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The Chairman
Australian Accounting Standards Board
PO BOX 204
Collins Street
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24 April 2013

Dear Mr Stevenson

Ernst & Young's global submissions to the IASB on the Exposure Drafts ED/2012/6 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28) and ED/2012/7 Acquisition of an Interest in a Joint Operation (Proposed amendments to IFRS 11)

Please find enclosed Ernst & Young's global submissions to the IASB on the above Exposure Drafts.

Yours sincerely

A stylized, handwritten signature of 'Ernst & Young' in a cursive script.

Ernst & Young

Encl:

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

23 April 2013

Dear Board members

Invitation to comment - Exposure Draft ED/2012/6 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28)*

The global organisation of Ernst & Young is pleased to respond to Exposure Draft ED/2012/6 *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28)* (the ED).

We strongly support the proposed amendments to IFRS 10 *Consolidated Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*, which address the issue of accounting for sales and contributions of assets between an investor and its associate or joint venture, as a practical solution to the diversity in practice. However, we are concerned that the ED relies on the definition of a business in IFRS 3 *Business Combinations*, as discussed further below.

The ED relies on the definition of a business per IFRS 3

Consistent application of the definition of a business has been an issue in practice in the past because the line between what is a business and what is actually just a collection of assets is unclear. We are concerned that, without greater clarification of this definition, the ED may not achieve the proposed reduction in diversity in practice.

We are aware of differences in interpretation of what constitutes a business under IFRS across a number of industries. For example, in the mining and metals sector it is considered that there could be additional clarification of the terms 'capable' and 'output' in the definition of a business. In the real estate sector there is concern that the ED again raises the issue as to whether or not a rented property (or a single property special purpose vehicle (SPV)) falls within the definition of a business.

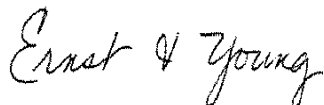
Further, IFRS 3 and US GAAP's ASC 805 *Business Combinations* are converged standards and both frameworks have the same definition of a business, however different applications of the definition have emerged. Appendix B includes the comment letter Ernst & Young submitted to the IFRS Interpretations Committee (the Committee) in August 2011 in reaction to the Committee's Tentative Agenda Decision - IFRS 3 *Business Combinations* - definition of a 'business'. The points raised in that letter still apply.

Therefore, we recommend that the IASB consider clarifying the definition of a business as soon as possible. We understand the reason for the IASB limiting the scope of this ED, and the fact that it is seeking to amend IFRS 10 and IAS 28 and not IFRS 3. We understand that this amendment is not the place for clarifying the definition of a business. However, we think that many of the divergent interpretations of the definition of a business could be addressed by adding examples to IFRS 3, or by further clarifying Appendix B to IFRS 3. We welcome the news that the Committee will continue its discussions of the definition of a business at a future meeting.

In Appendix A to this letter we answer the specific questions posed by the ED and note some other supplementary concerns and considerations around the proposed amendments.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas on +31 88 407 5035 or Luci Wright on +44 (0) 20 980 0043.

Yours faithfully

A handwritten signature in cursive script that reads 'Ernst & Young'.

Appendix A: Responses to the questions in the Exposure Draft ED/2012/6 Sale or Contribution of Assets between an Investor and its Associate or Joint Venture (Proposed amendments to IFRS 10 and IAS 28)

Question 1: proposed amendment to IFRS 10

The IASB proposes to amend IFRS 10 so that the gain or loss resulting from the sale or contribution of a subsidiary that does not constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture is recognised only to the extent of the unrelated investors' interests in the associate or joint venture. The consequence is that a full gain or loss is recognised on the loss of control of a subsidiary that constitutes a business, as defined in IFRS 3, including cases in which the investor retains joint control of, or significant influence over, the investee.

Do you agree with the amendment proposed? Why or why not? If not, what alternative do you propose?

Question 2: proposed amendment to IAS 28 (2011)

The IASB proposes to amend IAS 28 (2011) so that:

- (a) the current requirements for the partial gain or loss recognition for transactions between an investor and its associate or joint venture only apply to the gain or loss resulting from the sale or contribution of assets that do not constitute a business, as defined in IFRS 3; and
- (b) the gain or loss resulting from the sale or contribution of assets that constitute a business, as defined in IFRS 3, between an investor and its associate or joint venture is recognised in full.

Do you agree with the amendment proposed? Why or why not? If not, what alternative do you propose?

