

STAFF PAPER

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Accounting Standards Advisory Forum

Project	Definition of a business		
Paper topic	Comparison between FASB ED and IASB ED		
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Purpose of the paper

1. In June 2016, the International Accounting Standards Board (Board) published the Exposure Draft *Definition of a Business and Accounting for Previously Held Interests* (the IASB ED) (ED/2016/1). The Board's aims in publishing the ED are to clarify the definition of a business and the related application guidance. The Board anticipates that the proposed improvements will assist entities to determine whether a transaction should be accounted for as a purchase of assets or as a business combination.
2. The purpose of this paper is to obtain advice from ASAF members on the IASB ED. We are specifically seeking ASAF members' advice on whether the wording differences between the IASB ED and the Proposed Accounting Standards Update *Clarifying the Definition of a Business* (the FASB ED) issued by the FASB in November 2015 will lead to converged outcomes for the same transaction; that is whether the same transaction will be accounted for consistently under the two sets of proposals.
3. We will report feedback from the ASAF discussion to a future Board meeting.
4. This paper:
 - (a) compares the wording of the IASB ED with the wording of the FASB ED;
 - (b) explains the main wording differences; and

- (c) asks for ASAF members' advice on the wording differences between the two EDs, including any differences in practice that could emerge as a result of the different wording.

Comparison between FASB ED and IASB ED

5. Appendix A of this paper sets out the main wording differences between the FASB ED and the IASB ED. We have only included the differences in the Application Guidance, because we want the focus of the discussion with ASAF members on the authoritative part of the IASB ED. Consequently, the differences in the Basis for Conclusions and in the Illustrative Examples are not included in this paper.
6. The complete IASB ED can be accessed here: <http://www.ifrs.org/Current-Projects/IASB-Projects/Definition-of-a-business/Documents/Proposed-amendments-to-IFRS-3-and-IFRS-11-June-2016.pdf>.

Questions to ASAF members

Question 1

Do you have any advice regarding the wording differences, as summarised in Appendix A, between the IASB ED and the FASB ED, including any differences in practice that could emerge as a result of the different wording?

Question 2

Do you have any other advice on the proposed amendments to IFRS 3 to clarify the guidance on the definition of a business?

Appendix A – Comparison of the FASB ED and the IASB ED

Definition of a Process

- A1. The IASB ED aims to clarify paragraph B7 of IFRS 3 *Business Combinations*. The aim is to clarify that an organised workforce is an input to a business, but the intellectual capacity of an organised workforce (that is, the capacity of an organised workforce to perform a process even if the process is not documented) may provide a process.
- A2. We have also proposed to replace ‘ability to create outputs’ with ‘ability to contribute to the creation of outputs’. We have proposed this to be consistent with the Board’s decision that to constitute a business, an integrated set of activities and assets must include an input and a substantive process that together have the ability to contribute to the creation of outputs. The FASB has not proposed these wording changes. The wording differences are highlighted in yellow in the table below.

FASB ED – Paragraph 805-10-55-4	IASB ED – Paragraph B7
<p>Process. Any system, standard, protocol, convention, or rule that when applied to an input or inputs, creates or has the ability to create outputs. Examples include strategic management processes, operational processes, and resource management processes. These processes typically are documented, but an organized 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.</p>	<p>Process: Any system, standard, protocol, convention or rule that when applied to an input or inputs, creates or has the ability to create contribute to the creation of outputs. Examples include strategic management processes, operational processes and resource management processes. These processes typically are documented, but the intellectual capacity of 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.)</p>

Definition of Output

- A3. The Board has proposed very similar changes to the definition of output to that of the FASB. Our proposals differ only for the move of ‘other revenues’ to the end of the sentence, reflecting that other revenues are a residual.

FASB ED – Paragraph 805-10-55-4	IASB ED – Paragraph B7
<p>Output. The result of inputs and processes applied to those inputs that provide goods or services to customers, <u>other revenues, or investment income, such as dividends or interest</u> 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.</p>	<p>Output: The result of inputs and processes applied to those inputs that provide goods or services to customers, <u>investment income (such as dividends or interest) or other revenues</u> 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.</p>

Minimum requirements to be a business

- A4. Although the paragraphs in the table below look different, we believe they are substantially the same. The IASB ED proposes to move the sentence highlighted in green in the table below to the end of paragraph B8 of IFRS 3. Other wording changes are highlighted in yellow.

FASB ED – Paragraph 805-10-55-5	IASB ED – Paragraph B8
<p>To be capable of being conducted and managed for the purposes defined <u>described in paragraph 805-10-55-3A</u>, 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.</p> <p>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. <u>However, to be considered a business, the set must include, at a minimum, an input and a substantive process that together contribute to the ability to create outputs. ...</u></p>	<p>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. <u>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.</u> However, a business need not include all of the inputs or processes that the seller used in operating that business.</p>

Introduction describing how to apply the proposed guidance

- A5. The IASB ED proposes to include an introduction that describes the relationship between the two proposed assessments; the first being the assessment of concentration of fair value and the second being the assessment of whether an acquired process is substantive.
- A6. The IASB ED also proposes that the second assessment should be undertaken only when the fair value of the assets acquired is not concentrated in a single asset or group of similar assets.

