

Draft Comment Letter

Comments should be submitted by [18 October 2016] to
commentletters@efrag.org

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

[Date]

51. Sitzung IFRS-FA am 28.07.2016
51_04c_IFRS-FA_DefinitionBusiness_EFRAG_DCL

Dear Mr Hoogervorst,

Re: Exposure Draft ED/2016/01 *Definition of a Business and Accounting for Previously Held Interests*

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on Exposure Draft ED/2016/01 *Definition of a Business and Accounting for Previously Held Interests*, issued by the IASB on 28 June 2016 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

Definition of a business

EFRAG welcomes the IASB's objective of providing clearer application guidance to help determine whether an acquired set of activities and assets constitutes a business. The proposals respond to concerns expressed by many preparers of financial statements that the definition in IFRS 3 *Business Combinations* is too broad and lacks guidance on what should not be considered a business. This has resulted in a number of acquisitions being treated as business combinations which, in the view of the preparers, should have been treated as 'asset acquisitions'.

Overall, we believe that the proposals provide a more comprehensive framework for distinguishing business combinations from asset acquisitions compared to the current guidance in IFRS 3. We also believe the proposals are pragmatic and should help to reduce the workload in making this distinction in various situations that can be problematic under the current guidance. We agree that a business must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs.

We also support the inclusion of a 'screening test'. We understand this is intended to serve as a practical solution to allow entities to make the distinction relatively quickly in cases that are predominantly asset acquisitions, thereby limiting the need for further analysis. This should result in cost savings for preparers in these cases. However, we suggest some improvements are made to the application of the proposed screening test in relation to more borderline cases.

In respect of the proposed guidance on evaluating whether an acquired process is substantive, we agree with having two different sets of criteria depending on whether the set of activities and assets has outputs.

IASB ED Definition of a Business and Accounting for Previously Held Interests

We agree that examples are important in illustrating the application of the principles in the proposed guidance. However, we recommend that the examples focus more on the areas of the guidance that require significant judgement.

Finally, EFRAG encourages the IASB and the FASB to reach converged solutions on their respective proposed amendments.

Accounting for previously held interests

EFRAG supports 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 that meets the definition of a business. We agree that the proposal is consistent with the existing principles in IFRS 3.

We also support the proposed accounting for previously held interests in respect to the transactions described in paragraph B33C of the ED on the amendments to IFRS 11 *Joint Arrangements*.

EFRAG's detailed comments and responses to the questions in the ED are set out in the Appendix.

If you would like to discuss our comments further, please do not hesitate to contact Isabel Batista, Vincent van Caloen or me.

Yours sincerely,

Jean-Paul Gauzès
President of the EFRAG Board

APPENDIX

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?

Notes to constituents

- 1 *The IASB is proposing amending the description of a business slightly to read “A business consists of inputs and processes applied to those inputs that have the ability to contribute to creating outputs”. In doing so, the ED proposes to:*
 - (a) *clarify that to constitute a business, the 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.*
 - (b) *define ‘output’ as the result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest) or other revenues.*
 - (c) *delete the part of the sentence in paragraph B8 of IFRS 3 Business Combinations that refers to market participants’ capacity to acquire the business and continue to produce outputs.*
- 2 *The IASB decided to retain the requirement to perform the assessment from a market participants’ perspective of whether an acquisition includes a business, because relying on the business rationale and the strategic considerations of the acquirer would increase the subjectivity of the assessment and thus the diversity in practice.*

The proposed screening test

- 3 *The ED proposes that an entity assesses whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. If that is the case, the set of activities and assets is not a business.*
- 4 *The ED clarifies that 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).*
- 5 *Further the ED clarifies that the following would be considered as a single identifiable asset:*
 - (a) *a group of assets that would be recognised and measured as a single identifiable asset in a business combination; and*
 - (b) *tangible assets that are attached to, and cannot be physically removed and used separately from, other tangible assets without incurring significant cost, or significant diminution in utility or fair value to either asset.*