Overall, we support the proposed amendments to IFRS 10 and IAS 28. However, as discussed in the cover letter, we are concerned that the ED relies on the definition of a business in IFRS 3, and we note that consistent application of this definition has been an issue in practice in the past.

Analogy of the proposals of the ED to joint operations

Although the ED deals with sales and contributions of assets between an investor and its *joint venture* (inter alia), we have the following concerns and considerations around similar transactions related to the sale or contribution of assets by an investor to its *joint operation*, which we think would be worth mentioning, albeit outside the scope of the ED.

1. Recognition of the sale or contribution of a business to a joint operation in the consolidated financial statements of the joint operator:

While the ED aims to reduce uncertainty relating to accounting for sales or contributions of businesses to associates or joint ventures, we have also noted diversity in accounting for sales or contributions of businesses by investors to joint operations in the consolidated financial statements of the joint operators (investors):

- *View 1* - Sale or contribution of assets that constitute a business by a joint operator to its joint operation causes a change in the relationship between the joint operator and the underlying assets, representing a significant economic event. Therefore, the same principles as those proposed in the ED should apply to the sale or contribution of assets that constitute a business by a joint operator to its joint operation, i.e. full gain or loss recognition. The proponents of this view believe that paragraph B34 of IFRS 11 *Joint Arrangements* should apply only to sale or contribution of assets that do not constitute a business.
- *View 2* - Sale or contribution of assets that constitute a business by a joint operator to its joint operation will affect the joint operator's rights to the underlying assets. There was and continues to be a direct interest in the underlying assets themselves, therefore the gain or loss shall be recognised only to the extent of the unrelated investors' share in the underlying assets. The proponents of this view believe that paragraph B34 of IFRS 11 is applicable to sale or contribution of all kinds of assets, including those that constitute a business.

We recommend the IASB consider providing guidance on this issue either as part of this ED, or in a subsequent ED.

2. Recognition of the sale or contribution of a business within a subsidiary to a joint operation in the separate financial statements of the joint operator:

It is unclear how a sale or contribution of a business within a subsidiary to a joint operation should be accounted for in the separate financial statements of the joint operator. This may happen as a result of a sale of an interest in a subsidiary and/or a

change of facts and circumstances leading to the reassessment of control becoming joint control.

Assume for example that an investor has previously recognised the investment in a business within a subsidiary as a single investment at cost in accordance with IAS 27 *Separate Financial Statements*. After selling a portion of its interest in the subsidiary and reassessing the rights and obligations of the parties with respect to the investee, the investor concludes that it has joint control over its previous subsidiary, now classified as a joint operation. Therefore the investor should recognise the underlying assets and liabilities of the investee in its separate financial statements.

There are divergent views on how to account for any gain or loss on such transactions in the separate financial statements of the joint operator. That is, would the retained interest be remeasured and a full gain or loss be recognised, or should any gain or loss be recognised only to the extent of the unrelated investors' share in the underlying assets?

We recommend the IASB consider providing guidance on this issue either as part of this ED, or in a subsequent ED.

In addition, please also consider points raised in our comment letter to the Exposure Draft ED/2012/7 *Acquisition of an Interest in a Joint Operation (Proposed amendments to IFRS 11)*.

Question 3: transition requirements

The IASB proposes to apply the proposed amendments to IFRS 10 and IAS 28 (2011) prospectively to sales or contributions occurring in annual periods beginning on or after the date that the proposed amendments would become effective.

Do you agree with the proposed transition requirements? Why or why not? If not, what alternative do you propose?

We support the prospective application proposed by the ED.

However, we recommend that the IASB clarify whether it intended to require full retrospective application of the ED's proposals by first-time adopters. We believe that the proposals in the ED should be applied by first-time adopters prospectively from transition date, similar to the transition requirements of paragraph B7(c) of IFRS 1 *First-time Adoption of International Financial Reporting Standards*, and the transition requirements proposed in ED/2012/7 *Acquisition of an Interest in a Joint Operation*. Therefore we recommend that the IASB make the appropriate consequential amendments to IFRS 1.

We also recommend that the IASB extend the transition requirements of the ED to allow early adoption of the proposed amendments, similar to the transition requirements proposed in ED/2012/7 *Acquisition of an Interest in a Joint Operation*.

