October 31, 2016

Canadian Accounting Standards Board
277 Wellington Street West
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Ontario
M5V 3H2

Re: Exposure Draft ED/2016/01– Definition of a Business and Accounting for Previously Held Interests – Proposed amendments to IFRS 3 and IFRS 11

Thank you for the opportunity to comment on this Exposure Draft ("ED'). We have reviewed the ED and provided our responses based on the specific questions below to the International Accounting Standards Board ("the Board"). Provided our main concern below is addressed appropriately we do believe the proposed amendments are appropriate for application in Canada.

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 appreciate the Board's provision of additional application guidance, especially the illustrative examples, on applying the definition of a business. We also welcome the screening test, whereby an acquisition is not a business combination if the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets. Our expectation is that, with this new guidance, fewer acquisitions will qualify as business combinations and hence require the acquisition method of accounting. We believe that this screening test will be welcomed by our smaller public company clients as it should help to reduce their costs to determine whether a set of activities and assets acquired meets the definition of a business.

We would, however, like to bring the following three concerns to the Board's attention.

<u>Concern 1:</u>

We have one major concern with respect to the application of the proposed guidance to early-stage entities that do not yet produce outputs. The guidance applicable to early-stage entities does not consider how far the set of assets and activities acquired are from producing outputs. The elimination of IFRS 3 paragraph B10 and the amendment to the output definition may, perhaps inappropriately, result in more acquisitions involving early-stage entities meeting the definition of a business despite the set of assets and activities the being very far from producing outputs.

To illustrate our concern, we provide the following example for the Board's consideration:

> An early-stage technology company is acquired by Entity A. The assets acquired include hardware such as computers, servers and other office equipment and the intangibles relating to the software. At the

acquisition date, it is unknown whether the set of activities and assets acquired will be able to produce outputs in the future because there are still many uncertainties which may take a number of years to resolve. Since both the hardware and software have significant fair values the initial screening test will be failed. In addition, the workforce responsible for performing the development processes that converts the software (another acquired input) into outputs has also been acquired and has a significant value. As a result, the acquisition will be considered a business.

In our view, an acquisition such as is depicted in the example above should not meet the definition of a business if the acquired assets are truly far from producing outputs. We agree that, in many cases, this will not be the only factor that is considered when determining whether a business was acquired. However, we believe that the inability to produce outputs for some undefined period into the future should be a factor in the determination of whether the acquired set of activities and assets constitutes a business. Hence, we recommend that the amended application guidance reflect that.

Further, we believe that the cost incurred to perform the entire assessment (i.e., the concentration of fair value test and the substantive process test) may be significant. For some entities in the very early stages of development, this cost may outweigh the benefits, especially in situations where the acquired set of activities and assets are far from producing outputs, even if the ultimate conclusion would be in line with current assessment in accordance with IFRS 3.

To summarize, as a result of our concerns mentioned above, we ask that the Board consider whether there should be guidance included in IFRS 3's application material whereby the acquisition of a set of activities and assets that is considered very far from producing outputs cannot be considered to meet the definition of a business. In other words, the revised application guidance should indicate that how far the set of activities and assets is from producing outputs should be a key factor to consider when determining whether the set of activities and assets meets the definition of a business. In addition, this consideration of how far the set of activities and assets are from producing outputs may be conclusive in some circumstances. Overall, whether a very early stage entity meets the definition of a business should ultimately be a matter of judgement with consideration of the nature of the industry in which the entity operates and the efforts required by the entity before it will be able to produce outputs.

We have suggested some wording to supplement the guidance in B12A:

> Whether the acquisition of a set of activities and assets that is not yet producing outputs meets the definition of a business is a matter of judgement based on consideration of all the facts and circumstances. A key consideration for these types of acquisitions is how far the set of assets and activities acquired is from producing outputs. Specifically, the closer the set of activities and assets acquired is to producing outputs, the more likely it is that the set of activities and assets will meet the definition of a business. In some situations, consideration of this factor alone may be sufficient to conclude that the acquisition is not a business combination. *(It may be helpful if the Board were to include an example of a situation where this situation might be conclusive, and consider whether some of the factors in the deleted IFRS 3 paragraph B10 should be retained.)*
>
> In other situations, additional facts and circumstances should be considered. *(Here paragraph B12A and the assessment of concentration of fair value criteria should still be considered in order to conclude that the acquisition constitutes a business.)*

We have provided two links below to industry guidance that have emerged in Canada with respect to the oil and gas and mining sectors. These viewpoints provide guidance on applying the current definition of a business in these industries particularly where no outputs are being produced and have largely influenced our suggestions above. We think these viewpoints may be helpful for the IASB to address when considering our concerns and reflecting additional guidance per our suggestion for entities that are very far from producing outputs.

https://www.cpacanada.ca/en/business-and-accounting-resources/financial-and-non-financial-reporting/international-financial-reporting-standards-ifrs/publications/ifrs-asset-acquisition-versus-business-combination

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Concern No. 2:

Secondly, we are unsure why paragraph B12A mentions “acquired substantive process” but B12B does not use the word “substantive” and only refers to “acquired process”. We would like the board to consider whether the "substantive" in B12A as quoted previously should be removed because the intention of B12A is to determine if a substantive process was acquired for sets of activities and assets that do not have outputs at the acquisition date. Thus, including the term in B12A may be confusing to readers because it appears to require a conclusion on whether an acquired process is substantive before having applied the same paragraph that should be used in determining if an acquired process is substantive.