- 6 The ED does not define a group of similar identifiable assets. It proposes that the following assets shall not be combined into a single identifiable asset or considered a group of similar identifiable assets:
- (a) separately identifiable tangible and intangible assets;
 - (b) different classes of tangible assets (for example, inventory and manufacturing equipment) unless they meet the criterion to be considered a single identifiable asset;
 - (c) identifiable intangible assets in different intangible asset classes (for example, customer-related intangibles, trademarks, and in-process research and development);
 - (d) financial assets and non-financial assets; and
 - (e) different classes of financial assets (for example, cash, accounts receivable and marketable securities).
- 7 The ED clarifies in illustrative example A that an asset such as a building and an in-place lease are considered a single asset, because they are recognised and measured as a single identifiable asset in a business combination under IFRS 3. Illustrative example B (In process R&D project) and illustrative example H (Acquisition of investment properties) also illustrate when the fair value of the assets acquired is concentrated in a single asset.

Evaluating whether an acquired process is substantive

- 8 The ED does not provide a definition of a substantive process, but proposes two sets of criteria to determine whether an acquired set of activities and assets contains an input and a substantive process that together contribute to the ability to create outputs:
- (a) when an acquired set of activities and assets **does not, at the acquisition date, have outputs** (for example, an early-stage entity that has not started generating revenues), the set is a business only if it includes an **organised workforce** (which is an input) with the necessary skills, knowledge, or experience to perform an acquired substantive process that is **critical** to the ability to develop or convert another acquired input or inputs into outputs.
 - (b) when an acquired set of activities and assets **has outputs at the acquisition date** (for example, when it generates revenue before the acquisition), the set is a business if either:
 - (i) the acquired set of activities and assets includes a **process** (or group of processes) that, when applied to an acquired input or inputs, **contributes to the ability to continue producing outputs** and is considered **unique or scarce, or cannot be replaced** without significant cost, effort, or delay in the ability to continue producing outputs; or
 - (ii) the acquired set of activities and assets includes an **organised workforce** with the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that, when applied to an acquired input or inputs, is **critical** to the ability to continue producing outputs.
- 9 The ED clarifies that an acquired contract is not a substantive process, but may give access to an organised workforce. An entity is required to assess whether an organised workforce accessed through such a contractual arrangement performs a substantive process that it controls, and has therefore acquired.

- 10 Finally, the ED proposes to clarify that when evaluating whether an acquired set of activities and assets includes a substantive process, the presence of an insignificant amount of goodwill should not be considered as an indicator that an acquired process is substantive and the set of activities and assets is a business.

Illustrative examples

- 11 The ED proposes examples in paragraphs IE73-IE107 to illustrate the guidance on the definition of a business.
- 12 The examples A, B and H illustrate circumstances where the fair value is concentrated in a single identifiable asset or group of similar identifiable assets.
- 13 The examples C, D and E illustrate the application of the criteria when an acquired set of activities and assets does not have outputs.
- 14 The examples F, G, I, J and K illustrate the application of the criteria when an acquired set of activities and assets has outputs. In particular, examples G and J illustrate circumstances where the criterion in paragraph B12B(a) of the ED is met, whilst for examples I and K the criterion in paragraph B12B(b) of the ED is met.

EFRAG's response

EFRAG welcomes the IASB's objective of providing 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 challenges and reduce the assessment work required in various situations that can be problematic under IFRS 3's existing guidance.

We agree that a business must include, at a minimum, an input and a substantive process that together contribute to the creation of outputs, and we support the proposed change to the definition of output.

We also support the inclusion of a 'screening test'. We understand this is intended as a mandatory first step in the analysis and serves as a practical solution to allow entities to distinguish an asset (or group of assets) from a business relatively quickly in cases that are predominantly asset acquisitions. That is, in cases where substantially all of the fair value of the acquired set is concentrated in a single identifiable asset or group of similar identifiable assets, the set of activities and assets acquired would not constitute a business and no further analysis is needed. This should result in cost savings for preparers. However, we suggest some improvements are made to the application of the proposed screening test in relation to more borderline cases.

We agree with having two different sets of criteria when evaluating whether an acquired process is substantive, depending on whether the acquired set of activities and assets has outputs.

