IFRS

STAFF PAPER

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Accounting Standards Advisory Forum

Project	**Definition of a business**
Paper topic	Summary of tentative decisions on the Definition of a Business project – August 2017

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About this paper

This paper lists the International Accounting Standard Board's (Board's) tentative decisions up to 31 August 2017 on proposed amendments to IFRS 3 *Business Combinations* clarifying how an entity determines whether it has acquired a business or a group of assets. The Board proposed these amendments in the Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (the Exposure Draft) issued in June 2016.

Staff papers related to tentative Board decisions presented in this document are:

- April 2017 meeting – Agenda Paper 13 Analysis of the comments received on the screening test
- June 2017 meeting – Agenda Paper 13 Analysis of the comments received on the remaining proposals included in the ED

In the table below, the marked up text in the left hand column shows how proposals in the Exposure Draft differ from the existing text of IFRS 3. Deleted text is struck through and new text is underlined.

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Exposure Draft	Tentative decisions
Definition of a business (application of paragraph 3) B7 A business consists of inputs and processes applied to those inputs that have the ability to ~~create~~ <u>contribute to the creation of</u> outputs. Although businesses usually have outputs, outputs are not required for an integrated set <u>of activities and assets</u> to qualify as a business. The three elements of a business are defined as follows: (a) **Input:** Any economic resource that creates, or has the ability to ~~create,~~ <u>contribute to the creation of</u> outputs when one or more processes are applied to it. Examples include non-current assets (including intangible assets or rights to use non-current assets), intellectual property, the ability to obtain access to necessary materials or rights and employees. (b) **Process:** Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to ~~create~~ <u>contribute to the creation of</u> outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but <u>the intellectual capacity of</u> an organised workforce having the necessary skills and experience following rules and conventions may provide the necessary processes that are capable of being applied to inputs to create outputs. (Accounting, billing, payroll and other administrative systems typically are not processes used to create outputs.) (c) **Output:** The result of inputs and processes applied to those inputs that provide ~~or have the ability to provide a return in the form of dividends, lower costs or other economic benefits directly to investors or other owners, members or participants~~ <u>goods or services to customers, investment income (such as dividends or interest) or other revenues</u>.	**Definition of output** The Board tentatively a. confirmed the proposal to amend the definition of ‘output’ by removing the reference to the ability to reduce costs, and clarifying that ‘other revenues’ means other income arising from contracts that are within the entity’s ordinary activities but are outside the scope of IFRS 15 *Revenue from Contracts with Customers*. b. decided to align the definition of a business in Appendix A of IFRS 3 with the revised definition of output in paragraph B7(c) of IFRS 3.

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Exposure Draft	Tentative decisions
B8 To be capable of being conducted and managed for the purposes defined, an integrated set of activities and assets requires two essential elements—inputs and processes applied to those inputs, which together are or will be used to create outputs. ~~However, a business need not include all of the inputs or processes that the seller used in operating that business if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes.~~ To constitute a business, an integrated set of activities and assets must include, at a minimum, an input and a substantive process that together have the ability to contribute to the creation of outputs. However, a business need not include all of the inputs or processes that the seller used in operating that business.	**Minimum requirements to be a business** The Board tentatively decided to: a. clarify that to be considered a business an acquired set of activities and assets must include, at a minimum, an input and a substantive process that together are required to contribute significantly to the ability to create outputs. b. confirm the proposal to delete the second paragraph of paragraph B8.
B8A In order to assess whether a transaction is the acquisition of a business, an entity first assesses whether substantially all of the fair value of the gross assets acquired are concentrated in a single asset or group of similar assets. If the fair value is concentrated in this way then the transaction is not the acquisition of a business. If this concentration is not present then a further assessment is performed applying the requirements of paragraphs B12A–B12C. Paragraphs B12A–B12C provide a framework for evaluating whether the acquired set of activities and assets includes a substantive process. The diagram below summarises the assessment process set out in paragraphs B11A–B12C. [The diagram included in the ED is not reproduced in this paper]	**The screening test** The Board tentatively decided to: a. make the screening test optional on a transaction-by-transaction basis. Thus an entity could on a transaction-by-transaction basis elect to bypass the screening test and assess directly whether a substantive process has been acquired. b. confirm that the screening test is determinative. This means that if an entity has carried out the screening test and concluded that a concentration exists, the entity should treat the transaction as an asset purchase. There is no further assessment that might change that conclusion. If no concentration exists, the entity then should assess whether it has acquired a substantive process.

