RSM

RSM International Limited
50 Cannon St
London
EC4N 6JJ
UK

T +44 (0)207 6011080

www.rsm.global

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom
Email: commentletters@ifrs.org

27 October 2016

Re: 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,

On behalf of RSM International Limited, a worldwide network of independent audit, tax and consulting firms, we are pleased to comment on the IASB's Exposure Draft ED/2016/1 *Definition of a Business and Accounting for Previously Held Interests (Proposed amendments to IFRS 3 and IFRS 11)* ('the ED').

Overall, we support the amendments proposed in the ED as they provide greater clarity and will reduce current diversity in practice. However, we propose further enhancing clarifications.

Our comments and detailed responses to the questions set out in the Invitation to Comment section of the ED are detailed hereafter.

We would be pleased to respond to any questions the Board or its staff may have about any of our comments.

Please do not hesitate to contact me or Joelle Moughanni at +44 207 601 1080.

Sincerely,

Robert Dohrer
Global Leader - Quality and Risk
RSM International

THE POWER OF BEING UNDERSTOOD
AUDIT | TAX | CONSULTING

RSM is the brand used by a network of independent accounting and consulting firms, each of which practices in its own right. RSM International Limited does not itself provide any accounting and advisory services.

RSM International Limited
Registered in England & Wales
Registration no: 4040598
Registered office: as above

Lead sponsors
European Business Awards™

RSM

<u>Question 1</u>

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?

We agree overall with the proposed amendments to IFRS 3 as they provide clearer application guidance to help determine when an acquired set of assets and activities is a business. We consider that the proposals provide a more comprehensive and pragmatic framework for identifying a business that will help to address some of the current assessment challenges.

In particular, we support the introduction of a screening test based as a first step on an assessment of concentration of fair value as described in paragraphs B11A–B11C of the ED, in order to avoid unnecessary further analysis (as set out in paragraphs BC18-BC19 of the ED). However, we are of the opinion that if substantially all the fair value of the gross assets is concentrated in a single asset or group of similar assets is an indicator that the acquired set is not a business, but is not determinative on its own. In practice, this might not give the right result in all circumstances. For example, acquisitions of a shopping mall or a fund are most likely to include one significant asset (the property for the mall) or a group of similar assets (the financial assets for the fund) and processes that are outsourced (property management, asset management, etc.) which might be considered substantive, and the acquired set in each case is capable of producing outputs. However, both cases are likely to fail the first step analysis of the proposed assessment as the outsourcing contracts are expected to be at market conditions and rates and thus have nil value.
Therefore, we recommend that paragraph B11A of the ED be redrafted as a rebuttable presumption, instead of a firm determinative conclusion (proposed added text to the second sentence underlined): "Consequently, 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, then <u>there is a rebuttable presumption that</u> the set of activities and assets is not a business." We believe that such rebuttable presumption would be more consistent with paragraph B12C of the ED which acknowledges that an acquired contract may represent a substantive process. But for outsourced property management and asset management contracts that are on market terms, the acquisition will not be given the chance to pass the initial screening test in paragraph B11A of the ED as currently drafted.

In addition, we note that while the ED does not define the term 'similar', it describes circumstances in which certain classes of assets should not be considered to be similar (paragraph B11C). We are concerned that some may interpret the guidance in paragraph B11C as meaning systematically that assets in the same major asset class are similar, even though the individual assets may have different risk and/or economic characteristics. Thus, we recommend that the IASB articulates in a more principle-based manner when assets can be deemed similar for this purpose clarifying for example that the assets should be highly interrelated and their nature, risks and characteristics should be similar.
Also, the proposed illustrative examples are unclear as to which factors should be considered to determine whether assets in a group are similar: Example H refers to a broad class of tangible assets ('all office buildings' as per paragraph IE96(c) of the ED, irrespective of age, lease term, location, nature of the office space, etc.), whilst Example A refers to similar characteristics ('all single-family homes' that are similar in nature as per paragraph IE75(b) of the ED, therefore referring to a specific category of residential homes).

In relation to the second step of the proposed analysis to assess whether a transaction is the acquisition of a business, evaluating whether an acquired process is substantive differs depending on whether the acquired set of activities and assets has outputs at the acquisition date. Although it seems reasonable that the assessment should be different for entities at the development stage, the ED includes an example of a plant that temporarily closed at the acquisition date and which is assessed under paragraph B12A, which might seem rather arbitrary. In fact, if the same plant had been acquired just before or after the temporary closure, the acquisition would have been assessed under paragraph B12B, whereas what is being acquired under both scenarios could essentially be the same, in particular in situations of very short closure period. Consequently, we recommend that the Board adds the concept of 'prolonged' closure. Paragraph B12A of the ED could be redrafted as follows (added text underlined): "If a set of activities and assets does not, at the acquisition date, have outputs (for

example, it is an early-stage entity that has not started generating revenues, or an entity that has stopped generating revenues for a prolonged period),…". Example D (paragraphs IE83-85 of the ED) that explicitly refers to a temporarily closed-down manufacturing facility should be amended accordingly.

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 have no comments, except to encourage the IASB and the FASB to reach as much as possible converged solutions on their respective amendments.

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 agree with the proposed amendments to IFRS 3 and IFRS 11 as they are consistent with existing principles.

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 with the proposed transition requirements.

Although we are generally in favour of retrospective application of new and amended requirements in accordance with IAS 8 (in the name of enhanced comparability), we agree with the Board that, in the present case, retrospective application on transition may be impracticable, its cost may outweigh the benefits to users, and may involve the use of hindsight.

END OF DOCUMENT