SwissHoldings

Verband der Industrie- und Dienstleistungskonzerne in der Schweiz
Fédération des groupes industriels et de services en Suisse
Federation of Industrial and Service Groups in Switzerland

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

Comment Letter on the Exposure Draft – Definition of a Business and Accounting for Previously Held Interests

Dear Madam, dear Sir

SwissHoldings, the Swiss Federation of Industrial and Services Groups in Switzerland, represents 61 Swiss groups, including most of the country's major industrial and commercial enterprises. We very much welcome the opportunity to provide comments to this Exposure Draft.

Our detailed response (in the appendix) has been prepared in conjunction with our member companies.

Yours sincerely

SwissHoldings
Federation of Industrial and Service Groups in Switzerland

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cc SH Board

APPENDIX

ANSWERS TO SPECIFIC QUESTION IN INVITATION TO COMMENT

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?

Answer to Question 1

In general, we are supportive of the Board's objective to clarify the definition of a business. The determination of whether a transaction constitutes a business combination or an asset acquisition is very important to our members as the accounting significantly differs between the two types.

The introduction of the concept that a transaction is not a business combination, if the entire value is primarily concentrated in a single identifiable asset, would certainly simplify the business versus asset acquisition assessment for such transactions. In order to ensure that there is a consistent view on what is considered to be a single asset we suggest some refinements to the wording, in particular in IFRS 3.B11B.

This paragraph currently defines a single identifiable asset by reference to a single identifiable asset recognised in a business combination. Presumably reference is being made to IFRS 3.11 which states that the recognised assets and liabilities must meet the definitions in the framework. We think this is insufficient as this reference does not clearly answer the question on whether assets with similar characteristics or assets which are dependent on each other may be combined into a single asset for the screening test. Such guidance does not exist in the framework, but in the IFRS standards. For example IAS 38 (IAS 38.35 and IAS 36) has specific guidance for intangible assets acquired in a business combination stating that assets may be grouped together if this group is separable from other assets.

This is very relevant in the pharmaceuticals industry, where certain identifiable intangible assets are currently grouped together as a composite asset, classified as currently marketed product and valued as such for business combination accounting purposes. This is typically an asset group consisting of such items as the clinical trial data; formulae; the distribution network; brand value of the product etc. As each of these listed assets is dependent on the other, they are combined for accounting purposes and are identified as a single composite intangible asset.

They are interconnected to each other and therefore it makes sense to have a valuation of the group taken together. Furthermore, the appropriate amortisation period of each individual element is the same as the composite group.

It is our view that such a grouping should also be applied for the screening test and we believe it is implicit in the IFRS 3 B11B statement. However, IFRS 3 B11C then provides a list of assets which should not be combined into a single identifiable asset. Point c) in this paragraph explains that different intangible classes should not be combined into a single intangible asset. Thereby customer related assets and trademarks are mentioned. As mentioned above, it is current common practice in the pharmaceuticals industry that product specific trademarks and the customer relationship are usually combined into a composite single asset.

We believe it would be helpful if the revised wording made it clearer that under the circumstances outlined above a composite approach may be appropriate.

We also suggest that IFRS 3 B11C should be deleted as it seems to contradict existing guidance in certain standards and the guidance to be applied in IFRS 3 should simply be a reference to the relevant IFRS standard which specifically addresses the accounting for the asset being acquired.

In this context we wish to note, that the currently specified threshold of one single asset could be perceived to be very arbitrary. In the pharmaceuticals industry early stage development companies (often called biotech companies) are often acquired which are working simultaneously on a portfolio of compounds. Usually the entire value is in the R&D project(s) and the key R&D staff is taken over to ensure know-how transfer. As long as such a company only works on one compound, the transaction would be accounted for as an asset acquisition. It would appear that if it works on two compounds, it will most likely need to be accounted for as a business combination even though in effect the acquisition is a portfolio of early stage compounds. In such circumstances treating the portfolio as a single asset could make more business sense. We suggest that the staff take this point into account so that such transactions are not considered to be an acquisition of a business.

Assessment of concentration of fair value

While the concept of gross fair value of the assets acquired is useful in identifying concentrations of fair value on a specific asset or group of assets, it should be clarified that this assessment does not determine the initial measurement of the single asset or group of assets so identified.

