

**Summary of comments from AOSSG Acquisitions and Reporting Entity
Issues Working Group**

The WG Leader has received four comments from WG members (China, Hong Kong, Japan and Malaysia) as of 19 September 2016. This is the summary of the comments received.

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?

Comments from the AOSSG members

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China	<ul style="list-style-type: none"> • We appreciate IASB’s effort on tentatively proposed clarification and amendments to the definition of a business based on practical needs. It would help to address the inconsistent judgment and accounting issues in determining whether the acquisition of an entity with a single significant asset or a group of significant similar identifiable assets, for example an investment property or a vessel, with some simple processes associated with it, can be considered as a business. It would also simplify the judgment on whether such acquisition is a business or an asset, and significantly reduce the complexities in identifying a business and the cost in applying the standard. • However, further clarification is required as follows : <u>Identification of a single identifiable asset or group of similar identifiable assets</u> <ul style="list-style-type: none"> ➤ Based on requirements in paragraph B11C(a) in the Exposure Draft, separately identifiable tangible and intangible assets shall not be combined into a single identifiable asset or considered a group of similar identifiable assets. In our opinion, this requirement is

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	<p>inappropriate.</p> <ul style="list-style-type: none"> ➤ The reason is that the key in determining whether two or more assets can be considered as a group of similar assets should be analyzing if they are closely related regardless of external forms. For example, some smart production lines consist of the integration of closely related software and hardware. The software might have use value on its own and can be identified separately, but both entities and market participants expect to use the integrated production line for production activities. It seems unreasonable that the general production facilities are generally considered as an asset, while a different conclusion will be drawn for integrated facilities merely because they are the combination of tangible and intangible assets. In our opinion, whether a group of assets should be considered as similar identifiable assets should consider the factors such as whether the group of assets share the same risk characteristic and the same source of cash flows, etc. ➤ In addition, both illustrative Example A and H mentioned that, although the buildings and the land are two different classes of tangible assets, since the buildings are attached to the land and cannot be removed without incurring significant cost. Therefore, the buildings and the land are considered as a single asset. We understand the land is generally freehold in certain countries or regions, and it is generally accounted as fixed assets in practice. However, in mainland China, enterprises normally obtain the land use right for fixed years by paying land transferring fee or allocation by the state. The PRC accounting standard specifies that it should be accounted as intangible assets, i.e. land use right. As a result, the requirement is not aligned with China’s regulatory framework and practical situation, so we are unable to perform appropriate accounting according to such requirement. We suggest the Board consider to remove it. <p><u>The determination of business when the set of activities and assets has outputs but does not include an organized workforce</u></p> <ul style="list-style-type: none"> ➤ According to paragraph B12B in the Exposure Draft, an acquired set of activities and assets is a business, if the set has outputs at the acquisition date and includes a substantive process that, when applied to an acquired input or inputs, contributes to the ability to continue

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	<p>producing outputs. We are of the opinion that the thought above is more theoretical than practical to understand and apply. Therefore, we suggest the Board make further clarification.</p> <p><u>About market participants</u></p> <ul style="list-style-type: none"> ➤ The requirement has been removed from paragraph B8 in the Exposure Draft regarding analyzing market participants' capability of replacing missing elements (i.e., determining whether a particular set of activities and assets is a business should be based on the acquired elements themselves), while the requirement has been reserved in paragraph B11 regarding analyzing whether an acquired set of activities and assets is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. The logic inconsistency of the statements in the above two paragraphs makes it difficult to understand and apply the standard. ➤ For instance, assuming the operation of an acquiree already has outputs when an acquirer acquires the acquiree's whole set of production lines, inventories and other important assets, the acquirer has sufficient workforce and will not continue to hire the acquiree's employees. The acquiree's operation is a general process in the industry (i.e., the criteria of a process that is unique or scarce, or cannot be replaced without significant cost in paragraph B12B are not met), so the acquirer can mobilize its existing workforce or other market participants can supplement the workforce quickly to continue to operate the acquired assets and process without incurring significant replacement costs. In this case, whether the conclusion is made according to paragraphs B8 and B12B as not an acquisition of business or according to paragraph B11 as an acquisition of business from market participants' perspective? We suggest the Board further clarify the internal logic between the three paragraphs of B8, B11 and B12B.
Hong Kong	<p><u>HKICPA staff comments - General comments</u></p> <ul style="list-style-type: none"> • One Panel (HKICPA's Advisory Panel) member tentatively considers the proposed amendments are more than just clarifications to IFRS 3 <i>Business Combinations</i>. • In general, the Panel tentatively considers that the proposed amendments are extremely rule-based and seem to draw an arbitrary line, without any

