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Mr Hans Hoogervorst, Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London EC4M 6XH
United Kingdom

October 31, 2016

Dear Mr Hoogervorst,

On behalf of the Austrian Financial Reporting and Auditing Committee (AFRAC), the privately organised standard-setting body for financial reporting and auditing standards in Austria, we appreciate the opportunity to comment on *Exposure Draft ED/2016/1 Definition of a Business and Accounting for Previously Held Interests*.

Principal authors of this comment letter were Max Eibensteiner, Klemens Eiter, Peter Geyer, Christian Höllerschmid and Helmut Kerschbaumer. In order to assure a balanced Austrian view, the professional background of these authors is diverse.

GENERAL REMARKS

We welcome the initiative of the IASB and FASB to provide further guidance on the assessment whether a transaction is the acquisition of a business. Although the proposed amendments appear attractive, especially in those cases where the proposed "screening test" is applicable, we believe that the outcome of such judgment may not be meaningful in all situations. We have identified certain areas where we think the proposed guidance should be reconsidered and potentially further amended. These areas are outlined below.

We specifically address the fact that the accounting consequences of the assessment whether a transaction is the acquisition of a business or not are significant and can lead to fundamentally different numbers in the financial statements. For example, if the transaction is not the acquisition of a business, this would lead to the application of the initial recognition exemption in IAS 12.15 for deferred tax liabilities with a significant impact on certain industries such as real estate.

In addition, we think that some additional topics in IFRS 3 need to be discussed and clarified. Above all, we ask the IASB to react to or – if already on the agenda - accelerate the work on other topics raised during the Post-Implementation Review (PIR) of IFRS 3, in particular the subsequent accounting for goodwill and the effectiveness and complexity of testing goodwill for impairment.

SPECIFIC REMARKS

Question 1

The Board is proposing to amend IFRS 3 to clarify the guidance on the definition of a business (see paragraph 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 (i.e. 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?

Screening Test

We generally welcome the introduction of the "screening test" as a first step in determining whether a particular set of assets and activities is a business. This will provide a practical basis for the decision whether a transaction is the acquisition of a business or not. However, we suggest to consider the following considerations:

We raise some concerns on the definition of "gross assets" in paragraphs B11A-B11C. First, there may be situations where the consideration paid plus liabilities assumed (and non-controlling interest previously held) are equal or are substantially equal to the fair value of the gross assets acquired, despite the fact that these gross assets represent a business. For example, when acquiring a real estate company, substantially all of the fair value of the gross assets acquired may be concentrated on the real estate held by this company despite the fact that the acquired company includes a workforce servicing these real estate assets and performing asset management processes such as maintenance or rent collection. In these cases, the screening test may lead to the conclusion that the acquired set of activities and assets is not a business when in fact it is one. To mitigate such consequences and provide room for professional judgment we suggest that the proposed screening should better be used as an indication or rebuttable assumption than as a shortcut decision model.

Second, we recommend clarifying how unused tax loss carry forwards and/or deferred tax liabilities should be considered when determining the amount of "gross assets" in paragraph B11A. For example, considering significant deferred tax liabilities resulting from an acquisition being structured as a share deal may lead to the effect that the amount of "gross assets" significantly exceeds the fair value of the single asset acquired (and consequently a goodwill) also in a transaction which clearly is a purchase of a single asset (e.g. an oil/gas well). In a more general view, the determination of the fair value of the gross assets acquired as defined in paragraph B11A may trigger additional questions, such as: Why is the wording "may be determined" in the last sentence used? What alternative methods for determining the amount are possible? How are deferred tax assets, contingent considerations or non-controlling interest considered when determining gross assets? Is it appropriate to determine gross assets based on the terms of a business combination, although this is a test which should decide whether the transaction is one or not? We suggest to further clarify the definition. In any case we believe that this room for interpretation confirms our view that the screening test should be a rebuttable presumption rather than a decision model.

Evaluating whether an acquired process is substantive

With respect to the proposed guidance on the evaluation whether a set of activities and assets which does not have outputs includes a substantive process we disagree with the strong focus on the existence of an organised workforce in paragraph B12A. We think that there are situations where the set of activities and assets may not have outputs and no (own) workforce, but where it may still include a substantive process. For example, a company involved in the development of specific technologies or designs may have a contract with a service provider who performs the required activities on a contractual basis while the company itself owns intellectual property on which the technology or design is based on. Generally, we suggest to avoid the strong focus on the workforce criteria as there is an inherent danger that this would have an impact on the structuring of acquisitions in order to achieve the desired accounting consequences. For example, an acquirer may exclude the workforce from the set of acquired activities and assets, but rehire the key personnel on an individual basis after completion of the acquisition. As an alternative, we suggest the replacing of the strict rule-type requirement by a guidance which includes the absence of an organised workforce as one indicator for the assumption that the set of activities and assets does not constitute a business.

Additionally, paragraph B12A requires, besides an organised workforce, "another *acquired* input or inputs" for the determination of a business. As shown in Example D, paragraph IE 85, such other input (in this case inventories/raw materials) may be the decisive factor in such determination. We think that this does not provide a robust guidance in cases where such other input could be easily obtained on the market. In other words: We think that there should not be a different accounting for the acquisition of the factory in Example D, based only on the fact whether or not the acquirer obtains inventories (input) through the acquisition or via purchase from other suppliers. We therefore suggest to change the phrase “another acquired input or inputs” in paragraph B12A into “another input or inputs”.

While we welcome the use of examples to increase the understandability of the standards we do have some comments on these examples:

Example C appears somehow unrealistic since an acquirer would generally not buy a television station without employees or other assets if he does not have own resources to operate the station. The conclusion in IE 82 states that the activities and assets do not have outputs. In our view and given the facts (equipment, license) we would conclude that the activities and assets do have outputs since it would be easily possible to operate the station. Therefore, we question whether the conclusion in example C is correct.

As outlined above we do not agree with the design of and the conclusions reached in Example D, IE85. From a business view on the transaction the non-existence of inputs that the workforce could develop or convert into outputs should not be decisive if such input is readily obtainable on the market. See our comment above.

We think that there are some inconsistencies in example H and I: As the office park is fully leased also in example H, somebody needs to perform the activities described in example I, such as leasing, tenant management and managing and supervising all operational processes. In case the workforce is not acquired as part of the transaction as it is the fact pattern in example H, an acquirer could easily replace the workforce by own staff or outsource these activities. In addition, industry experience shows that in most cases the purchase price would not be significantly higher if the purchased set of activities and assets include the workforce. Therefore, in our opinion, the example does not reflect real situations and is too “black & white” in its conclusions. We suggest to include additional facts and information in the example which provide a broader basis for the determination whether the acquisition is a business combination or not.

<u>Question 2</u>

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 generally do not have any concerns regarding the use of different wording in the Board’s and FASB’s proposals. However, to avoid differences in practice and diverse interpretations, we suggest to include a statement that diverse interpretations and differences in application are not intended despite a different wording.

<u>Question 3</u>

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.

<u>Question 4</u>

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.

Kind regards

Romuald Bertl
Chairman