



January 22, 2016

Ms. Susan Cospers
Technical Director
Financial Accounting Standards Board
401 Merritt 7, P.O. Box 5116
Norwalk, CT 06856-5116

RE: File Reference No. 2015-330

Dear Ms. Cospers:

PricewaterhouseCoopers LLP appreciates the opportunity to comment on the FASB's proposed Accounting Standards Update, Business Combinations (Topic 805): *Clarifying the Definition of a Business*. In our experience, preparers have been challenged distinguishing between asset acquisitions and business combinations and, based on existing guidance, many transactions that are essentially asset acquisitions have been considered acquisitions of businesses. We believe that preparers and users would be best served by aligning the recognition and measurement guidance, eliminating the accounting differences between the acquisitions and dispositions of assets and businesses, as any effort to modify the definition of a business will likely increase the judgment and complexity required to apply the proposed guidance. However, recognizing that this would be a longer-term project, we support the Board's interim objective of clarifying the definition of a business in a manner that will likely reduce the number of transactions considered to include a business.

We encourage the Board to continue its collaboration with the IASB to ensure that the final guidance on the definition of a business under US GAAP and IFRS remain converged. Similarly, the Board should collaborate with the IASB to maintain alignment when revisiting the accounting differences between the acquisition and disposition of assets and businesses more broadly.

In general, we agree with the three core elements of the Board's proposal:

1. Introducing a practical screen that excludes from the definition of a business a transaction where substantially all of the fair value is concentrated in a single identifiable asset or group of similar identifiable assets
2. Explicitly requiring that a business must, at a minimum, have an input and a substantive process, and, in that regard, eliminating the need to evaluate whether a missing element can be replaced by market participants
3. Narrowing the definition of outputs to be consistent with how outputs are described under the new revenue standard

However, we believe that the Board should clarify certain aspects of the proposal to achieve greater consistency and less complexity in its application. Our observations for the Board's consideration are summarized in the following broad categories: (1) the application of the proposed screen, (2) the evaluation of an organized workforce, (3) the evaluation of acquired processes (other than an organized workforce), and (4) the use of examples and illustrations.



Proposed screen

We agree with the Board’s proposal to introduce a screen to more efficiently identify transactions that are clearly asset acquisitions. However, we are concerned that the screen could result in some transactions being considered asset transactions that if subject to the proposed definition would likely be considered transactions involving businesses. This is particularly true when an acquired set of assets and activities (collectively referred to as a “set”) contains an organized workforce that is performing a process critical to producing outputs. In such cases, we believe that the proposed screen could result in an acquired set being identified as an asset even though it would otherwise be identified as a business. This is because an organized workforce (or contractual arrangements that take the place of an organized workforce) often represents an insignificant portion of the overall fair value of an acquired set as they are often paid market rates for their services.

For example, assume that a single identifiable asset (e.g., a developed technology) is acquired and its fair value is 95% of the total consideration. The organized workforce—consisting of highly-trained personnel with significant knowledge of the acquired technology—critical to generating outputs is also transferred. Despite the fair value of the workforce being significant qualitatively, but representing no more than 5% of the total consideration, the acquired set would likely be deemed an asset under the screen, but a business under the framework.

To mitigate this potential inconsistency, we believe that application of the screen should not be permitted when an acquired set includes an organized workforce (or contractual arrangements that take the place of an organized workforce). This would still give companies that acquire an organized workforce the opportunity to demonstrate that the workforce is not performing a critical process under the proposed framework, and if so, conclude that the acquired set is an asset (assuming there are no other substantive processes). We believe this approach would address the challenge in practice associated with considering a market participant’s ability to readily replace a workforce, while still ensuring that all acquired sets with an input and a substantive process (including a critical organized workforce) are considered businesses.

We also believe that application of the screen should be optional. A reporting entity should be permitted to apply the framework if they believe it would be more efficient or result in a conclusion that better reflects the economics of a particular transaction.