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	<p>conceptual underpinning, between an asset (or group of assets) and a business. Nevertheless, they think that in limited circumstances, applying this rule-based approach might reduce the diversity in practice. Also, this rule-based approach will likely be welcomed by small medium practitioners and entities.</p> <ul style="list-style-type: none"> • Overall, the Panel (including preparers) tentatively does not think that the proposed amendments represent a marked improvement over the existing guidance under IFRS 3 due to a lack of conceptual basis of what is a business versus an asset. The Panel tentatively considers that the lack of underlying principles would mean that when applying these rules against the complex fact-patterns of reality, the proposed rule-based approach would result in the identification of an asset or business that in substance does not make sense. • Furthermore, the Panel tentatively thinks that although an asset acquisition and a business combination are different in nature, it is not always clear why some aspects of the applicable accounting treatments should be different. Such aspects include accounting for directly attributable acquisition-related costs, deferred taxes, consideration in the form of shares, contingent consideration and step acquisitions. They consider that the IASB should consider if certain differences in accounting treatment between an asset acquisition and business acquisition could be eliminated or reduced, for example, by extending the initial recognition exemption of deferred tax relating to assets and liabilities acquired in a business combination. <p><u>HKICPA staff comments - Specific comments</u></p> <ul style="list-style-type: none"> • Regarding the reference to 'market participant' in paragraphs B8, B11 and BC11-14: <ul style="list-style-type: none"> ➤ There is no major concern with the removal of the reference to 'market participant' in paragraph B8, for the reasons as stated in paragraph BC12. ➤ Paragraph B11, which retains the reference to 'market participant', does not contradict paragraph B8. This reference to 'market participant' should be retained for reasons as stated in paragraph BC14. ➤ However, the proposed amendments still do not clarify what is

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	<p>considered a 'market participant' which is currently one of the areas of difficulty in IFRS 3.</p> <ul style="list-style-type: none"> ➤ It was suggested that the IASB should clarify what is a 'market participant'. <ul style="list-style-type: none"> • Regarding the revision to the definition of outputs in paragraphs B7(c) and BC15-17: <ul style="list-style-type: none"> ➤ The revised definition is heading in the right direction, for the reasons as stated in paragraph BC15. However, it will not have a significant difference in practice as the term 'other revenues' means any other economic benefits. ➤ It was suggested that the IASB should clarify, or add examples, as to what types of other economic benefits could be considered 'other revenues'. For example, would investment returns or profits generated from flipping an asset such as real estate, be considered 'other revenues'. • Regarding the proposed screening test in paragraphs B8A-11C and BC18-21: <ul style="list-style-type: none"> ➤ The screening test is too rigid and prescriptive. Although it is intended to be a practical expedient, it does not allow for consideration of qualitative factors which might be crucial in assessing the substance of an asset versus a business. ➤ This potentially opens the door to valuation issues and structuring, depending on whether the entity wanted the acquisition to be accounted for as an asset acquisition or a business combination. In many cases, the same valuation methods would be used and hence the concentration of fair value could be manipulated. In these circumstances, what are the underlying principles and qualitative factors that need to be considered in identifying the substance of an asset versus a business? ➤ Nevertheless, it was noted that small medium practitioners and entities may welcome the screening test as a practical expedient. • Regarding the guidance for a substantive process in paragraphs B12-12C and BC22-29: <ul style="list-style-type: none"> ➤ In general, the application of paragraphs B12-B12C may be difficult in