We provide a number of suggestions for improving the application of the proposals to the definition of a business.

Finally, we recommend that the illustrative examples focus more on the areas of the guidance that require significant judgement.

- 15 EFRAG's response is structured into four sections:
- (a) a business consists of inputs and processes applied to those inputs that have the ability to contribute to creating outputs;
 - (b) if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar assets (the proposed screening test);

- (c) evaluating whether an acquired process is substantive; and
- (d) the illustrative examples.

A business consists of inputs and processes that contribute to creating outputs

- 16 EFRAG agrees that a business must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs. We consider that these minimum requirements provide a helpful framework to help entities distinguish between an asset acquisition and a business combination. Absent these minimum requirements, the definition of a business would be so broad as to potentially include many transactions that economically are more in the nature of asset acquisitions.
- 17 EFRAG supports the proposed change to the definition of outputs to narrow the definition to focus on goods and services provided to customers. In our view, it is not always clear what the current definition of outputs in IFRS 3 represents.
- 18 The proposed definition of outputs is “the result of inputs and processes applied to those inputs that provide goods or services to customers, investment income (such as dividends or interest) or other revenues”. This definition excludes returns in the form of lower costs and other economic benefits provided directly to investors or other owners, members or participants and defines output.
- 19 We understand that the reason for including ‘other revenues’ is that not all entities have revenues that are within the scope of IFRS 15 *Revenue from Contracts with Customers*. However, EFRAG is concerned that the term may be interpreted more broadly than intended and/or interpreted in different ways. We therefore recommend that the IASB clarify in paragraph 7(c) or in the Basis for Conclusions what is intended to be included in ‘other revenues’. We recognise that paragraph BC17 refers to circumstances where the output of the entity is sold to ‘internal’ customers (that is, other entities in the same group) in cases when an acquirer buys a supplier and subsequently consumes all the output from the supplier, which may indicate that ‘other revenues’ include intra-group revenue. We recommend that this be made clearer as other activities may also generate revenues outside the scope of IFRS 15, such as activities in the scope of IFRS 16 *Leases* or IFRS 4 *Insurance Contracts*.
- 20 Furthermore, EFRAG agrees with the deletion in paragraph B8 of IFRS 3 of the reference to the ‘market participant’s capability’ of replacing missing elements by integrating the acquired set of activities and assets into its own and continuing to produce outputs. We acknowledge that, as written, paragraph B8 is too broad. We support the IASB’s view that the assessment of whether an acquisition is a business should be based on what has been acquired, rather than whether some specific market participants could replace missing elements.
- 21 We note that the ED retains the reference to ‘market participant’ in paragraph B11 of IFRS 3. We understand this reference is to market participants in general. This is because it is used in the context of clarifying that, when assessing whether an acquired set of activities and assets is a business, it is not relevant whether the specific seller operated the set as a business or whether the specific acquirer intends to do so.
- 22 However, we understand that some may interpret the wording ‘by a market participant’ in B11 to be inconsistent with a definition of a business that focuses on the ‘ability to contribute to create outputs’, irrespective of whether it is conducted or managed as a business by a particular market participant. We therefore suggest deleting the words ‘by a market participant’ in the first sentence of paragraph B11. This change would also highlight the importance of the fact-driven nature of this assessment, irrespective of the assessor’s own circumstances (including those of a specific market participant).

- 23 Finally, we recommend the IASB to clarify whether an acquired 'integrated' set of assets and activities is intended to mean the same as an acquired set of assets and activities.

