the FASB’s tentative decisions may cause significant differences in the application of the guidance.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Accounting for previously held interests

Proposals in the ED

The ED provided guidance on the accounting for previously held interests in order 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.

EFRAG’s tentative position

EFRAG agreed with the proposed amendments.

Constituents’ comments

Most constituents supported EFRAG’s tentative position.

However, some constituents made suggestions to improve the wording by clarifying the interaction between the proposed guidance and the principles in IFRS 11 *Joint Arrangements* and IFRS 3, articulating the comprehensive analysis of the IFRS Interpretations Committee when it developed the proposed guidance, and clarifying the interaction between the definition of a business and its legal form.

EFRAG’s response to constituents’ comments

EFRAG’s final position

Considering the feedback received by constituents, EFRAG maintained its tentative position on the proposed guidance. However, EFRAG included in its final comment letter the suggestion to include the comprehensive analysis performed by the IFRS Interpretations Committee when it developed the proposed guidance.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Transition requirements

Proposals in the ED

The ED proposed that an entity would be required to apply the proposed amendments to IFRS 3 and IFRS 11 to any transaction that occurs on or after the date from which the amendments are first applied, with earlier application of the amendments permitted.

EFRAG’s tentative position

EFRAG agreed with the proposed transition requirements.

Constituents’ comments

All constituents supported EFRAG’s tentative position that agreed that the proposals should be applied prospectively.

EFRAG’s response to constituents’ comments

EFRAG’s final position

Considering the feedback received by constituents, EFRAG maintained its tentative position on the proposed guidance.

Appendix: List of respondents

Table 1: List of respondents

Name of constituent¹	Country	Type / Category
Accounting Standards Committee of Germany	Germany	Standard Setter
European Securities and Markets Authority	Europe	European Regulator
The Linde Group	Germany	Preparer
Danish Accounting Standards Committee	Denmark	Standard Setter
Institute for the Accountancy Profession in Sweden	Sweden	Professional Organisation
Autorité des Normes Comptables	France	Standard Setter
Fédération des Experts-comptables Européens	Europe	European Organisation
Financial Reporting Council	United Kingdom	Standard Setter
Swedish Enterprise Accounting Group	Sweden	Business Organisation
Organismo Italiano di Contabilità	Italy	Standard Setter
The Institute of Chartered Accountants in England and Wales	United Kingdom	Professional Organisation
Dutch Accounting Standards Board	Netherlands	Standard Setter
ACTEO AFEP MEDEF	France	Business Organisation
Engie	France	Preparer

¹ Respondents whose comment letters were considered by the EFRAG Board before finalisation of the comment letter.