We understand that the issue of “Variable payments for the separate acquisition of PPE and intangible assets” will be subject of a separate narrow-scope project to amend IAS 16, IAS 38 and IFRIC 12[1]. Therefore, we suggest that the Board specify in B11A of this amendment that the measurement requirements of IAS 16, IAS 38 and IFRIC 12 continue to apply in the case that the

[1] IFRIC Update March 2016

transaction is primarily a purchase of a single asset or a group of assets (i.e. it is not a business in the scope of IFRS 3).

If this is not done, there may be a risk that the gross fair value of the assets might be used not only for the assessment under IFRS 3 but also for the initial measurement under those other relevant standards in a way that increases diversity in practice until the issuance of the narrow-scope amendment.

Evaluating whether an acquired process is substantive

In general, 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 or not. 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. 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.

Furthermore, the guidance in B12C implies that an acquired contract is not a substantive process. However, it clarifies that an acquired outsourcing agreement may be considered to provide access to an organised workforce that performs a substantive process with the latter being subject to the entity's own assessment based on the terms of the contract. It would be helpful if the Board could provide some indicators on how in such cases the substantive process is considered to be critical to the ability to develop or convert another acquired input or inputs into outputs.

In the pharmaceuticals industry, companies may acquire early stage drug development companies in which a significant amount of the drug development work is performed by contract research organisations and the target company has a minimal workforce. Example B – acquisition of a drug candidate of the ED seems unrealistic by assuming that the fair value associated with the contract that provides outsourced clinical research and a contract that provides outsourced clinical manufacturing have zero market value. In our view, this example should be expanded to focus on the area of the guidance that requires more judgment (e.g. an acquired outsourcing agreement that is considered to provide access to an organised workforce that performs a substantive process). Such judgment should consider 1) whether or not the process can be replaced without significant cost, effort, or delay, and 2) whether the process is considered unique or scarce.

Furthermore, in this example we are wondering whether this example as written would have to be accounted for as a business combination, if two IPR&D projects were acquired and all the other basis facts are the same. This is due to the fact that point b) explicitly states that there is a contract with the Contract Research Organisation (CRO). The question is whether the standard setter presumed the CRO contract to give access to an organised workforce (B12C) with the experience to perform an acquired process (B12A). Therefore we wish to point out that in this case our view is that the innovative thinkers who explored the compound are performing all substantial processes. Therefore we would not have accounted for this acquisition as a business combination if two projects were acquired.

In addition, Example D – manufacturing facility of the ED concludes, correctly in our view that the facility plus the workforce are not by themselves a business. However, we wonder what the conclusion would be if the entity acquires in addition a contract with a limited term, but with no prospect of further business after that contract ends and the purchaser is not acquiring any customer list or relationships or intellectual property. Based on the proposed guidance in B12C of the ED some entities might conclude that the contract is an input that the workforce could transform into an output by fulfilling the contract and conclude that what is being transferred is a business. However, in our view, this cannot be seen as a business because it seems unlikely it can continue to sustain itself after the end of the initial contract without additional elements. We would appreciate if the IASB could clarify paragraph B12C of the ED and provide additional factors to be considered in evaluating whether the contract represents an input in order to reduce diversity in practice.

<u>Further suggested refinements</u>

Furthermore, we are of the view that instead of adding to IFRS 3 B9 the sentence “Similarly, an acquired set of activities and assets that is not a business might have liabilities”, the preceding sentence “Nearly all businesses also have liabilities, but a business need not have liabilities.” should have been deleted. This is because the acquisition of liabilities often depends on the form of the transaction, i.e. asset or share deal and not so much on whether a business or an asset is acquired. Therefore, we suggest removing any reference to liabilities.

Also, we think that in the definition of outputs the term “Other Revenue” should be explained in order to avoid different interpretations.

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?

Answer to Question 2

We understand that the IASB and the FASB reached substantially converged tentative conclusions on how to clarify and amend the definition of a business. However, the IASB also needs to ensure that the accounting outcomes for those transactions are aligned. In this context we encourage the Board to adopt the converged conclusion with identical wording as this would eliminate potential inconsistencies in the application of the standard.

Furthermore, the accounting treatment for deferred taxes in an asset acquisition is different between FASB and IASB and the impact for the financial statements is often significant. In our view the interaction between IFRS 3 Business Combinations and the initial recognition exception in IAS 12 needs to be assessed in detail as otherwise although the same definition of a business applies, the accounting outcome is different. Considering that the new definition is narrowing the scope of the transactions that are considered to be business acquisitions, the impact of those differences would be material.

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?

Answer to Question 3

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?

Answer to Question 4

We agree that the proposals should be applied prospectively with early application permitted.