The proposed screening test (assessment of concentration of fair value)

- 24 The ED proposes a screening test designed to simplify the assessment of whether an acquired set of activities and assets constitutes a business. We understand that the proposal is intended as a mandatory first step in the analysis and serves as a practical solution to simplify the assessment in some cases. The effect of the screening test is that, in cases where substantially all of the fair value of the acquired set is concentrated in a single identifiable asset or group of similar identifiable assets, the set of activities and assets acquired is not considered to constitute a business and no further analysis is needed.
- 25 We appreciate the difficulties in drafting a practical solution that is easy to apply, addresses concerns that the existing definition is too broad and reaches the appropriate conclusion in every possible set of facts and circumstances. On this basis we agree with the IASB (paragraph BC19) that, in most cases, the proposed screening test and the guidance on the definition of a business (including evaluation of substantive processes) would result in the same conclusion.
- 26 EFRAG observes that the application of the current guidance in borderline cases requires a significant amount of judgement. We therefore support the proposal on the grounds that we consider that the screening test will make the analysis more straight-forward and should result in overall cost savings for preparers in some cases that currently require significant judgement.

Similar identifiable assets

- 27 EFRAG observes that the ED does not define the term 'similar', but only describes circumstances, in paragraph B11C, in which certain classes of assets should not be considered to be similar. Some may interpret the guidance in paragraph B11C as meaning that assets in the same major asset class are similar, even though the individual assets may have different risk and/or economic characteristics.
- 28 In order to ensure that the screening test is applied consistently, we recommend that the IASB articulate in a more principle-based manner when assets can be deemed similar for this purpose. This should clarify which factors play a role in this assessment (for example, that the nature, risks and characteristics of the assets should be similar) without broadening the scope of the proposed screening test.
- 29 EFRAG also recommends that the IASB provide additional clarification by expanding the examples on the application of paragraphs B11B-B11C of the ED to better illustrate the grouping of similar identifiable assets.

Evaluating whether an acquired process is substantive

- 30 The ED proposes guidance to assist entities in determining whether a substantive process has been acquired. The proposed amendments include two different sets of criteria for consideration, depending on whether the acquired set of activities and assets has outputs. Paragraph B12A addresses situations in which the acquired set has no outputs, and paragraph B12B addresses situations with outputs.
- 31 EFRAG understands that different sets of criteria are proposed because more persuasive evidence is required when the acquired set of activities and assets has no outputs. In such cases, the acquired set is a business only if it includes both (i) an organised workforce that performs a process that is critical to the creation of outputs; and (ii) another input (or inputs) that is (are) intended to be developed into outputs. We understand that the guidance in B12A implies that if an acquired set of

assets and activities has no outputs, the absence of an organised workforce would mean that the set cannot meet the definition of a business. Accordingly, the absence of an organised workforce is decisive in these cases. For the avoidance of doubt, we recommend that the IASB clarifies that in such cases the absence of an organised workforce would mean that the set cannot meet the definition of a business under B7 and B8 of the ED. In contrast, if the set has outputs, the guidance in B12B(a) implies that an organised workforce is not required if the set includes a process (or processes) that is (are) unique or scarce or cannot be replaced without significant cost, effort or delay in the ability to continue to produce outputs.

- 32 We note that the relevance to the assessment of the presence or absence of an organised workforce could become increasingly questionable as the trend towards automation of certain business process continues. We therefore believe this aspect of the guidance might need to be revisited in due course. Nonetheless, we consider this aspect of the guidance to be appropriate and helpful for the time being.
- 33 More generally, we agree that having different sets of indicators is helpful when evaluating whether an acquired process is substantive. We also consider the criteria to be appropriate indicators that a substantive process has been acquired, in cases when the acquired set of activities and assets has outputs and when it does not. In particular, we consider that it is helpful to have a set of criteria to assess a substantive process when an acquired set of activities and assets has no outputs on the grounds that these cases have generally provided more problematic under existing guidance.
- 34 To determine which set of criteria should be used, paragraphs B12A and B12B of the ED refer to the presence of outputs at the acquisition date. However, paragraph BC17 of the ED refers to the capability of generating outputs. We understand this difference to be intentional in that paragraphs B12A and B12B are referring to the presence or absence of actual outputs at the acquisition date. However, to mitigate any potential inconsistency, EFRAG recommends that the IASB reviews paragraph BC17 of the ED to ensure that there is no confusion on the meaning of ‘has outputs’ when determining which set of criteria should be applied.
- 35 EFRAG also agrees that the presence of more than an insignificant amount of goodwill may indicate that an acquired process is substantive. However, we consider that the discussion of the presence of goodwill may cause confusion if considered as a separate indicator in addition to the two sets of indicators. EFRAG therefore recommends that the first two sentences of paragraph B12 are moved to the Basis for Conclusions.