Concern No. 3:

Lastly, we would like to recommend that, while amending IFRS 3, the Board also consider providing sufficient guidance and clarifying the accounting for asset acquisitions (i.e. acquisitions that do not meet the definition of a business) that are currently included in IFRS 3.2(b) especially since the amendments as a result of this ED are expected to result in more acquisitions being classified as asset acquisitions.

We are aware of the following issues relating to asset acquisitions which require clarification in IFRSs:

- The current guidance in IFRS 3.2(b) does not address how the difference between the consideration paid and the total fair value of the identifiable asset and liabilities should be treated in a situation where the consideration exceeds the total fair values of the identifiable assets acquired. Intuitively, the consideration allocated cannot exceed the carrying amount of the identifiable assets in accordance with the applicable standard. However, it would be helpful if any guidance relating to asset acquisitions can specifically address this matter by also highlighting the applicable standards on measurement of such assets and recognition of any potential day one loss.

- IAS 39.43 and IFRS 9 generally require an entity to recognize individual financial instruments at fair value and AG76 provides guidance on accounting for the difference between transaction price and fair value. In situations where there is a difference between the purchase price and the fair value of the assets acquired, it is unclear whether both IFRS 3 and IAS 39 apply, or if IAS 39 takes precedent with respect to allocating and recognizing this difference. The Canadian IFRS Discussion Group meeting held in September 2016 discussed this particular issue relating to asset acquisitions where financial assets were included in the group of assets acquired. The Board may wish to review the IFRS Discussion Group meeting summary when considering amendments to clarify the accounting for asset acquisitions with respect to this issue.

- It is widely understood in practice that IFRS 2 is applied to asset acquisitions that were effected by issuing shares where the acquisition does not meet the definition of a business combination. Further, practice has also emerged whereby the reverse acquisition guidance of IFRS 3 is applied by analogy to asset acquisitions to which IFRS 2 is applied because the acquiree does not meet the definition of a business. For example, a reverse acquisition between a private company and a listed shell company in order to affect a listing for the private company. It would be helpful if at some point IFRS 3 addressed these principles that have emerged in practice and which have also been addressed by the IFRIC.

A simple interim solution may be to amend IFRS 3.2(b) as follows so that entities can apply their judgement in allocating the cost of the assets acquired based on the requirements of applicable IFRSs and what was negotiated as the "cost" for each asset which may be fair value:

2 This IFRS applies to a transaction or other event that meets the definition of a business combination. This IFRS does not apply to:

(a) …

(b) the acquisition of an asset or a group of assets that does not constitute a *business*. In such cases the acquirer shall identify, ~~and~~ recognise <u>and measure</u> the individual identifiable assets acquired (including those assets that meet the definition of, and recognition criteria for, *intangible assets* in IAS 38 *Intangible Assets*) and liabilities assumed <u>in accordance with the applicable IFRSs</u>. Judgement may be needed to determine how any difference between the total fair value of the assets and liabilities and the consideration paid is allocated with consideration of the applicable IFRSs, the price that was negotiated for each asset and what any excess relates to. ~~The cost of the group shall be allocated to the individual identifiable assets and liabilities on the basis of their relative *fair values* at the date of purchase.~~ Such a transaction or event does not give rise to goodwill.

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?

While there may be some differences in practice because of the differences in wording, these differences do not appear concerning at this stage given that the standards are substantially converged and that the FASB and the Board believe that the amendments will reduce differences in application. We believe that the Board will consider any differences in practice that may emerge and take any appropriate action.

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. In addition, we would like the Board to consider additional amendments to IFRS 11 paragraph 21 and B33A to clarify that "an entity" relates to a joint operator or a party that participates in, but does not have joint control of, a joint operation. In addition, these paragraphs appear to indicate that the same principles in IFRS 3 apply to an initial interest acquired and a subsequent additional interest acquired in a joint operation. We suggest that those paragraphs be amended to clarify that guidance for initial and subsequent acquisitions are different and to refer to the appropriate paragraphs in IFRS 11 dealing with the initial and subsequent interests acquired.

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 support the proposed transition requirements because prospective application facilitates a less cumbersome application process. Further, retrospective application may not be possible when an entity does not have all the information it needs to make the new business combination assessment for acquisitions that happened in the past. In addition, retrospectively assessing the quantitative impact of any changes in the classification from asset acquisition to business combination or vice versa would require hindsight, given that new valuations may be needed at a point in history.

Yours truly,

MNP LLP

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