FASB ED – Paragraph 805-10-55-5 (last sentence)	IASB ED – Paragraph B8A
<p><u>...Paragraphs 805-10-55-5A through 55-5D provide a framework to assist an entity in evaluating whether the set includes both an input and a substantive process.</u></p>	<p><u>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.</u></p>

- A7. The IASB ED also reorders the paragraphs relating to the assessment of concentration of fair value and the proposed guidance on substantive processes so that they reflect the order in which the tests are required to be performed. We also propose to add a flowchart to illustrate the relationship between the two proposed assessments after paragraph B8A.

Assessment of concentration of fair value

- A8. The IASB ED proposes to add the sentence highlighted in green in the table below to introduce the new assessment and to make clear the consequence of meeting the concentration of fair value test.
- A9. The IASB ED also proposes to include an explanation to clarify the meaning of ‘gross assets acquired’. Consequently, we have proposed to add the sentences highlighted in yellow in the table below. In particular, we have specified that the gross assets acquired may be determined by adding back the fair value of liabilities assumed to the consideration paid, because of concerns that measuring the fair value of non-identifiable assets may be challenging. This residual approach is the approach used to measure goodwill in IFRS 3.

FASB ED – Paragraph 805-10-55-9A	IASB ED – Paragraph B11A
<p>Notwithstanding the guidance in paragraphs 805-10-55-4 through 55-9, 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, the set is not considered a business.</p>	<p>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).</p>

- A10. The paragraphs in the table below are similar; we have proposed not to include the words highlighted in yellow, because paragraphs B11B and B11C of the IASB ED (that is equivalent to 805-10-55-9C) are each presented as explanations that both apply to the requirements in paragraph B11A and one is not dependent on the other.

FASB ED – Paragraph 805-10-55-9B	IASB ED – Paragraph B11B
<p><u>For purposes of applying the guidance in paragraph 805-10-55-9A, a single identifiable asset includes any individual asset or group of assets that could be recognized and measured as a single identifiable asset in a business combination unless that group of assets cannot be combined under paragraph 805-10-55-9C.</u></p> <p><u>In addition, for purposes of this evaluation, tangible nonfinancial assets that are attached to and cannot be physically removed and used separately from other tangible nonfinancial assets without incurring significant cost or significant diminution in utility or fair value to either asset should be considered a single asset.</u></p>	<p><u>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.</u></p> <p><u>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.</u></p>

A11. The paragraphs in the table below are similar; we are proposing to change the order of the subparagraphs, for example subparagraph ‘b’ in paragraph B11C is comparable to subparagraph ‘e’ in paragraph 805-10-55-9C. We have highlighted with the same colour the equivalent subparagraphs in each ED. Additionally, we are proposing to align some of the adjectives according to how they are used in the applicable IFRS Standard, specifically the terms ‘major’ and ‘separately identifiable’.

FASB ED – Paragraph 805-10-55-9C	IASB ED – Paragraph B11C
<p><u>For purposes of applying the guidance in paragraph 805-10-55-9A, the following should not be combined into a single asset or considered similar assets:</u></p> <p>a. <u>Tangible and intangible assets</u> (for example, real estate and in-place lease intangibles)</p> <p>b. <u>Identifiable intangible assets in different major intangible asset classes</u> (for example, customer-related intangibles, trademarks, and in-process research and development), except for groups of identifiable intangible assets that are recognized and measured as a single identifiable asset in accordance with this Topic (for example, complementary intangible assets that have</p>	<p><u>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:</u></p> <p>(a) <u>separately identifiable tangible and intangible assets;</u></p> <p>(b) <u>different classes of tangible assets</u> (for example, inventory and manufacturing equipment) unless they meet the criterion to be considered a single identifiable asset in paragraph B11B;</p> <p>(c) <u>identifiable intangible assets in different intangible asset classes</u> (for example, customer-related intangibles, trade marks, and in-process research and development);</p>

<p>similar useful lives as described in paragraphs 805-20-55-18 and 805-20-55-30)</p> <p>c. Financial and nonfinancial assets</p> <p>d. <u>Different major classes of financial assets (for example, cash, accounts receivable, and marketable securities)</u></p> <p>e. Different major classes of tangible nonfinancial assets (for example, inventory, manufacturing equipment, and automobiles) other than those that meet the criterion to be considered a single asset in paragraph 805-10-55-9B.</p>	<p>(d) financial assets and non-financial assets; and</p> <p>(e) <u>different classes of financial assets (for example, cash, accounts receivable and marketable securities).</u></p>
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Substantive process

A12. In the table below, we highlight the main differences between paragraph 805-10-55-5A of the FASB ED and paragraph B12A of the IASB ED. In particular, we have proposed to:

- (a) specify that this assessment should be done at acquisition date;
- (b) replace the sentence ‘the set would have both an input and a substantive process that together contribute to the ability to create outputs if’ with ‘the set is a business only if’ because, in our view, it is not necessary to repeat the minimum requirement to be a business in this paragraph;
- (c) clarify that an organised workforce is an input.