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B9	The nature of the elements of a business varies by industry and by the structure of an entity’s operations (activities), including the entity’s stage of development. Established businesses often have many different types of inputs, processes and outputs, whereas new businesses often have few inputs and processes and sometimes only a single output (product). Nearly all businesses also have liabilities, but a business need not have liabilities. <u>Similarly, an acquired set of activities and assets that is not a business might have liabilities.</u>	
B10	~~An integrated set of activities and assets in the development stage might not have outputs. If not, the acquirer should consider other factors to determine whether the set is a business. Those factors include, but are not limited to, whether the set:~~ ~~(a) has begun planned principal activities;~~ ~~(b) has employees, intellectual property and other inputs and processes that could be applied to those inputs;~~ ~~(c) is pursuing a plan to produce outputs; and~~ ~~(d) will be able to obtain access to customers that will purchase the outputs.~~ ~~Not all of those factors need to be present for a particular integrated set of activities and assets in the development stage to qualify as a business.~~ <u>[Deleted]</u>	
B11	Determining whether a particular set of <u>activities and</u> assets ~~and activities~~ is a business should be based on whether the integrated set is capable of being conducted and managed as a business by a market participant. Thus, in evaluating whether a particular set 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.	

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B11A A transaction is not a business combination if the transaction is primarily a purchase of a single asset or group of assets. Consequently, if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of activities and assets is not a business. The fair value of the gross assets acquired includes the fair value of any acquired input, contract, process, workforce and any other intangible asset that is not identifiable. The fair value of the gross assets acquired may be determined by adding the fair value of the liabilities assumed to the fair value of the consideration paid (plus the fair value of any non-controlling interest and previously held interest, if any).	**The screening test** The Board tentatively decided to: a. confirm that the screening test is determinative. b. specify that the gross assets considered in the screening test exclude: (i) goodwill resulting from the effects of deferred tax liabilities; and (ii) deferred tax assets.
B11B A single identifiable asset, for the test in paragraph B11A, is any asset or group of assets that would be recognised and measured as a single identifiable asset in a business combination. In addition, for this assessment, tangible assets that are attached to, and cannot be physically removed and used separately from, other tangible assets without incurring significant cost, or significant diminution in utility or fair value to either asset, shall be considered a single identifiable asset.	**The screening test** The Board tentatively decided to clarify that the guidance on 'a single asset' in the screening test also applies when one of the acquired assets is a right-of-use asset, as described in IFRS 16 *Leases* (for example a leasehold land and the building on it are considered a single asset for the screening test).

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B11C In addition, for the test in paragraph B11A, the following assets shall not be combined into a single identifiable asset or considered a group of similar identifiable assets: (a) separately identifiable tangible and intangible assets; (b) different classes of tangible assets (for example, inventory and manufacturing equipment) unless they meet the criterion to be considered a single identifiable asset in paragraph B11B; (c) identifiable intangible assets in different intangible asset classes (for example, customer-related intangibles, trade marks, and in-process research and development); (d) financial assets and non-financial assets; and (e) different classes of financial assets (for example, cash, accounts receivable and marketable securities).	**The screening test** The Board tentatively decided to clarify that: a. when assessing whether assets are 'similar' for the screening test, an entity should consider the nature of each single asset and the risks associated with managing and creating outputs from the assets. b. the new guidance on what assets may be considered a single asset or a group of similar assets is not intended to modify the existing guidance on similar assets in paragraph 36 of IAS 38 *Intangible Assets* and the term 'class' in IAS 16 *Property, Plant and Equipment*, IAS 38 and IFRS 7 *Financial Instruments: Disclosures*.
B12 ~~In the absence of evidence to the contrary, a particular set of assets and activities in which goodwill is present shall be presumed to be~~ When evaluating whether a set of activities and assets includes a substantive process, the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive and the set of activities and assets is a business. However, a business need not have goodwill. Paragraphs B12A–B12C provide a framework to assist an entity in evaluating whether the set of activities and assets includes a substantive process. Paragraphs B12A and B12B include two different sets of criteria to consider, depending on whether the set of activities and assets has outputs. Paragraph B12A sets out the criteria to consider when the set of activities and assets does not have outputs. Paragraph B12B sets out the criteria to consider when the set of activities and assets has outputs.	**Goodwill** The Board tentatively decided: a. to remove from paragraph B12 of IFRS 3 the existing statement that a set of assets and activities in which goodwill is present is presumed to be a business. b. not to include the statement, proposed in the ED, that the presence of more than an insignificant amount of goodwill may be an indicator that an acquired process is substantive.