Finally, the Board indicated in the basis for conclusions that a qualitative assessment can be performed in applying the screen. We agree, but believe the use of qualitative considerations should be included in the implementation guidance.

Organized workforce

We agree that the acquisition of an organized workforce performing a critical process should be a key factor in concluding that an acquired set constitutes a business. However, we encourage the Board to clarify whether the assessment should be made over the individuals comprising the organized workforce, the functions performed by the organized workforce, or both. For example, if an entity acquires an early-stage technology company and a few computer scientists, it is unclear whether the entity should only focus on the criticality of the individual computer scientists (who may have the custom knowledge that cannot



be easily replaced), or the criticality of computer scientists as a functional group to the acquired set (because computer scientists provide critical services in general for similar companies).

While we agree with eliminating the need to evaluate whether a missing element can be replaced by market participants, we observe that the proposal may lead to different accounting outcomes for similar transactions depending on transaction-specific circumstances related to the acquiree's workforce. For example, an acquisition could be deemed an asset acquisition when a target company's employees decline an acquirer's employment offer in the newly merged company or a target company's employees are subject to a rehiring process by the acquirer. We do not believe that such actions should determine whether an acquired set is an asset or a business.

Acquired processes (other than an organized workforce)

In order for an acquired process to be considered substantive, we agree that it should not be replaceable without significant cost, effort, or delay in the continuity of producing outputs. However, we encourage the Board to clarify how significance should be assessed in this context. For example, assume an acquired manufacturing company includes a production line that is predominantly automated and there is no organized workforce that is critical to the continuation of outputs. However, replacing each of the automated functions could take time, during which the assembly line would have to be temporarily idled. In this fact pattern, some companies may conclude that the acquired manufacturing plant itself is an input and a substantive process, whereas others may conclude that the acquired set has only an input, and no substantive process. Accordingly, we recommend that the Board provide additional clarification on how companies should assess the significance of acquired processes.

Examples and illustrations

We recognize that the use of examples is important in illustrating the application of the principles in the proposed guidance. However, we believe that some of the proposed examples may not clearly illustrate the application of these principles. This is primarily because the examples are overly detailed, preventing the reader from discerning which specific facts (or changes in facts relative to other examples) ultimately affect the accounting outcome. For example, Case B and Case E have similar fact patterns, but result in different conclusions. It is unclear which facts drive the resulting difference in conclusion. We recommend distilling the examples to include only the relevant facts and highlighting the key principle being addressed, including: (1) the grouping of similar assets for purposes of applying the screen, (2) the qualitative considerations when applying the "substantially all" aspect of the screen, (3) the types of employees or functions that perform a critical process, and (4) the types of processes that cannot be replaced without significant cost, effort, or delay in production.

To help make the proposed guidance more user-friendly, we recommend that the Board include a decision flowchart. In addition, we believe the screen should precede the framework for assessing whether the acquired set includes a substantive process.



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In summary, we support the Board's objective of revising the definition of a business and agree with the underlying principles in the proposed guidance. However, we encourage the Board to consider our suggested clarifications to help reduce potential inconsistencies in application.

Our responses to the questions in the exposure draft are contained in the appendix. If you have any questions regarding our comments, please contact Pat Durbin at (973) 236-5152 or Larry Dodyk at (973) 236-7213.

Very truly yours,

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

PricewaterhouseCoopers 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?

Yes, we agree that a business must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs.

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?

As discussed in our cover letter, we support providing a framework for determining whether an acquired set contains an input and a substantive process that together contribute to the ability to create outputs. However, we believe that the framework for evaluating an organized workforce and acquired processes should be clarified.

We believe that the indicator of whether a process is substantive in paragraph 805-10-55-5B(c)—that the acquired process is considered unique or scarce—is redundant in relation to the indicator in the preceding sub-paragraph regarding the inability to replace the process without significant cost, effort, or delay in production. Therefore, we recommend removing this indicator from the proposal.