Illustrative examples

- 36 EFRAG considers that examples are helpful to clarify the application of the proposed guidance. However, we also consider that the illustrative examples should focus on the areas of the guidance where significant judgement is required.
- 37 In addition, in EFRAG’s opinion, some of the proposed examples may not clearly illustrate the application of the principles and may lead to confusion. This is primarily the case in relation to the examples that illustrate the application of the screening test and the application of the substantive process criteria in cases where an acquired set of activities and assets do not have outputs.
- 38 In particular, we consider that the following areas of judgement are not sufficiently clear in the illustrative examples provided in the ED:
- (a) It is unclear which factors should be considered to determine whether a group of assets is similar: example H refers to a broad class of tangible assets (any ‘office building’, therefore irrespective of age, lease term, location or nature of

the office space), whilst example A refers to similar characteristics ('all single-family homes', therefore referring to a specific category of residential homes).

- (b) Example C refers to an acquisition of a television station but states that the set of activities and assets does not have outputs. In our view, the mere fact that it is a television station could imply the presence of some form of output such as transmission of content. We recommend that the title of the example is changed to acquisition of 'broadcasting assets' to avoid confusion.
 - (c) It is unclear which factors determine whether an acquired set of activities and assets is capable of producing outputs: example D refers to "not currently producing outputs" and example E states "has not yet generated revenues and does not have outputs". However, the definition of a business in paragraph B7 of the ED refers to the ability to generate outputs, and paragraph BC17 indicates that the assessment of a business must focus on "capable of generating outputs". We are concerned that example D appears to contradict paragraph BC17 as it relates to very similar circumstances.
 - (d) Example D does not provide the basis for determining that there is an organised workforce. As the factory was closed down, employees no longer work in the facility. One interpretation could be that the acquirer hires former employees on an individual basis.
 - (e) Example I (in paragraph IE99) implies that the entity has measured the value of its organised workforce and has concluded that there is significant fair value associated with the acquired workforce. This seems inconsistent with the last sentence of paragraph B11A, which implies that this is not required in order to apply the proposed screening test.
- 39 Finally, EFRAG observes that the illustrative examples should clarify further the following areas of judgement when applying the indicators set out in paragraphs B12A and B12B of whether an acquired process is substantive:
- (a) Can processes be considered as "critical" if they can be easily sourced from market participants? Or should only "unique" processes that are critical to the ability to continue producing outputs be considered to be substantive?
 - (b) To which extent should the acquired set of activities and assets be "capable" of producing outputs? Should the output be comparable to the output generated by the acquiree prior to the acquisition? Should the output consist of similar goods and/or services?

Question to constituents

- 40 Do you consider that the proposed illustrative examples are sufficient to illustrate how the proposed guidance on what is considered a business should be applied? If not, which areas of the proposed guidance should be clarified further in the illustrative examples?

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?

Notes to constituents

- 41 *The Basis for Conclusions states that 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.*
- 42 *The differences are as follows:*
- (a) *the illustrative examples were amended to clarify that a building acquired and an in-place operating lease shall be considered a single asset for the evaluation of the 'substantially all' threshold when applying the proposed screening test;*
 - (b) *the Basis for Conclusions was amended to address the case when an entity acquires a supplier that then ceases generating revenues, because all output is consumed by the acquirer;*
 - (c) *the paragraphs relating to the proposed screening test are presented before the proposed guidance on substantive processes;*
 - (d) *additional guidance is provided on the concept of 'gross assets acquired';*
 - (e) *the guidance on whether an acquired contract can be a substantive process has been simplified (paragraph B12C of the ED);*
 - (f) *one additional illustrative examples has been included (example K – acquisition of mortgage loan portfolio); and*
 - (g) *the wording of the illustrative examples has been streamlined.*

EFRAG's response

EFRAG encourages the IASB and the FASB to reach converged solutions on their respective proposed amendments.

