11 November 2016

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

RESPONSE TO EXPOSURE DRAFT – DEFINITION OF A BUSINESS AND ACCOUNTING FOR PREVIOUSLY HELD INTERESTS (PROPOSED AMENDMENTS TO IFRS 3 AND IFRS 11) (“ED”)

ISCA sought views from its members on the above ED through a two-month public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms.

We welcome and support IASB’s initiative to clarify the guidance on the definition of a business and the accounting for previously held interests, as under the existing guidance, it is challenging for preparers to distinguish between an asset acquisition and a business acquisition. The distinction between an asset acquisition and a business acquisition is particularly important because of differences in accounting treatments (other than goodwill) such as those stated below.

(i) The recognition of deferred taxes arising from initial recognition of assets and liabilities in the case of business combinations, but not in the case of asset acquisitions.

(ii) The expensing of acquisition-related costs in the case of business combinations, but capitalisation of such costs in the case of asset acquisitions.

(iii) The different measurement basis used for assets acquired under a business combination (fair value at acquisition date) and assets acquired under the case of asset acquisitions (cost basis for most non-financial assets). For example, the carrying amount of a hotel would be different, depending on whether the acquisition is treated as a business combination or an asset acquisition.

(iv) Contingent liabilities assumed in a business combination are recognised if it represents present obligation that arises from past events and its fair value can be measured reliably with subsequent changes to profit or loss. Under asset acquisition, this is not recognised and is subject to requirements of IAS 37.
As highlighted in our previous comment letter, dated 17 June 2014, for “Request for Information – Post-implementation Review: IFRS 3 Business Combinations”, we do not see any convincing reasons or perceived benefits for the above differences and further noted that these differences could result in structuring opportunities whereby companies structure their deals such that they achieve their preferred accounting treatment. We would like to take this opportunity to urge IASB to re-assess whether the differentiated accounting treatment is justified and warranted.

We also believe that there are certain areas which could be enhanced to achieve greater consistency and less complexity in its application. Our detailed comments and responses to the questions in the ED are set out below.

**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?*

We generally agree with the proposed clarification of the guidance on the definition of a business as it makes it more precise and allows for lower degree of judgement.

Paragraph B8A provides a 2-step screening test to aid in the determination of whether a set of activities and assets acquired constitutes a business.

We agree that the screening test will provide a practical and expedient way for entities to determine whether an acquired set of assets and activities is a business acquisition or an asset acquisition.

Notwithstanding the above, we are concerned that the screening test may result in some transactions being classified as an asset purchase once the transaction meets the criteria set in step 1 of the screening test (i.e. substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar assets) even though the transaction may meet the proposed definition of a business. In capital-intensive industries, an acquired set of activities and assets may be “dominated” by a single high-value asset, and the organised workforce included in the set of activities may be assigned a relatively low value even though it is critical to the ability to develop the inputs into goods to be provided to customers. In view of this potential inconsistency, we would like to suggest for the screening test to be retained as a “rebuttable presumption” whereby there is room for judgment to be exercised to result in a conclusion that best reflects the economics of a transaction.
In addition, we believe that the meaning of a “group of similar identifiable assets” may not be clear. In a case of a mixed property development comprising retail and residential elements that was purchased, it is not clear whether the retail and residential elements located within the same property could be considered “similar”. Although IFRS 3, paragraph B11C lists down assets which should not be considered similar, we believe that an entity may require to use significant judgement in determining what is “similar” if no further clarification is provided.

Examples in paragraphs IE 74 to IE 107 illustrate the guidance on the definition of a business

We agree that the examples have provided much needed guidance to demonstrate the principles in the proposed amendments to the definition of a business.

In Illustrative example D (paragraph IE83 to IE85), the criteria in paragraph B12A is applied on the basis that “the purchased set of activities and assets is not currently producing outputs”. We wish to highlight that this may lead to entities wrongly concluding that IFRS 3, paragraph B12A will apply as long as no outputs is produced at the acquisition date, notwithstanding that the acquired inputs and processes would still be “capable of generating outputs and so qualify as a business, if the criteria in paragraph B12B are met. In view of this potential misconception, we would like to suggest for further clarification to be made in this illustrative example.

Basis for Conclusions paragraph BC12 explains the rationale of the removal of the consideration of the ability of market participants to integrate the acquired set of activities and assets from paragraph B8

The removal of “market participants’ perspective” from paragraph B8 is helpful as the assessment of whether an acquired set of activities and assets include a business should be based on what has been acquired from the acquirer’s perspective instead of on how a market participant could potentially integrate the acquired set of activities and assets.

Basis for Conclusions paragraph BC14 explains the rationale for retaining the evaluation of an acquired set to be performed from a market participant’s perspective as stated in paragraph B11

We noted that in contrast to the removal of the “market participants’ perspective” above, IASB has retained the “market participants’ perspective” in the evaluation so as to prevent similar transactions being accounted for differently depending on the intention of the acquirer.

We believe that the intention of the acquirer including business rationale, strategic considerations and objectives of the acquirer are important factors that should be considered in determining whether there is an asset purchase or a business purchase. For instance, an acquirer has purchased a run-down hotel with the intention to demolish it and to
build a new condominium in its place. This would have been considered to be an asset purchase. Whereas another acquirer who purchased a similar run-down hotel has the intention to improve the hotel so as to continue running it as a hotel. This would have been considered to be a purchase of business. Using the guidance under paragraph B11, the winning acquirer may be “forced” to account for the purchase of the run-down hotel as an asset acquisition if the other market participants have evaluated that the run-down hotel as not being capable of being conducted and managed as a business. The accounting treatment would not be reflective of the true economics of the transaction. We would like to propose for the removal of “market participants’ perspective” from paragraph B11.

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 are of the view that identical wording (if possible) should be used to minimize differences in application / interpretation under IFRS and under US GAAP. We do not have any comments on the differences that could emerge as a result of different wording.

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.

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 noted and agree with IASB’s rationale for proposing prospective application of the amendments to IFRS 3 and IFRS 11 in view that retrospective application of these proposals may be costly and impracticable.

We wish to highlight that Singapore listed companies are required to transit to IFRS for annual periods beginning on or after 1 January 2018, accordingly these companies are required to apply the requirements of IFRS 1. IFRS 1 generally requires retrospective application unless there are transitional reliefs from retrospective application in IFRS 1. In view of the cost and impracticability of retrospective application of the proposals, we would like to suggest for similar transitional reliefs to be provided in IFRS 1.

Should you require any further clarification, please feel free to contact Ms Lim Ju May, Deputy Director, Technical Advisory and Professional Standards, or Ms Felicia Tay, Manager, Technical Advisory and Professional Standards, from ISCA via email at jumay.lim@isca.org.sg or felicia.tay@isca.org.sg respectively.

Yours faithfully,

Titus Kuan
Director
Technical Advisory and Professional Standards