Appendix B: The comment letter in reaction to Tentative Agenda Decision - IFRS 3 *Business Combinations* - definition of a 'business'

International Financial Reporting Standards Interpretations
Committee
30 Cannon Street
London
EC4M 6XH

19 August 2011

Dear IFRS Interpretations Committee members,

Tentative Agenda Decision - IFRS 3 *Business Combinations* - definition of a 'business'

The global organisation of Ernst & Young is pleased to submit its comments on the discussion by the IFRS Interpretations Committee (the Interpretations Committee) on the definition of a business that occurred during the July 2011 meeting. We believe that the definition of a business determination is a significant practice issue and are aware of emerging differences of interpretation of what constitutes a business under IFRS across a wide array of industries. In addition to the issues raised at the last Interpretations Committee meeting, we have included below a series of questions that highlights other specific practice areas where differences of interpretation have emerged.

We strongly support the Interpretations Committee taking this issue onto its agenda and recommend that the Interpretations Committee consider these additional questions in any future deliberations. We believe that many of these issues could be addressed by adding examples to IFRS 3, or further clarifying Appendix B to IFRS 3. Further, given that IFRS 3 and ASC 805 *Business Combinations* are converged standards, we recommend that the IASB work with the FASB staff (or EITF) to reach a converged solution.

1. If the acquired integrated set of activities and assets includes only observable inputs and outputs, are processes presumed to be embedded in the acquisition such that the acquired set would constitute a business?

When an acquired integrated set of activities and assets includes inputs and outputs but no observable process, we are aware of potential diversity in practice in the determination of whether the acquired set of activities and assets constitutes a business. Some believe that because the revenue producing activities associated with the acquired set remain substantially the same before and after the acquisition, processes are embedded in the acquisition and, therefore, the acquired set constitutes a business. However, others believe that regardless of the fact there is a continuing revenue stream, if the acquired set does not include an observable process, the acquired set does not constitute a business.

The following example in the real estate industry illustrates these two views¹.

Example 1: Acquisition of land and fully leased large commercial building subject to a long term lease

Entity A acquires (1) land and (2) a fully-leased large commercial building with long-term leases with multiple tenants. Entity A does not acquire the processes that have been established to manage the leases (e.g., lease management, selection of tenants, marketing decisions, investment decisions) or the processes to provide services (e.g., security, cleaning, maintenance) to the building. Entity A will provide lease management and other building services through its own employees or through new outsourcing contracts with suppliers.

View A: Entity A acquired a business pursuant to IFRS 3. Entity A acquired inputs (the land and fully leased building) and outputs (rental income). Because the revenue producing activities associated with the acquired set of activities and assets remain substantially the same before and after the acquisition, processes are embedded in the acquisition and, therefore, the acquired set constitutes a business.

View B: Entity A did not acquire a business pursuant to IFRS 3. While Entity A acquired inputs (land and fully leased building) and outputs (rental income), because it did not acquire any observable process, the acquired set of activities and assets is not a business even though the building is currently generating rental income. While IFRS 3 states that not *all* of the processes used in operating the business need to be acquired, proponents of this view believe that an observable process must be included in the acquired set for the acquisition to meet the definition of a business.

2. When assessing whether a market participant is capable of acquiring a business and continuing to produce outputs, how (from what perspective) is “output” determined?

When assessing whether a market participant is capable of acquiring a business and continuing to produce outputs, we are aware of potential diversity in practice (particularly in the extractive industry) on how (from what perspective) “output” is considered. Some consider “output” from the perspective of a market participant whereas others consider “output” from the perspective of the acquirer.

Those that believe “output” should be considered from the perspective of a market participant point to the guidance in paragraph B11 of Appendix B to IFRS 3. This paragraph states “Thus, in evaluating whether a particular set [of activities and assets] is a business, it is not relevant whether a seller operated the set as a business, or whether the acquirer intends to operate the set as a business.” This paragraph clarifies that the

¹ This issue is also prevalent in other industries. For example, in the shipping industry, a buyer may acquire only a ship and the charter (but not a crew or any other processes). In the banking industry, a buyer may acquire only a portfolio of financial assets (but not employees to manage or collect cash flows from the portfolio, or any other processes).

perspective of the acquirer is irrelevant in the definition of a business determination and that “output” should be considered from the perspective of a market participant.