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 that the criteria in paragraphs 805-10-55-5A through 55-5D are necessary to evaluate whether an acquired set includes both an input and a substantive process. As discussed in our cover letter, we encourage the Board to clarify the criteria to help reduce potential inconsistencies in the application of the proposed guidance.

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?

Yes, we agree that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive. We also agree with the Board's statement in the basis for conclusions that the consideration of goodwill should not be an additional step in the analysis – i.e., preparers should not be required to perform a purchase price allocation as part of the analysis of whether an acquired set constitutes an asset or a business.

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 changes proposed to the definition of outputs and believe that aligning the definition with the description of outputs in the new revenue standard is appropriate.



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 agree with the Board's proposal to introduce a screen to the overall framework in order to more efficiently identify transactions that are clearly asset acquisitions. Further, we agree that assessing whether substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar assets is an appropriate foundation for the screen. However, as noted in our cover letter, we believe that the Board should consider certain clarifications in how the screen is applied and that use of the screen should be optional.

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 that, in most cases, the identification of a group of similar identifiable assets would be operable based on the proposed guidance in paragraph 805-10-55-9C. However, we encourage the Board to include an additional example illustrating the considerations preparers should make when assessing whether certain acquired assets (e.g., two separate in-process research and development projects) should be treated as similar.

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

While we believe the proposed changes will result in more meaningful financial reporting, we also believe that the increased need for application of judgment in the proposed model will likely lead to increased cost and complexity in some situations. As such, we encourage the Board to consider the points of clarification outlined in our cover letter in order to mitigate some of the additional cost and complexity.

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 believe both public and nonpublic entities should be able to adopt the proposed amendments within one to two years from the issuance of an Accounting Standards Update. We believe that early adoption should be permitted.

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?

Yes, we agree that the amendments should be applied prospectively to transactions that occur on or after the effective date. We agree that no specific disclosures related to transition are necessary.



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?

As discussed in our cover letter, we believe examples are helpful in illustrating the application of the principles in the proposed guidance. However, we believe that some of the examples should be clarified such that users can discern the specific facts (or changes in facts relative to other fact patterns) that ultimately affected the accounting outcome.

For example, Case B and Case E seem to have similar fact patterns but result in different conclusions. Case B involves an entity that acquires a single in-process research and development project, and contractual arrangements (an at-market clinical research organization contract and a clinical manufacturing organization contract) that take the place of employees. In this example, the entity concludes that all of the consideration would be allocated to the in-process research and development project. The acquisition is treated as an asset acquisition because substantially all of the fair value of the gross assets acquired is attributable to a single identifiable asset. Case E involves an entity that acquires multiple in-process research and development projects, an organized workforce, and certain tangible assets. In this example, the entity concludes that there is fair value attributable to the organized workforce, in addition to the tangible assets. As a result, substantially all of the fair value of the gross assets acquired is not attributable to a single identifiable asset or group of similar identifiable assets and the entity has to assess whether the acquired set includes a substantive process. The example indicates that the entity concludes it has acquired a substantive process because the workforce is deemed critical to the production of outputs. As such, the acquisition is treated as a business combination. It is unclear why there is fair value attributable to the organized workforce in Case E, but not to the equivalent contracts in Case B.

Consistent with our concern regarding application of the screen when there is a workforce, these cases demonstrate that because there is a workforce, the acquisition of additional tangible assets, such as a corporate headquarters, could become a determinative factor in whether an acquired set is a business or an asset.

Separately, Case D involves an entity that acquires a manufacturing facility and equipment, and assumes furloughed employees. The example states that, while the employees have the necessary skills, knowledge, or experience to use the equipment, the equipment cannot be developed or converted into outputs by those employees and therefore the acquired set is not a business. It is unclear how the requirement to assess whether an integrated set is capable of being conducted and managed as a business by a market participant was factored into this conclusion.

Lastly, we recommend distilling the examples to include only the key facts relevant to the application of the principle the example is attempting to illustrate.

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

No, we do not believe that the changes to the Master Glossary create any unintended consequences.