RE: Comments on the proposed amendments to IFRS 3 and IFRS 11

Dear Sir / Madam,

Mazars welcomes the opportunity to answer to the proposed amendments to IFRS 3 and IFRS 11 regarding the definition of a business and the accounting for previously held interests in a joint operation.

*Definition of a business*

As indicated in our answer to the Post Implementation Review of IFRS 3, the boundary between an acquisition of assets and a business combination is not always clear. As a consequence, we welcome any effort or project aimed at clarifying this topic.

We believe that the proposed amendments to IFRS 3 are globally positive as they clarify the different steps to undertake to reach a conclusion, which is an improvement compared to the existing guidance.

However, we have concerns regarding the proposed guidance:

- The ‘screening test’ appears rule based. It could lead to classify some transactions as assets acquisitions in situations where the application of the second part of the decision tree would lead to the adverse conclusion (i.e. one can identify inputs and a substantive process). We believe that the Board should turn the concentration of fair value into a rebuttable presumption that the acquired set of activities and assets is not a business.
The notion of an organised workforce, capable to perform a substantive process, appears to be a key factor in assessing whether an acquired set of activities and assets constitutes a business. We therefore recommend the IASB to clarify this notion and help drawing the dividing line between an organized workforce that represents a substantive process and one that does not.

The Board considers that the presence of more than an insignificant amount of goodwill is an indicator that an acquired process is substantive and the acquired set of activities and assets is a business (in the current IFRS 3, the presence of goodwill leads to a presumption that the acquired set is a business). We agree with that statement, but we do not see clearly how the assessment of this indicator interacts with the rest of the guidance.

We also appreciate the IASB’s efforts to give practical examples of how to apply the guidance for concluding whether an acquisition is a business or a group of assets. However, some examples would need to be reconsidered or further clarified.

*Accounting for previously held interests*

We agree with the proposed amendment to IFRS 3 and IFRS 11 regarding the accounting for previously held interests in a joint operation. Remeasuring those interests when obtaining control of a joint operation that is a business is consistent with other types of step acquisitions.

Our answers to the specific questions raised in this exposure draft are presented in the attached appendix.

We would be pleased to discuss our comments with you and are at your disposal should you require further clarification or additional information.

Yours sincerely,

Michel Barbet-Massin  
*Head of Financial Reporting Technical Support*
Appendix: detailed answers to the questions raised in the exposure draft.

**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 (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?

Overall, as the existing guidance is not always applied consistently, giving rise to diversity in practice, we believe that the proposed amendments to IFRS 3 are an improvement.

We believe that the use of a systematic approach is useful. This said, including a flowchart based on the wording of paragraphs B12A and B12B, or even preferably a flowchart guiding through the different steps, would be most helpful to the users.

**Screening test**

We believe that the introduction of a ‘screening test’ is useful. However, we think that it should only be used as an indicator, or a rebuttable presumption, rather than as a decisive factor in a rule-based approach. Users should be able to exercise their professional judgement and consider all relevant factors before reaching a conclusion.

There may be situations, in capital intensive industries (real estate, wind or solar farms…) or other industries (biotechs…), where substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, and where the transaction also includes a substantive process, or an organised workforce capable of performing a substantive process. The proposed amendment would lead to the conclusion that the transaction is the acquisition of a group of assets whereas one would normally consider that the set of activities is a business (and applying the second part of the decision tree would lead to that conclusion).

Moreover, we believe that the guidance is not clear on how to implement the screening test, and in particular how to measure the fair value of the gross assets acquired. The method proposed in paragraph B11A (adding the fair value of the liabilities to the fair value of the...
consideration paid) is only an example, and we think that the fair value of the gross assets could also be measured by adding the fair value of the acquired identifiable and non-identifiable assets (resulting from a pre-PPA). In that respect, illustrative examples are not really useful: they do not illustrate how to implement the screening test. They rather make a statement on the concentration of fair value that is both part of the fact pattern and the conclusion of the screening test.

