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The 100 Group

Financial Reporting Committee

Hans Hoogervorst Esq
Chairman
International Accounting Standards Board
IFRS Foundation
30 Cannon Street
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Submitted by email at commentletters@ifrs.org

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Dear Hans

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

We welcome the opportunity to comment on the above consultation.

Who we are

The 100 Group of Finance Directors represents the views of the finance directors of FTSE 100 and several large UK private companies. Our member companies represent almost 90% of the market capitalisation of the UK FTSE 100 Index. Our aim is to contribute positively to the development of UK and international policy and practice on matters that affect our businesses, including taxation, financial reporting, corporate governance and capital market regulation. Whilst this letter expresses the views of The 100 Group of Finance Directors as a whole, those views are not necessarily those of our individual members or their respective employers.

Our views

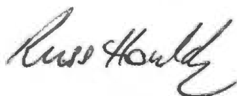
We welcome the proposed changes in the Exposure Draft on the Definition of a Business and Accounting for Previously Held Interests. Many of the changes are supportable, pragmatic and will help determine whether an acquired set of activities and assets constitute a business. It also largely addresses our previous concerns that the definition of a business, as it is currently interpreted, is too wide.

We welcome the upfront test that if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets (the "screening test"), then the set of activities and assets is not a business. We note the proposed change, and others, are a shift from a principles to a rules based approach. However, we support the inclusion of the screening test as it will act as an expedient to allow preparers to make the distinction between an asset and business acquisition relatively quickly.

The complex language in this Exposure Draft would make IFRS 3 and IFRS 11 difficult to understand. There are a number of places where the wording can be made clearer to avoid potential misunderstandings, notably in the references to "similar" assets, goodwill, processes and acquired workforces. We also strongly encourage the IASB to use diagrams and tables to aid understanding.

Please feel free to contact me through the 100 Group's website, www.the100group.co.uk, should you wish to discuss our comments.

Yours sincerely



Russ Houlden
Chairman
Financial Reporting Committee - The 100 Group of Finance Directors

The 100 Group

Responses to specific questions

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?

Paragraph B7 – Definition of a business

We welcome the clarification in paragraph B7 to the definition of "output" when determining if an acquisition is a business. As per our previous response we believed the previous definition of an asset acquisition was too narrow. We recommend the IASB also update the definition of a business in Appendix A of IFRS 3 for consistency.

Paragraph B11A – B11C – Assessment of concentration of fair value

We welcome the upfront test that if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets (the "screening test"), then the set of activities and assets is not a business. This addresses our concern raised in our previous response that it was very difficult to view an acquisition as anything other than a business under IFRS 3.

The proposed wording for the screening test does not discuss the treatment of deferred tax and whether this should be included in the test. We recommend that the IASB make this clear. The exercise to compute deferred tax is only relevant if you have a business acquisition and is a significant piece of work for preparers. In our view, the IASB should clarify that deferred tax is excluded from the screening test.

We recommend the IASB expand the examples included in B11 A-C to clarify the statements raised in the proposed standard and to stop the potential for misinterpretation. For example, the ED does not define the term "similar" in "similar identifiable assets". We also suggest the wording in B11 C(a) is tightened to make its meaning clear. We currently understand it to mean that tangible assets should not be combined with intangible assets, however it could be interpreted to mean that tangible assets should not be combined together and nor should intangible assets be combined together.

Paragraph B12 – B12C - Evaluating whether an acquired process is substantive

We welcome the deletion of the opening sentence to paragraph B12: "In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be a business." However, we do not agree with the inclusion of the following sentences to paragraph B12: "When evaluating whether a set of activities and assets includes a substantive process, the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive and the set of activities and assets is a business. However, a business need not have goodwill." We believe this addition does not add any further clarification and in certain circumstances will lead to confusion.

We assume the IASB means an *acquired* "organised workforce" in paragraph B12A as per Example E (paragraph IE87). If this is the case, we suggest this is clarified in paragraph B12A.

The terms "process", "substantive process", "critical" and "unique or scarce" are used at various points when describing the components necessary for a business, for example:

- B12A (no outputs) refers to a "substantive process" that is "critical"; whereas
- B12B (outputs) refers to a "process" (perhaps implying this process does not need to be substantive, despite the definition in B8) that is either "unique or scarce" (regardless of the presence of a workforce) or "critical" (if there is a workforce).

We find this rules-based guidance complicated and confusing. We strongly recommend the IASB simplifies the definition of a "substantive process" and suggest that it is defined in paragraph B8 as "critical to the ability to develop or convert input[s] into output[s] or one that is unique or scarce, or cannot be replaced without significant costs, effort or delay in the ability to continue producing outputs".

If the current definitions are to be retained, we recommend that paragraphs B12A and B12B could be better explained with a flow-chart diagram. See our example at Appendix A, which also highlights the confusing use of different terms in the ED.

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 do not have any comments as the proposed standard is not a converged standard, and we apply IFRS.

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?

In our view the proposed wording in the standard is overly complex and difficult to understand. A simple table (see below) explains the situation more clearly. We also note that there are other types of transactions, for example, involving arrangements in which no parties share joint control (refer IFRS 11.B8), that are not discussed in IFRS 11 or this Exposure Draft.

Before	***After***	***Do you remeasure?***	***Our ref***
Participates in...	*Joint control*	✗	a
Joint control	*Joint control*	✗	*
Participates in...	*Control*	✓	b
Joint control	*Control*	✓	b

* Already covered by IFRS 11 and/or IFRS 3.

Obtaining joint control (our ref: a)

We welcome the IASB's proposal "on obtaining joint control, an entity should not remeasure previously held interests in the assets and liabilities of the joint operation." We agree that the proposal is in line with IFRS 11.23.

Obtaining control of previously held interests (our ref: b)

Since IFRS 3 requires the remeasurement of previously held interests when obtaining control of a business, we agree that the proposal to clarify that that remeasurement is required when the previous interest was in a joint operation is consistent with the principles of IFRS 3.

However, in our view, some of the non-intuitive accounting requirements driven by the fair value focus of IFRS 3 create complexity with little added value for users. The current accounting results in an arbitrary gain or loss that is non-intuitive to many users and is often adjusted for by users of accounts. Similarly, many companies remove the impact of step acquisitions from underlying earnings, indicating a consensus that this is not considered beneficial to users of accounts.

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. Revisiting and then potentially retrospectively adjusting the accounting for past acquisitions and consequentially restating financial statements would be a complex and a highly impractical exercise with the costs outweighing any benefit.

IFRS 3: Diagram to show if an acquisition is a business or asset acquisition