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	<p>practice, due to a lack of underlying principles supporting the guidance.</p> <ul style="list-style-type: none"> ➤ For example, paragraph 12A states that for a set of acquired activities and assets (that do not have outputs at acquisition date) to be a business; it must include an organized workforce, and another acquired input. However, it is unclear: (i) what an organized workforce actually means; (ii) why an organized workforce is a required input; and (iii) why another acquired input is required. It was commented that in some cases, an acquisition which is in substance a business under IFRS 3, may not meet the criteria in paragraph 12A. ➤ For example, an organized workforce could be performing menial/manual work and are easily replaceable. Furthermore, depending on the purpose of acquisition, often the organized workforce would not be acquired with the set of assets and activities. Or, an organized workforce may be acquired as part of the business at no additional value, but the acquirer may subsequently terminate the employment contracts shortly after the acquisition. ➤ The intention of paragraph 12C is also unclear in the sense of how 'control' is applied in the context of an acquired contract and assessment of a substantive process. ➤ This potentially opens the door to structuring issues, depending on whether the entity wanted the acquisition to be accounted for as an asset acquisition or a business combination. <ul style="list-style-type: none"> • Regarding the examples in paragraphs IE73-IE107: <ul style="list-style-type: none"> ➤ The application of paragraphs B12A to B12C are unclear, particularly with Examples B, C, D. For these examples, it was commented that the IASB did not provide sufficient context and details of the fact pattern as it was difficult to follow the rationale and arrive at the conclusion as illustrated. ➤ It is important for the IASB to add more explicit reasoning in their examples, and to have underlying principles so that qualitative considerations can also be made when applying the proposed amendments. This is especially true for real life complex fact patterns, where different facts and circumstances may lead different parties to a different conclusion when applying the proposed amendments.

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	<ul style="list-style-type: none"> ➤ For Example B, the Panel tentatively commented that under IFRS 3, it is likely to be identified as a business. However, under the proposed amendments, the example is not considered a business because the outsourced contracts, which are priced at current market rates, have an associated fair value of nil. Hence, the example does not pass the initial proposed screening test. The Panel tentatively commented that more conceptual reasoning needs to be added, and that IASB should clarify why outsourced contracts priced at current market rates have an associated fair value of nil. ➤ For Example C, the Panel tentatively commented that under IFRS 3, it is likely to be identified as a business. However, under the proposed amendments, it is not considered a business because an organized workforce is not acquired. ➤ For Example D, the Panel tentatively commented that there seems to be a contradiction with the reference 'organized workforce' between paragraph IE83 "purchaser also hires the employees that works in the facility" and IE85 "the set includes an organized workforce". The Panel tentatively thinks that the concept of hiring the employees is different from acquiring the employees. Furthermore, the fact that the manufacturing facility was "temporarily closed-down" does not necessarily mean it is not, in substance, a business—it could be closed down for just a month for renovation purpose.
Japan	<ul style="list-style-type: none"> • The ASBJ staff generally agree with the proposed amendments to IFRS 3. • However, the ASBJ staff suggest the IASB to: <ul style="list-style-type: none"> ➤ Add sufficient guidance on the terms requiring judgment, such as “substantive”, “similar” and “significant”, to promote the consistent application in practice, ➤ Add sufficient guidance on what “organised workforce” is and how the fair value of organised workforce is determined, because the definition is unclear and the assessment on whether the workforce meets the definition might be difficult, and ➤ Clarify the case where a set of activities and assets has output “at the acquisition date”, because it might be inappropriate to determine that the acquired set does not have outputs at the acquisition date if it