- 43 EFRAG understands that the IASB's proposed amendments to IFRS 3 and FASB's Proposed Accounting Standards Update *Clarifying the Definition of a Business* are based on substantially converged tentative conclusions.
- 44 We also understand that the objective of FASB's Proposed Accounting Standards Update was to narrow the application of the definition of a business in US GAAP so that practice under US GAAP and IFRS may be more closely aligned.
- 45 We therefore encourage the IASB and the FASB to reach converged solutions on their respective proposed amendments.

Question to constituents

- 46 Do you anticipate any difference in practice in applying IFRS or US GAAP as a result of the differences in 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?

Notes to constituents

Proposed change to IFRS 3

- 47 *The ED states that obtaining control of a business that is a joint operation for which the acquirer held an interest in its assets and liabilities immediately before the acquisition date (either as a joint operator or as a party to a joint arrangement as defined in IFRS 11) is a business combination achieved in stages.*
- 48 *The ED proposes that when an entity obtains control of a joint operation that is a business, the previously held interest in the assets and liabilities of that joint operation are remeasured to fair value.*

Proposed change to IFRS 11

- 49 *The ED proposes that when an entity increases its interest in a joint operation, in which the entity is already a joint operator, but joint control is maintained, the previously held interests in the in the assets and liabilities of that joint operation are not remeasured.*
- 50 *Previously held interests are also not remeasured when an entity that is already a party to a joint operation increases its interest and obtains joint control of that joint operation.*
- 51 *In reaching these conclusion, the IASB observed that, the transactions do not result in a change in the group boundaries or the method of accounting of the previously held interests in the operation (IFRS 11 principles apply before and after the transaction).*

EFRAG's response

EFRAG agrees with the proposed amendments.

- 52 *EFRAG supports 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 that meets the definition of a business. We agree that the proposal is consistent with the existing principles in IFRS 3.*
- 53 *We also support the proposed accounting for previously held interests in respect to the transactions described in paragraph B33C of the ED (amendments to IFRS 11). We agree that the proposals are consistent with existing principles that no remeasurement of a previously held interest is required when the underlying transaction does not result in a change in the group boundaries or the method of accounting for previously held interests in the joint operation.*

- 54 We also agree that the proposal to amend paragraph B33C of IFRS 11 is consistent with the principle in paragraph 24 of IAS 28 *Investments in Associates and Joint Ventures*. This states that when an investment in an associate becomes an investment in a joint venture (or vice versa), the entity does not remeasure the previously held interest because the entity continues to apply the equity method before and after the transaction.
- 55 We observe that paragraph BC3 of the proposed amendment to IFRS 11 could imply a wider scope than the proposed change to paragraph B33C. Paragraph BC3 refers to cases when “an investor obtains joint control of a business that is a joint operation”. We believe the proposals intend to capture only transactions for which the previously held interests were accounted for under IFRS 11 both before and after the transaction (in other words, cases in which the reporting entity was previously a party to the joint operation in question and had rights to the assets, and obligations for the liabilities, relating to the joint operation). We therefore recommend that the IASB reviews paragraph BC3 and clarifies this wording if necessary.

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?

Notes to constituents

- 56 *The ED proposes that an entity would be required to apply the proposed amendments to IFRS 3 and IFRS 11 to any transaction that occurs on or after the date from which the amendments are first applied, with earlier application of the amendments permitted.*
- 57 *The Basis for Conclusions of the ED states that the IASB considered that requiring retrospective application would be costly and impracticable in most situations, as it would require an entity to go back and analyse all of its acquisitions of both assets and businesses to re-evaluate the new definition and its accounting effect.*

EFRAG’s response

EFRAG agrees with the proposed transition requirements.

- 58 EFRAG generally supports retrospective application of new, or amendments to existing, Standards and Interpretations.
- 59 However, in this case, EFRAG agrees that the proposals should be applied prospectively (on or after the effective date of the amendments) as the costs for preparers of retrospective application are expected to outweigh the benefits to users in the way of decision-useful information.