A13. In addition, in order to make the paragraph easier to read we have proposed to:

- (a) split the first sentence of paragraph 805-10-55-5A into two sentences,
- (b) move the sentence highlighted in green to the end of paragraph B12A; and
- (c) not include in the IASB ED the sentence highlighted in blue in paragraph 805-10-55-5A.

FASB ED – Paragraph 805-10-55-5A	IASB ED – Paragraph B12A
<p>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 if it includes an organized workforce</p>	<p>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</p>

<p>that has the necessary skills, knowledge, or experience to perform an acquired process (or group of processes) that, when applied to another acquired input or inputs, is critical to the ability to develop or convert that acquired input or inputs into outputs. <u>An entity should consider the following in evaluating whether the acquired workforce is performing a substantive process:</u></p> <p>a. <u>A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all the processes required to create outputs.</u></p> <p>b. Inputs that the organized workforce could develop (or is developing) or convert into outputs could include the following:</p> <p>1. Intellectual property that could be used to develop a good or service</p> <p>2. <u>Resources</u> that could be developed to create outputs</p> <p>3. <u>Access</u> to necessary materials or rights that enable the creation of future outputs.</p> <p>Examples could include technology, mineral interests, real estate, or in-process research and development.</p>	<p>workforce (<u>which is an input</u>) with the necessary skills, knowledge, or experience to perform an acquired substantive process (or group of processes). <u>In addition</u>, 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.</p> <p>Inputs that the organised workforce could develop (or is developing) or convert into outputs include the following:</p> <p>(a) intellectual property that could be used to develop a good or service;</p> <p>(b) <u>other economic resources</u> that could be developed to create outputs; or</p> <p>(c) <u>rights to access</u> necessary materials or rights that enable the creation of future outputs.</p> <p>Examples of the inputs in paragraphs (a)–(c) include technology, in-process research and development projects, real estate and mineral interests.</p> <p><u>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.</u></p>
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A14. In the table below, we highlight the main differences between paragraph 805-10-55-5B of the FASB ED and paragraph B12B of the IASB ED. In particular, we have proposed to:

- (a) specify that this assessment should be done at acquisition date;
- (b) consolidate subparagraphs ‘b’ and ‘c’ of paragraph 805-10-55-5B in subparagraph ‘a’ of paragraph B12B, because they are similar (ie the first part of the two subparagraphs is the same);
- (c) delete the sentence highlighted in blue, because the concept of ‘not critical’ is already explained in B12A.

FASB ED – Paragraph 805-10-55-5B	IASB ED – Paragraph B12B
When the set has outputs (that is, there is a continuation of revenue before and after the transaction), the set would have both an input and a substantive process that together	If a set of activities and assets has outputs <u>at the acquisition date</u> (for example, if it generates revenue before the acquisition), the set is a business if either:

<p>contribute to the ability to create outputs when any of the following are present:</p> <p>a. An organized workforce that has 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. A process (or group of processes) is not critical if, for example, it is considered ancillary or minor in the context of all of the processes required to continue producing outputs.</p> <p>b. The acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and cannot be replaced without significant cost, effort, or delay in the ability to continue producing outputs.</p> <p>c. The acquired process (or group of processes), when applied to an acquired input or inputs, contributes to the ability to continue producing outputs and is considered unique or scarce.</p>	<p>(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</p> <p>(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.</p>
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A15. We have summarised paragraph 805-10-55-5C in the first sentence of paragraph B12C (ie an acquired contract is not a substantive process), because generally an acquired contract is an input.

A16. The second part of paragraph B12C is similar to paragraph 805-10-55-5D. Both paragraphs say that an acquired outsourcing agreement may be considered to provide access to an organised workforce that performs a substantive process. However, we have proposed to clarify that, in this case, the acquirer should assess whether the outsourced workforce performs a substantive process and whether the acquirer controls that substantive process.

FASB ED – Paragraphs 805-10-55-5C and 805-10-55-5D	IASB ED – Paragraph B12C
<p>805-10-55-5C If a set has outputs, a continuation of revenues does not, on its own, indicate that both an input and a substantive process have been acquired. Accordingly, assumed contractual arrangements that provide for the continuation of revenues (for example, customer contracts, customer lists, and leases [when the set is the lessor]) should be excluded</p>	<p><u>An acquired contract is not a substantive process.</u></p>

<p><u>from the analysis in paragraph 805-10-55-5B of whether a process has been acquired.</u></p> <p>805-10-55-5D <u>For purposes of the analysis in paragraphs 805-10-55-5A through 55-5B, an organized workforce could consist of employees and/or certain contractual arrangements that take the place of employees (for example, a property or asset management contract). An entity should consider whether the service provided through a contractual arrangement performs an acquired process (or group of processes) that is critical to the ability to create outputs when applied to another acquired input or inputs or if the contractual arrangement is an acquired input.</u></p>	<p><u>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).</u></p>
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