Those that believe “output” should be considered from the perspective of the acquirer point to the reference to “continuing to produce outputs” in paragraph B8 of Appendix B to IFRS 3. That is, in evaluating whether a market participant is capable of continuing to produce outputs, only outputs that the acquirer intends to create are considered (i.e., only market participants in the same market as the acquirer are considered). In this case, if the seller were producing an output different from the one intended by the acquirer or the acquired set of activities and assets is not capable of currently producing the output intended by the acquirer, then the acquired set would not constitute a business.

The following example in the extractive industry illustrates these two views.

Example 2: Acquisition of a mineral interest in which the seller has performed geological studies and surveys and has commenced exploration activities

ABC Co. and Target Co. are mining companies. ABC Co. is a large exploration and production entity and Target Co. is a junior exploration stage entity. Target Co. owns land and a mineral interest and its principal activity is the exploration of this property (not necessarily the extraction of the mineral resources). Target Co. has some exploration processes (it has conducted drilling, sampling, geological studies, etc.) and determined through the resulting data that there are inferred, measured and/or indicated mineral resources, but has not yet commenced extraction of the minerals. ABC Co.'s intended output is the mineral itself. ABC Co. acquires Target Co. and thus acquires the interest in the mineral property and the exploration processes and resulting data.

View A: ABC Co. acquired a business under IFRS 3. ABC Co. acquired inputs (land and mineral interest) and processes (exploration processes). Because the acquired set of activities and assets is capable of providing a return to investors and a market participant would be capable of continuing the exploration activities to create outputs, ABC Co. acquired a business. The acquired set of integrated activities and assets is considered a business even though Target Co. is not currently producing the mineral (the intended output of ABC Co.).

View B: ABC Co. did not acquire a business under IFRS 3. ABC Co. acquired inputs (land and mineral interest) and processes (exploration processes). Because the property is not currently producing the output intended by ABC Co., the acquired set is not a business.

3. Do studies/research/know-how represent an input, a process or an output?

When an acquired set of integrated activities and assets includes studies/research/know-how, we are aware of potential diversity in practice (particularly in the life sciences and extractive industries²) on whether such information represents an input, a process or an output. Often, this issue arises when an integrated set of activities and assets is in the development stage.

The following example in the life sciences industry illustrates the different views.

Example 3: License to a product candidate

Pharma A licenses a product candidate from Biotech B. The terms of the license agreement entitle Pharma A to the “know how” associated with the product candidate. The license agreement defines the “know how” as “all biological materials and other tangible materials, inventions, practices, methods, protocols, formulas, knowledge, know-how, trade secrets, processes, procedures, specifications, assays, skills, experience, techniques, data and results of experimentation and testing, including pharmacological, toxicological, safety, stability and pre-clinical and clinical test data and analytical and quality control data, patentable or otherwise.” Pharma A does not acquire any employees or other processes from Biotech B.

View A: Pharma A did not acquire a business under IFRS 3. Pharma A has acquired only inputs (license and “know how”). The “know how” represents an input that enhances the value of the product candidate. “Know how” is not viewed as a system, standard, protocol, convention or rule that when applied to the license, creates or has the ability to create outputs, and therefore is not a process. While Pharma A acquired inputs (license and “know how”), it did not acquire any processes to apply to the license to create outputs.

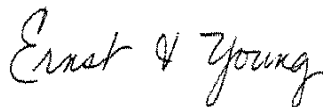
View B: Pharma A acquired a business under IFRS 3. Pharma A has acquired inputs (license) and processes (“know how”). The “know how” represents a process that can be applied to the license to create outputs. That is, a market participant would be capable of using the “know how” to continue the development of the product candidate to create outputs (e.g., the commercialisation of the product candidate or achieving certain stages of furthered development of clinical trials, which may increase the value of the product candidate).

² In addition, we believe that this issue may have relevance to other industries where intellectual property is commonly acquired, such as in the technology industry.

View C: Pharma A acquired a business under IFRS 3. Pharma A has acquired inputs (license) and outputs (“know how”). The “know how” represents an output because a market participant could license/sell the product candidate and “know how” to generate a return. In some cases, market participants are not in the business of developing and commercialising a product candidate³. Instead, after the product candidate achieves a certain stage of clinical development, such market participants will license/sell the product candidate and “know how” to another party for final development and commercialisation. Because the acquired set of activities and assets is capable of providing a return to investors, processes are embedded⁴ in the acquisition and, therefore, the acquired set constitutes a business.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 (0)20 7951 3152.

Yours faithfully



cc: Financial Accounting Standards Board
Emerging Issues Task Force

³ This can also be seen in Example 2.

⁴ See Issue 1.