



Tel: 312-856-9100
Fax: 312-856-1379
www.bdo.com

330 North Wabash, Suite 3200
Chicago, IL 60611

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Via email to director@fasb.org

Susan M. Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: Clarifying the Definition of a Business (File Reference No. 2015-330)

Dear Ms. Cospers:

We are pleased to provide comments on the Board's proposal to clarify the definition of a business within Topic 805.

We note this proposal represents a middle ground between the two definitions that have preceded it in Statement 141(R) and EITF 98-3. In our opinion, this is accomplished primarily by softening the emphasis of a "market participant" perspective and also through introducing a screen based on the value of the acquired assets. We are supportive of the intended cost savings that will result from fewer acquisitions being accounted for as businesses, such as a reduction in the number of valuations that will be necessary to remeasure liability-classified contingent consideration agreements each period.

We believe a few refinements are needed in the final standard, including additional guidance to determine when certain contracts are considered a process or an input, given the emphasis that the exposure draft places on a "substantive process." We also have included several other recommendations in our responses to the questions in the Appendix.

We would be pleased to discuss our comments with the FASB staff. Please direct questions to Adam Brown at (214) 665-0673 or Ken Gee at (415) 490-3230.

Very truly yours,

BDO USA, LLP

Appendix

Question 1: Do you agree that to be a business a set of assets and activities must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs? If not, what other alternatives would you suggest?

We agree with the proposed definition of a business, subject to the clarifications suggested below.

Question 2: Paragraphs 805-10-55-5A through 55-5D provide guidance on determining whether a set contains an input and a substantive process that together contribute to the ability to create outputs. Are the criteria appropriate, and would they be operable in practice? If not, why?

We generally agree that the criteria are appropriate and operable, but we have several recommendations for clarifying the final guidance.

805-10-55-5A: We suggest the Board clarify what is meant by “resources” in subparagraph (b)(2) (for example, natural resources). As drafted, “resources that could be developed to provide outputs” doesn’t appear to add value. Rather, it seems only to recharacterize the examples in (b)(1) and (b)(3).

Additionally, we suggest the Board edit this paragraph as follows to emphasize the importance of the organized workforce as described in BC 21:

When a set does not have outputs (for example, an early stage company that has not generated revenues), the set would have both an input and a substantive process that together contribute to the ability to create outputs only if it includes an organized workforce...

805-10-55-5C: Paragraph 16 of the Basis for Conclusions states the Board’s intent is to provide unbiased guidance regarding whether a transaction involves a business or asset(s). However, paragraph 805-10-55-5C includes prescriptive guidance on certain inputs to exclude from the analysis, and therefore seems to indicate a bias toward asset accounting. We suggest expanding the discussion in paragraph 805-10-55-5C to distinguish between contracts (inputs) and those processes which are necessary to be applied to the contracts (processes) to generate outputs. For example, the language should distinguish between a lease contract (input) and a property management system (process). As currently drafted, the language may be interpreted to mean both the inputs and the related processes should be excluded from the analysis.

805-10-55-5D: Paragraph 26 of the Basis for Conclusions indicates significant judgment will be required “to distinguish between when the service provided through the contractual arrangement is applying a process to another input in the set and when the contractual arrangement is itself an input.” We believe the guidance in paragraph 805-10-55-5D should be strengthened to indicate how the assessment should be performed, narrowing the need for “significant judgment.” Indeed, it seems to represent a shortcoming of the proposal to emphasize the importance of a “substantive process” when distinguishing assets from businesses, but then to offer no guidance on how to discern when a contractual arrangement is a substantive process.

In addition, we recommend the Board more clearly distinguish between an “employee” (as used in subparagraph (a) of paragraph 805-10-55-4A and in paragraph 805-10-55-5D) and “organized workforce” (as used in subparagraph (b) of paragraph 805-10-55-4A and in paragraphs 805-10-55-

5A through 55-5D). As currently worded, subparagraph (b) of paragraph 805-10-55-4A may be interpreted to mean that an organized workforce itself represents a process, but we believe the Board intends an organized workforce to be considered an input.

805-10-55-5C and 55-5D: We suggest the Board clarify that contracts discussed in paragraph 805-10-55-5C are those which generate revenues or cash inflows for an entity, whereas contracts discussed in paragraph 805-10-55-5D are those which generally result in expenses or cash outflows for an entity. That is, outbound cash flows may be an indicator of when a contract is a process rather than an input.

Question 3: Would the proposed guidance be operable without the criteria in paragraphs 805-10-55-5A through 55-5D? Why or why not?

We believe the criteria in paragraphs 805-10-55-5A through 55-5D are necessary for the proposed model to be operable. Further, we recommend including a flowchart in the final ASU to depict the decision model, similar to other recent standards such as ASU 2015-02.¹

Question 4: Paragraph 805-10-55-9 provides that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive. Do you think this indicator is appropriate and operable? Why or why not?