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B12A If a set of activities and assets does not, at the acquisition date, have outputs (for example, it is an early-stage entity that has not started generating revenues), the set is a business only if it includes an organised workforce (which is an input) with the necessary skills, knowledge, or experience to perform an acquired substantive process (or group of processes). In addition, that acquired substantive process (or group of processes) shall be critical to the ability to develop or convert another acquired input or inputs into outputs. Inputs that the organised workforce could develop (or is developing) or convert into outputs include the following: (a) intellectual property that could be used to develop a good or service; (b) other economic resources that could be developed to create outputs; or (c) rights to access necessary materials or rights that enable the creation of future outputs. Examples of the inputs in paragraphs (a)–(c) include technology, in-process research and development projects, real estate and mineral interests. A process (or group of processes) is not critical if, for example, it is ancillary or minor within the context of all the processes required to create outputs.	**Guidance on substantive processes** The Board tentatively decided: a. to confirm the guidance proposed in the ED to assess whether a substantive process has been acquired, including the guidance on acquired outsourcing agreements. b. to specify in the guidance on substantive processes that difficulties in replacing an acquired workforce may indicate that the workforce performs a substantive process.

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B12B If a set of activities and assets has outputs at the acquisition date (for example, if it generates revenue before the acquisition), the set is a business if either: (a) the acquired set of activities and assets includes a process (or group of processes) that, when applied to an acquired input or inputs, contributes to the ability to continue producing outputs, even without the acquisition of an organised workforce, and that process (or group of processes) is considered unique or scarce, or cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs; or (b) the acquired set of activities and assets includes an organised workforce with the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that when applied to an acquired input or inputs, is critical to the ability to continue producing outputs.	**Guidance on substantive processes** The Board tentatively decided to: a. confirm the guidance proposed in the ED on assessing whether a substantive process has been acquired, including the guidance on acquired outsourcing agreements, and to specify in the guidance on substantive processes that difficulties in replacing an acquired workforce may indicate that the workforce performs a substantive process. b. clarify that if an acquired set of assets generated revenues before the acquisition, but is integrated by the acquirer and no longer generates revenues after the acquisition, that set of assets is regarded as creating outputs.
B12C An acquired contract is not a substantive process. However, an acquired contract may give access to an organised workforce, for example a contract for outsourced property management or outsourced asset management. An entity shall assess whether an organised workforce accessed through such a contractual arrangement performs a substantive process that the entity controls, and thus has acquired (for example, considering the duration and the renewal terms of the contract).	**Guidance on substantive processes** The Board tentatively decided to confirm the guidance on acquired outsourcing agreements.

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Transition 64N [Draft] *Definition of a Business and Accounting for Previously Held Interests* (Amendments to IFRS 3 and IFRS 11) added paragraphs 42A, B8A, B11A–B11C and B12A–B12C, amended paragraphs B7–B8, B9, B11 and B12 and deleted paragraph B10. An entity shall apply those amendments to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after [effective date]. Earlier application of the amendments is permitted. If an entity applies those amendments for an earlier period it shall disclose that fact.	**Transition** The Board tentatively confirmed the proposal that an entity would not be required to apply the proposed amendments to transactions that occur before the effective date of the amendments.
[Draft] Amendments to the illustrative examples of IFRS 3 *Business Combinations* IE73 The examples in paragraphs IE74–IE107 illustrate the guidance in paragraphs B7–B12C on the definition of a business. In each of the examples, the first step of the analysis is an assessment of concentration of fair value described in paragraphs B11A–B11C. If substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or group of similar identifiable assets, then the set of acquired activities and assets is not a business, and no further analysis is carried out. If no such concentration exists, the entity evaluates, whether the set includes an input and a substantive process that together have the ability to contribute to the creation of outputs. [The illustrative examples proposed in the ED are not reproduced in this paper]	**Illustrative examples** The Board tentatively decided to: a. confirm the proposal to add illustrative examples to help with determining what is considered a business. b. explore the possibility of illustrating in an example how the guidance on outsourcing agreements may be applied; and c. clarify the fact patterns of the illustrative examples by separating the assumptions in each example from the conclusions.