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	<p>previously had outputs before the acquisition date, but not at the acquisition date.</p>
<p>Malaysia</p>	<p><u>MASB staff draft preliminary response</u></p> <ul style="list-style-type: none"> • We are supportive of the Board clarifying the guidance on the definition of a business. We agree with the Board’s proposal to: <ul style="list-style-type: none"> ➤ clarify that to be considered a business, an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs; ➤ revise the definition of outputs to be consistent with the new revenue standard i.e. focus on goods and services provided to customers; and ➤ introduce a screen to more efficiently identify transactions that are clearly asset acquisitions. • In addition, the MASB staff would like to suggest the Board to consider adding an illustrative example to clarify the application of the screen to a situation when substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar assets but the acquisition contains an organised workforce which is critical to the production of outputs. <ul style="list-style-type: none"> ➤ This suggestion came about because there are some practitioners who expressed concern that the application of the screen might result in unintended consequences in certain acquisitions (i.e. transactions which are business acquisitions being unintentionally accounted for as asset acquisitions). For example, when an acquisition contains an organised workforce which is critical to the production of outputs, the application of the screen might result in the acquisition being accounted as an asset acquisition, instead of a business acquisition. This is because an organised workforce often represents an insignificant portion of the overall fair value as they are often paid market rates for their services. ➤ In order to prevent the above from occurring, they have recommended that the Board consider including a rebuttable presumption that the acquired set of activities and assets is not a business if substantially all of the fair value of the gross assets acquired are concentrated in a single identifiable asset or group of similar assets and this presumption can be overcome in limited circumstances prescribed by Board. In this

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	<p>regard, they believe acquisitions which contain an organised workforce critical to the production of outputs would be a circumstance when this presumption could be overcome.</p> <p>➤ Alternatively, in order to prevent unintended consequences, these practitioners suggested that the Board may consider making the screen optional or as a first level test whereby entities are required to further consider other factors if they believe that other factors would result in an outcome that better reflect the economics of a particular acquisition.</p>

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 difficulties in the proposals, including any differences in practice that could emerge as a result of the different wording?

Comments from the AOSSG members

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China	<ul style="list-style-type: none"> As stated under paragraph 6 of the Basis for Conclusions of the Exposure Draft, though worded differently, the amendments proposed by the Board and those proposed by FASB are based on substantially converged tentative conclusions. We do not believe certain different wording would result in any differences in practice when entities apply the standards, but we still suggest the Board and FASB conduct further negotiation, reaching a consistent conclusion to avoid unnecessary differences.
Hong Kong	<p><u>HKICPA staff comments - General comments</u></p> <ul style="list-style-type: none"> Staff tentatively recommend that the wording of the IASB and FASB standards should be as aligned as possible if both boards continue to aim to have a converged standard. Any differences in wording would inevitably lead to potential differences in practice. Staff tentatively note that the FASB proposal does not include the flowchart for illustrating the assessment in determining what is a business. Staff tentatively do not think that this would translate to any significant

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	<p>differences in practice.</p> <ul style="list-style-type: none"> • However, it seems that the FASB proposal includes additional discussions in the basis of conclusion relating to "group of processes" and "single or similar asset threshold". Refer BC31 and BC34 to 40 of the FASB proposal. Staff tentatively thinks that this additional discussion in the FASB proposal may potentially lead to some differences in practice.
Japan	<ul style="list-style-type: none"> • The ASBJ staff strongly support the attempt of the IASB and the FASB to promote consistency in the application in practice across jurisdictions. • However, some examples in the IASB ED are different from those in the FASB ED (Examples H and K) and thus the ASBJ staff are concerned that these examples may lead to diversity in practice. • According to paragraph BC31 of the IASB ED, the IASB believes that the proposed amendments would align the IASB's and the FASB's proposed amendments (except when there is already a difference between IFRS Standards and US GAAP) and that the proposed wording could be clearer for its international stakeholders although the IASB decided to propose amendments to IFRS 3 that are worded differently from the FASB ED. However, the ASBJ staff are not convinced with such argument. The ASBJ staff urge the IASB and the FASB to use the same wording with the same order of the paragraphs to the extent possible. • The IASB ED presents the paragraphs relating to the assessment of concentration of fair value (paragraphs B11A to B11C) before the proposed guidance on evaluating a substantive process (paragraphs B12 to B12C), while the FASB ED presents them in the opposite order. The ASBJ staff believe the order presented in the IASB ED is more sensible.
Malaysia	<p><u>MASB staff draft preliminary response</u></p> <ul style="list-style-type: none"> • MASB Secretariat observed that the statement underlined (see below) may create confusion for paragraph B11A (whose objective is to clarify the meaning of 'gross assets acquired' in a transaction that is <u>not</u> a business combination). The phrase 'any other intangible asset that is not identifiable' could be interpreted as including goodwill as goodwill is defined as an asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised. However, goodwill is present only in a business combination. Therefore, this statement may create