We do not object to the inclusion of this indicator, as similar guidance has existed for some time. However, we do not view this indicator as critical to reaching a conclusion.

Question 5: Do you agree with the changes proposed to the definition of outputs? That is, do you agree that for purposes of evaluating whether a transferred set is a business, outputs should be focused on goods and services provided to customers? If not, why?

We agree with the proposed definition of outputs.

Question 6: Paragraphs 805-10-55-9A through 55-9C specify that if substantially all the fair value of the gross assets acquired is concentrated in a single identifiable asset, the set is not a business. Is it appropriate to include such a threshold, and would it be operable? If not, why?

We believe the threshold included in paragraphs 805-10-55-9A through 55-9C is appropriate and operable, and will assist entities in the determination of whether a set is a business or an asset purchase.

However, we suggest the Board clarify whether or not an entity should determine whether an in-process research & development (IPR&D) asset has alternative future use prior to performing the analysis in paragraphs 805-10-55-9A through 55-9C. In other words, if acquired IPR&D would not qualify as a recognized asset outside of a business combination, should an entity consider it to have zero fair value upon acquisition for purposes of the “screen”? Our sense is that the focus is on the value of the IPR&D, regardless of whether it will be recognized as an asset or an expense.

Further, we recommend elevating the first sentence of BC37 to paragraph 805-10-55-9A of the final standard in order to clarify that the relative fair value analysis should contemplate gross

¹ *Amendments to the Consolidation Analysis*

assets acquired, not net assets or total consideration paid. Refer to our response to Question 11 for additional comments on this concept.

Question 7: The threshold in paragraph 805-10-55-9A also applies to a group of similar identifiable assets. Would the identification of a group of similar identifiable assets be operable? If not, why?

We believe application of the threshold in paragraph 805-10-55-9A to a group of similar identifiable assets is reasonable.

As it applies to commercial real estate, we believe clarification would be helpful regarding whether ground leases (when the acquirer becomes the lessee), which are generally classified as intangible assets, should be combined with or separated from the related leasehold improvements (e.g., buildings and other structures), which are classified as tangible assets. If the ground lease is considered an intangible asset, it appears the ED will reach different conclusions under paragraph 55-9A for the purchase of a building subject to a ground lease compared to the same building being situated on owned property.

Further, we request the Board clarify whether assets subject to capital leases should be classified as intangible or tangible assets for purposes of this evaluation. While paragraph 805-10-55-9C(a) indicates in-place leases would be considered intangible assets, it's unclear whether "in-place leases" includes capital leases.

Lastly, we recommend clarifying whether a right-of-use asset under the forthcoming Leases standard will be considered tangible or intangible, and whether a distinction exists between finance and operating leases for this purpose.

Question 8: Will the proposed guidance reduce the cost and complexity of applying the definition of a business? Why or why not?

We do not expect the proposed guidance to reduce the cost and complexity of initially applying the definition of a business because the proposed model is slightly more complex than the current model.

However, because the proposed guidance would result in fewer acquisitions being accounted for as business combinations, and more being accounted for as asset acquisitions, some simplification will result. For example, fewer valuations will be necessary to remeasure liability-classified contingent consideration agreements each period.

Question 9: How much time would be necessary to adopt the amendments in this proposed Update? Should early adoption be permitted? Would the amount of time needed to apply the proposed amendments by entities other than public business entities be different from the amount of time needed by public business entities?

We propose an effective date for all entities for periods beginning after December 15, 2016, with early adoption permitted, including early adoption for financial statements of private companies which have not yet been made available for issuance.

Question 10: Do you agree that the amendments in this proposed Update should be applied prospectively to any transaction that occurs on or after the date of adoption, and do you agree that there should be no explicit transition disclosure requirements? Why or why not?

We agree that the amendments should be applied prospectively to any transaction that occurs on or after the date of adoption, and that there should be no explicit transition disclosure requirements. We believe current GAAP disclosures regarding assets and businesses acquired will continue to be sufficient.

Question 11: Do the examples in paragraphs 805-10-55-51 through 55-88 clearly illustrate the application of the proposed guidance? Why or why not?