**Substantive process**

We support the core principles of the guidance on evaluating whether an acquired process is substantive.

We agree that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive. However, the IASB should clarify how the assessment of this indicator interacts with the rest of the guidance as this indicator seems to be left apart in the analysis required by § B12A-B12B.

The IASB should also clarify how the goodwill is determined for purposes of assessing this indicator, as goodwill does not always reflect the value of substantive processes (for example when goodwill arises from deferred tax liabilities).

Example J (acquisition of oil and gas operations) let us think that a substantive process may be included in the acquired assets themselves (IE104), without the need for an organised workforce to operate them. While we agree with the conclusion of this example that the acquisition is a business combination, we note that the proposed amendments to the standard present the non-current assets as inputs (B7(a)) and not as processes.

We believe that if the infrastructure is considered capable of including a substantive process, it should be clearly stated in the standard (and not only in the illustrative examples). Moreover, a guidance should be included helping identify assets that include a substantive process. Indeed, an increasing number of industries are based on assets that do not require a workforce to operate (e.g. wind or solar farms): it would be useful to have a guidance that helps assessing whether those assets include a substantive process.

**Organised workforce**

We believe that the guidance provided in B12C on how to determine, in the case where an acquired contract gives access to an organised workforce, whether the acquirer has control over the organised workforce could be further detailed, and would benefit from an example to illustrate how this guidance can be applied.

Also, it is not always clear whether an organized work force, that is an input (see § B12A), includes a substantive process (§ B12C).

Considering the weight given to the notion of an organized workforce, the guidance would benefit from a definition of this notion. It is not clear whether it is restricted to the criticality of the individuals composing a workforce which cannot be easily replaced or whether it also encompasses a workforce that can easily be replaced. In practice, what are the key elements determining that the workforce is a critical process or an input?
Illustrative examples

We appreciate the IASB’s efforts to give practical examples on how to assess whether an acquisition meets the requirements of a business or an asset. In general, the examples are useful because they help illustrate theoretical and/or abstract areas. However, some examples should be further clarified and/or be more realistic.

In particular, the examples should focus more on the main areas of judgement, and the fact pattern and rationale for the conclusion should be more detailed, so that one can easily identify the key elements that govern the conclusion. Some fact patterns could be proposed with variations to help better understand which element of the fact pattern is differentiating.

As an illustration of this point, we think that the conclusion reached on example D (Acquisition of a manufacturing facility) is not straightforward:

- It is concluded that the set of activities and assets purchased is not a business because there is no other acquired input that the workforce could develop or convert into outputs. As a business does not need to include all the necessary inputs (BC10), the conclusion is difficult to understand.

- We question whether acquiring some inventory would have changed the conclusion. For example, raw materials inventory could probably be converted into outputs by the employees through the use of the acquired equipment.

- If the missing input can be easily procured from any supplier, why is it so important that the acquired set of activities and assets includes inventories for being qualified as a business?

- It would be helpful to propose variations in order to understand when the judgment switches from asset to business.
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 believe that the proposals are closely aligned and this will contribute to a consistent application.

We strongly encourage the IASB and the FASB to work closely to converge as much as possible. That is why we regret that the IASB has conducted its PIR of IFRS 3 later than the FASB. The FASB is currently redeliberating its Exposure-Draft and has already made decisions, while the IASB is still waiting for comment letters. We fear that the IASB will align on FASB’s decisions without having the opportunity to debate and to be part of the decision.
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 support the IASB’s proposal to clarify the accounting for previously held interests in the assets and liabilities of a joint operation when an entity obtains control over a joint operation meeting the definition of a business.

We agree with the proposed amendment. Having a similar accounting treatment for previously held interests for the different types of transactions by which an entity obtains control of a business is logical.

This said, we are not convinced that this situation is frequent in practice.
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?

Yes, we agree. Prospective application, with early application permitted, appears to be a reasonable approach in the circumstance (as it will not require to revise IFRS 3 classification for past operations, which would have been burdensome with low benefits compared to cost).