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	<p>confusion with the other sections of paragraph B11A which offers guidance for a transaction that is not a business combination. The Board may wish to consider further clarification so as to avoid any misinterpretation.</p> <p><u>Extract of paragraph B11A:</u></p> <p>A transaction is not a business combination if the transaction is primarily a purchase of a single asset or group of assets. 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 the set of activities and assets is not a business. <u>The fair value of the gross assets acquired includes the fair value of any acquired input, contract, process, workforce and any other intangible asset that is not identifiable.</u> The fair value of the gross assets acquired may be determined by adding the fair value of the liabilities assumed to the fair value of the consideration paid (plus the fair value of any non-controlling interest and previously held interest, if any).</p>

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?

Comments from the AOSSG members

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China	<ul style="list-style-type: none"> • We generally agree with the amendments on the grounds that the amendments in the Exposure Draft are basically in line with those in paragraph 42 of current IFRS 3 and paragraph 24 of current IAS 28.
Hong Kong	<p><u>HKICPA staff comments</u></p> <ul style="list-style-type: none"> • Our Panel tentatively agrees with the proposals and considers the proposed

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	<p>accounting for previously held interests to be consistent with the existing principles in IFRS 3 <i>Business Combinations</i> and IFRS 11 <i>Joint Arrangements</i>.</p> <ul style="list-style-type: none"> • However, we consider that paragraph BC2 of IFRS 11 is not directly relevant to the proposed amendment to IFRS 11 and suggest the IASB to elaborate clearly the reason in the Basis for Conclusions. • We noted that the IASB indefinitely postponed the effective date of a previous amendment to IFRS 10 and IAS 28 (<i>Sale or Contribution of Assets between an Investor and its Associate or Joint Venture</i>) pending the outcome of its research project on the equity method of accounting. As such, we suggest that the IASB considers whether issuing piecemeal amendments such as this clarification is necessary at this stage. We would tentatively support making the amendments as part of the IASB's comprehensive research project.
Japan	<ul style="list-style-type: none"> • Regarding the accounting for previously held interests, the ASBJ staff understand that the proposed amendments address only a limited types of transactions that involve changes in the interests. The ASBJ staff believe that the IASB should holistically address the accounting for previously held interests where the accounting for the remeasurement of previously held interests is unclear, rather than adopting a piecemeal approach, to promote the application in accordance with consistent principles. • On the other hand, the ASBJ staff believe the proposed amendments are consistent with existing requirements and they address diversity of practice regarding acquisitions of interests in businesses that are joint operations. • Therefore, the ASBJ staff suggest the IASB to address the transactions involving changes in the interests that are not considered in the proposed amendments, after the finalising the proposed amendments.
Malaysia	<p><u>MASB staff draft preliminary response</u></p> <ul style="list-style-type: none"> • We agree with the proposed amendments.

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?

Comments from the AOSSG members

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China	<ul style="list-style-type: none">• We agree with these the transition requirements. The reason is that if the amendments are applied retrospectively, entities will have to reanalyze all transactions regarding acquisition of assets and businesses according to the amendments, which is costly and sometimes impracticable for entities.
Hong Kong	<u>HKICPA staff comments</u> <ul style="list-style-type: none">• We tentatively agree with the rationale in paragraph BC4 of IFRS 11 and paragraph BC32 of IFRS 3.
Japan	<ul style="list-style-type: none">• The ASBJ staff agree with the proposed transition requirements.
Malaysia	<u>MASB staff draft preliminary response</u> <ul style="list-style-type: none">• We agree with the proposed transition requirements.