We agree with the addition of detailed examples to the implementation guidance. We recommend the following to improve the clarity and organization of the examples:

- Include an index of the examples prior to paragraph 805-10-55-52 to indicate which industry and which paragraph of the guidance each example is addressing.
- Consider expanding some of the examples to include various outcomes. For example, in Case A, consider demonstrating how the accounting treatment would differ if ABC determined the in-place leases did have significant fair value.
- Ensure consistency of naming of example entities used throughout examples (for instance, in Cases B and E, the acquirer is alternately referred to as "Pharma Co." and "Big Pharma").
- Case F - clarify in paragraph 805-10-55-70 that Company B paid consideration to Company A in exchange for the distribution rights. Otherwise, that arrangement might be understood as simply an executory contract instead of a purchase transaction.
- Case G - in paragraph 805-10-55-73, replace the phrase "all of the manufacturing equipment and processes required..." with "any of the manufacturing equipment and processes required..."

In addition, the examples in Case A (paragraphs 805-10-55-52 through 55-55), Case H (805-10-55-76 through 55-83) and Case I (805-10-55-84 and 55-85) help illustrate the application of the proposed guidance with respect to the real estate industry. However, the Board should consider:

- Indicating whether below-market leases should be included in gross assets for purposes of the evaluation in paragraphs 805-10-55-9A through 55-9C. Paragraph 37 of the Basis for Conclusions is clear that the screen is applied with respect to total assets, not to total consideration paid or net assets so that debt (e.g., a mortgage on a building) and "other liabilities" won't skew the analysis. However, it is unclear why a lease would be treated differently in the analysis based on whether it is above or below market, i.e., whether it represents an asset or a liability.
- Including additional examples in the final guidance given the likely impact on transactions in the real estate industry. For instance, we believe diversity in practice may exist under the current guidance with respect to certain sale-leaseback transactions. An example of a sale-leaseback transaction between an acquirer and an owner-operator (i.e., where no previous lease existed) as well as an example where a seller terminates the existing lease prior to the sale and concurrently enters into a new lease with the acquirer may help to eliminate future diversity in practice in similar transactions.

We also believe the Board should revise and expand Case J (paragraphs 805-10-55-86 through 55-88) to clarify it and better communicate how the guidance is to be applied to transactions in the oil and gas industry.

- The example in paragraph 805-10-55-86 states that the assets Company Y acquired include *drilling* equipment. In the scenario described, it seems unlikely that Company Y would have acquired drilling equipment because the property is producing oil, and it appears that in order to operate the acquired properties Company Y must have acquired the *pumping* equipment needed to extract the commodities from underground. We recommend that the Board revise the example accordingly.
- We believe Case J contains a misapplication of current GAAP. Paragraph 805-10-55-87 in the Exposure Draft describes the acquired mineral interests as “intangible assets.” However, ASC 805-20-55-37 states that acquired mineral interests are tangible assets:

Particular use rights may have characteristics of tangible, rather than intangible, assets. For example, mineral rights, defined as the legal right to explore, extract, and retain at least a portion of the benefits from mineral deposits, are tangible assets. An acquirer should account for use rights based on their nature.

We recommend that the Board correct this error. Further, when the mineral interests are appropriately considered tangible assets, then the next question would be whether the mineral interests, equipment and gathering system are different major classes of tangible nonfinancial assets (paragraph 805-10-55-9C, subparagraph (e)). We believe they are not. Therefore, it appears that whether the acquired set in Case J is a group of similar identifiable assets or a business would hinge on whether the mineral interests, equipment and gathering system (a) could be recognized and measured as a single identifiable asset in a business combination and (b) whether they are attached to and cannot be physically removed and used separately from other tangible nonfinancial assets without incurring significant cost (paragraph 805-10-55-9B). With respect to criterion (a), if the acquirer uses the full cost method, the condition would be met. If the acquirer uses the successful efforts method, practice may vary. In any event, we do not think the accounting method used by the acquirer should affect whether an acquired set is assets or a business. With respect to criterion (b), we think the condition would be met. Therefore, we think that in Case J substantially all of the fair value of the gross assets acquired is concentrated in a group of similar identifiable assets and the acquired set is not a business.

- In the oil and gas industry, rather than acquiring 100% interests in oil and gas properties, it is common to acquire less than 100% undivided interests in properties. Further, sometimes the properties are operated by the seller, sometimes the seller has non-operated interests (i.e., the properties are operated by another interest owner), and sometimes a combination of these situations exists (i.e., some of the acquired properties are operated by the seller and some are non-operated interests). We recommend that the Board add an example that addresses the application of the guidance in these situations.
- Acquisitions occur in the oil and gas industry where (a) substantially all of the fair value of the gross assets acquired is *not* concentrated in a group of similar identifiable assets, (b) a large portion of the acquired set, when viewed in isolation, would be an asset (rights to drill on unevaluated land), and (c) a small portion of the acquired set, when viewed in isolation, would be a business. We recommend that the Board add an example that addresses the application of the guidance in these situations.

Question 12: Do the changes to the Master Glossary create any unintended consequences?

We agree with the changes to the Master Glossary and do not foresee any unintended consequences.